

Note: The following table appears in the printed Annual Report on the facing page of the Chairman's Letter and is referred to in that letter.

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in S&P 500 with Dividends Included	Relative Results (1)-(2)
(1)	(2)	(1)-(2)	
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
19995	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
Average Annual Gain — 1965-2004	21.9	10.4	11.5
Overall Gain — 1964-2004	286,865	5,318	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2004 was \$8.3 billion, which increased the per-share book value of both our Class A and Class B stock by 10.5%. Over the last 40 years (that is, since present management took over) book value has grown from \$19 to \$55,824, a rate of 21.9% compounded annually.*

It's per-share intrinsic value that counts, however, not book value. Here, the news is good: Between 1964 and 2004, Berkshire morphed from a struggling northern textile business whose intrinsic value was less than book into a diversified enterprise worth far more than book. Our 40-year gain in intrinsic value has therefore somewhat exceeded our 21.9% gain in book. (For an explanation of intrinsic value and the economic principles that guide Charlie Munger, my partner and Berkshire's vice-chairman, and me in running Berkshire, please read our Owner's Manual, beginning on page 73.)

Despite their shortcomings, yearly calculations of book value are useful at Berkshire as a slightly understated gauge for measuring the *long-term* rate of increase in our intrinsic value. The calculations are less relevant, however, than they once were in rating any single year's performance versus the S&P 500 index (a comparison we display on the facing page). Our equity holdings (including convertible preferreds) have fallen considerably as a percentage of our net worth, from an average of 114% in the 1980s, for example, to less than 50% in recent years. Therefore, yearly movements in the stock market now affect a much smaller portion of our net worth than was once the case, a fact that will normally cause us to underperform in years when stocks rise substantially and overperform in years when they fall.

However the yearly comparisons work out, Berkshire's long-term performance versus the S&P remains all-important. Our shareholders can buy the S&P through an index fund at very low cost. Unless we achieve gains in per-share intrinsic value in the future that outdo the S&P, Charlie and I will be adding nothing to what you can accomplish on your own.

Last year, Berkshire's book-value gain of 10.5% fell short of the index's 10.9% return. Our lackluster performance was not due to any stumbles by the CEOs of our operating businesses: As always, they pulled more than their share of the load. My message to them is simple: Run your business as if it were the only asset your family will own over the next hundred years. Almost invariably they do just that and, after taking care of the needs of their business, send excess cash to Omaha for me to deploy.

I didn't do that job very well last year. My hope was to make several multi-billion dollar acquisitions that would add new and significant streams of earnings to the many we already have. But I struck out. Additionally, I found very few attractive securities to buy. Berkshire therefore ended the year with \$43 billion of cash equivalents, not a happy position. Charlie and I will work to translate some of this hoard into more interesting assets during 2005, though we can't promise success.

In one respect, 2004 was a remarkable year for the stock market, a fact buried in the maze of numbers on page 2. If you examine the 35 years since the 1960s ended, you will find that an investor's return, including dividends, from owning the S&P has averaged 11.2% annually (well above what we expect future returns to be). But if you look for years with returns anywhere close to that 11.2% – say, between 8% and 14% – you will find only *one* before 2004. In other words, last year's "normal" return is anything but.

*All figures used in this report apply to Berkshire's A shares, the successor to the only stock that the company had outstanding before 1996. The B shares have an economic interest equal to 1/30th that of the A.

Over the 35 years, American business has delivered terrific results. It should therefore have been easy for investors to earn juicy returns: All they had to do was piggyback Corporate America in a diversified, low-expense way. An index fund that they never touched would have done the job. Instead many investors have had experiences ranging from mediocre to disastrous.

There have been three primary causes: first, high costs, usually because investors traded excessively or spent far too much on investment management; second, portfolio decisions based on tips and fads rather than on thoughtful, quantified evaluation of businesses; and third, a start-and-stop approach to the market marked by untimely entries (after an advance has been long underway) and exits (after periods of stagnation or decline). Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy only when others are fearful.

Sector Results

As managers, Charlie and I want to give our owners the financial information and commentary we would wish to receive if our roles were reversed. To do this with both clarity and reasonable brevity becomes more difficult as Berkshire's scope widens. Some of our businesses have vastly different economic characteristics from others, which means that our consolidated statements, with their jumble of figures, make useful analysis almost impossible.

On the following pages, therefore, we will present some balance sheet and earnings figures from our four major categories of businesses along with commentary about each. We particularly want you to understand the limited circumstances under which we will use debt, given that we typically shun it. We will not, however, inundate you with data that has no real value in estimating Berkshire's intrinsic value. Doing so would tend to obfuscate the facts that count.

Regulated Utility Businesses

We have an 80.5% (fully diluted) interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.7 million electric customers make it the third largest distributor of electricity in the U.K.; (2) MidAmerican Energy, which serves 698,000 electric customers, primarily in Iowa; and (3) Kern River and Northern Natural Pipelines, which carry 7.9% of the natural gas consumed in the U.S.

The remaining 19.5% of MidAmerican is owned by three partners of ours: Dave Sokol and Greg Abel, the brilliant managers of these businesses, and Walter Scott, a long-time friend of mine who introduced me to the company. Because MidAmerican is subject to the Public Utility Holding Company Act ("PUHCA"), Berkshire's voting interest is limited to 9.9%. Voting control rests with Walter.

Our limited voting interest forces us to account for MidAmerican in an abbreviated manner. Instead of fully incorporating the company's assets, liabilities, revenues and expenses into Berkshire's statements, we make one-line entries only in both our balance sheet and income account. It's likely, though, that PUHCA will someday – perhaps soon – be repealed or that accounting rules will change. Berkshire's consolidated figures would then incorporate all of MidAmerican, including the substantial debt it utilizes (though this debt is not now, nor will it ever be, an obligation of Berkshire).

At yearend, \$1.478 billion of MidAmerican's junior debt was payable to Berkshire. This debt has allowed acquisitions to be financed without our partners needing to increase their already substantial investments in MidAmerican. By charging 11% interest, Berkshire is compensated fairly for putting up the funds needed for purchases, while our partners are spared dilution of their equity interests. Because MidAmerican made no large acquisitions last year, it paid down \$100 million of what it owes us.

MidAmerican also owns a significant non-utility business, HomeServices of America, the second largest real estate broker in the country. Unlike our utility operations, this business is highly cyclical, but nevertheless one we view enthusiastically. We have an exceptional manager, Ron Peltier, who through both his acquisition and operational skills is building a brokerage powerhouse.

HomeServices participated in \$59.8 billion of transactions in 2004, a gain of \$11.2 billion from 2003. About 24% of the increase came from six acquisitions made during the year. Through our 17 brokerage firms – all of which retain their local identities – we employ more than 18,000 brokers in 18 states. HomeServices is almost certain to grow substantially in the next decade as we continue to acquire leading localized operations.

Last year MidAmerican wrote off a major investment in a zinc recovery project that was initiated in 1998 and became operational in 2002. Large quantities of zinc are present in the brine produced by our California geothermal operations, and we believed we could profitably extract the metal. For many months, it appeared that commercially-viable recoveries were imminent. But in mining, just as in oil exploration, prospects have a way of “teasing” their developers, and every time one problem was solved, another popped up. In September, we threw in the towel.

Our failure here illustrates the importance of a guideline – *stay with simple propositions* – that we usually apply in investments as well as operations. If only one variable is key to a decision, and the variable has a 90% chance of going your way, the chance for a successful outcome is obviously 90%. But if ten independent variables need to break favorably for a successful result, and each has a 90% probability of success, the likelihood of having a winner is only 35%. In our zinc venture, we solved most of the problems. But one proved intractable, and that was one too many. Since a chain is no stronger than its weakest link, it makes sense to look for – if you’ll excuse an oxymoron – mono-linked chains.

A breakdown of MidAmerican’s results follows. In 2004, the “other” category includes a \$72.2 million profit from sale of an Enron receivable that was thrown in when we purchased Northern Natural two years earlier. Walter, Dave and I, as natives of Omaha, view this unanticipated gain as war reparations – partial compensation for the loss our city suffered in 1986 when Ken Lay moved Northern to Houston, after promising to leave the company here. (For details, see Berkshire’s 2002 annual report.)

Here are some key figures on MidAmerican’s operations:

	<i>Earnings (in \$ millions)</i>	
	<i>2004</i>	<i>2003</i>
U.K. utilities	\$ 326	\$ 289
Iowa utility	268	269
Pipelines	288	261
HomeServices.....	130	113
Other (net)	172	190
Loss from zinc project.....	(579)	(46)
Earnings before corporate interest and taxes.....	605	1,076
Interest, other than to Berkshire	(212)	(225)
Interest on Berkshire junior debt	(170)	(184)
Income tax	(53)	(251)
Net earnings.....	<u>\$ 170</u>	<u>\$ 416</u>
Earnings applicable to Berkshire*	\$ 237	\$ 429
Debt owed to others.....	10,528	10,296
Debt owed to Berkshire	1,478	1,578

*Includes interest earned by Berkshire (net of related income taxes) of \$110 in 2004 and \$118 in 2003.

Insurance

Since Berkshire purchased National Indemnity (“NICO”) in 1967, property-casualty insurance has been our core business and the propellant of our growth. Insurance has provided a fountain of funds with which we’ve acquired the securities and businesses that now give us an ever-widening variety of earnings streams. So in this section, I will be spending a little time telling you how we got where we are.

The source of our insurance funds is “float,” which is money that doesn’t belong to us but that we temporarily hold. Most of our float arises because (1) premiums are paid upfront though the service we provide – insurance protection – is delivered over a period that usually covers a year and; (2) loss events that occur today do not always result in our immediately paying claims, because it sometimes takes many years for losses to be reported (asbestos losses would be an example), negotiated and settled. The \$20 million of float that came with our 1967 purchase has now increased – both by way of internal growth and acquisitions – to \$46.1 billion.

Float is wonderful – if it doesn’t come at a high price. Its cost is determined by underwriting results, meaning how the expenses and losses we will ultimately pay compare with the premiums we have received. When an underwriting profit is achieved – as has been the case at Berkshire in about half of the 38 years we have been in the insurance business – float is better than free. In such years, we are actually paid for holding other people’s money. For most insurers, however, life has been far more difficult: In aggregate, the property-casualty industry almost invariably operates at an underwriting loss. When that loss is large, float becomes expensive, sometimes devastatingly so.

Insurers have generally earned poor returns for a simple reason: They sell a commodity-like product. Policy forms are standard, and the product is available from many suppliers, some of whom are mutual companies (“owned” by policyholders rather than stockholders) with profit goals that are limited. Moreover, most insureds don’t care from whom they buy. Customers by the millions say “I need some Gillette blades” or “I’ll have a Coke” but we wait in vain for “I’d like a National Indemnity policy, please.” Consequently, price competition in insurance is usually fierce. Think airline seats.

So, you may ask, how do Berkshire’s insurance operations overcome the dismal economics of the industry and achieve some measure of enduring competitive advantage? We’ve attacked that problem in several ways. Let’s look first at NICO’s strategy.

When we purchased the company – a specialist in commercial auto and general liability insurance – it did not appear to have any attributes that would overcome the industry’s chronic troubles. It was not well-known, had no informational advantage (the company has never had an actuary), was not a low-cost operator, and sold through general agents, a method many people thought outdated. Nevertheless, for almost all of the past 38 years, NICO has been a star performer. Indeed, had we not made this acquisition, Berkshire would be lucky to be worth half of what it is today.

What we’ve had going for us is a managerial mindset that most insurers find impossible to replicate. Take a look at the facing page. Can you imagine *any* public company embracing a business model that would lead to the decline in revenue that we experienced from 1986 through 1999? That colossal slide, it should be emphasized, did not occur because business was unobtainable. Many billions of premium dollars were readily available to NICO had we only been willing to cut prices. But we instead consistently priced to make a profit, not to match our most optimistic competitor. We never left customers – but they left us.

Most American businesses harbor an “institutional imperative” that rejects extended decreases in volume. What CEO wants to report to his shareholders that not only did business contract last year but that it will continue to drop? In insurance, the urge to keep writing business is also intensified because the consequences of foolishly-priced policies may not become apparent for some time. If an insurer is optimistic in its reserving, reported earnings will be overstated, and years may pass before true loss costs are revealed (a form of self-deception that nearly destroyed GEICO in the early 1970s).

Portrait of a Disciplined Underwriter
National Indemnity Company

<u>Year</u>	<u>Written Premium (In \$ millions)</u>	<u>No. of Employees at Year-End</u>	<u>Ratio of Operating Expenses to Written Premium</u>	<u>Underwriting Profit (Loss) as a Per- centage of Premiums (Calculated as of year end 2004)*</u>
1980	\$79.6	372	32.3%	8.2%
1981	59.9	353	36.1%	(.8%)
1982	52.5	323	36.7%	(15.3%)
1983	58.2	308	35.6%	(18.7%)
1984	62.2	342	35.5%	(17.0%)
1985	160.7	380	28.0%	1.9%
1986	366.2	403	25.9%	30.7%
1987	232.3	368	29.5%	27.3%
1988	139.9	347	31.7%	24.8%
1989	98.4	320	35.9%	14.8%
1990	87.8	289	37.4%	7.0%
1991	88.3	284	35.7%	13.0%
1992	82.7	277	37.9%	5.2%
1993	86.8	279	36.1%	11.3%
1994	85.9	263	34.6%	4.6%
1995	78.0	258	36.6%	9.2%
1996	74.0	243	36.5%	6.8%
1997	65.3	240	40.4%	6.2%
1998	56.8	231	40.4%	9.4%
1999	54.5	222	41.2%	4.5%
2000	68.1	230	38.4%	2.9%
2001	161.3	254	28.8%	(11.6%)
2002	343.5	313	24.0%	16.8%
2003	594.5	337	22.2%	18.1%
2004	605.6	340	22.5%	5.1%

*It takes a long time to learn the true profitability of any given year. First, many claims are received after the end of the year, and we must estimate how many of these there will be and what they will cost. (In insurance jargon, these claims are termed IBNR – incurred but not reported.) Second, claims often take years, or even decades, to settle, which means there can be many surprises along the way.

For these reasons, the results in this column simply represent our best estimate at the end of 2004 as to how we have done in prior years. Profit margins for the years through 1999 are probably close to correct because these years are “mature,” in the sense that they have few claims still outstanding. The more recent the year, the more guesswork is involved. In particular, the results shown for 2003 and 2004 are apt to change significantly.

Finally, there is a fear factor at work, in that a shrinking business usually leads to layoffs. To avoid pink slips, employees will rationalize inadequate pricing, telling themselves that poorly-priced business must be tolerated in order to keep the organization intact and the distribution system happy. If this course isn't followed, these employees will argue, the company will not participate in the recovery that they invariably feel is just around the corner.

To combat employees' natural tendency to save their own skins, we have always promised NICO's workforce that *no one* will be fired because of declining volume, however severe the contraction. (This is not Donald Trump's sort of place.) NICO is not labor-intensive, and, as the table suggests, can live with excess overhead. It can't live, however, with underpriced business and the breakdown in underwriting discipline that accompanies it. An insurance organization that doesn't care deeply about underwriting at a profit *this* year is unlikely to care *next* year either.

Naturally, a business that follows a no-layoff policy must be especially careful to avoid overstaffing when times are good. Thirty years ago Tom Murphy, then CEO of Cap Cities, drove this point home to me with a hypothetical tale about an employee who asked his boss for permission to hire an assistant. The employee assumed that adding \$20,000 to the annual payroll would be inconsequential. But his boss told him the proposal should be evaluated as a \$3 million decision, given that an additional person would probably cost at least that amount over his lifetime, factoring in raises, benefits and other expenses (more people, more toilet paper). And unless the company fell on very hard times, the employee added would be unlikely to be dismissed, however marginal his contribution to the business.

It takes real fortitude – embedded deep within a company's culture – to operate as NICO does. Anyone examining the table can scan the years from 1986 to 1999 quickly. But living day after day with dwindling volume – while competitors are boasting of growth and reaping Wall Street's applause – is an experience few managers can tolerate. NICO, however, has had four CEOs since its formation in 1940 and *none* have bent. (It should be noted that only one of the four graduated from college. Our experience tells us that extraordinary business ability is largely innate.)

The current managerial star – make that superstar – at NICO is Don Wurster (yes, he's "the graduate"), who has been running things since 1989. His slugging percentage is right up there with Barry Bonds' because, like Barry, Don will accept a walk rather than swing at a bad pitch. Don has now amassed \$950 million of float at NICO that over time is almost certain to be proved the negative-cost kind. Because insurance prices are falling, Don's volume will soon decline very significantly and, as it does, Charlie and I will applaud him ever more loudly.

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Another way to prosper in a commodity-type business is to be the low-cost operator. Among auto insurers operating on a broad scale, GEICO holds that cherished title. For NICO, as we have seen, an ebb-and-flow business model makes sense. But a company holding a low-cost advantage must pursue an unrelenting foot-to-the-floor strategy. And that's just what we do at GEICO.

A century ago, when autos first appeared, the property-casualty industry operated as a cartel. The major companies, most of which were based in the Northeast, established "bureau" rates and that was it. No one cut prices to attract business. Instead, insurers competed for strong, well-regarded agents, a focus that produced high commissions for agents and high prices for consumers.

In 1922, State Farm was formed by George Mecherle, a farmer from Merna, Illinois, who aimed to take advantage of the pricing umbrella maintained by the high-cost giants of the industry. State Farm employed a "captive" agency force, a system keeping its acquisition costs lower than those incurred by the bureau insurers (whose "independent" agents successfully played off one company against another). With its low-cost structure, State Farm eventually captured about 25% of the personal lines (auto and homeowners) business, far outdistancing its once-mighty competitors. Allstate, formed in 1931, put a similar distribution system into place and soon became the runner-up in personal lines to State Farm. Capitalism had worked its magic, and these low-cost operations looked unstoppable.

But a man named Leo Goodwin had an idea for an even more efficient auto insurer and, with a skimpy \$200,000, started GEICO in 1936. Goodwin's plan was to eliminate the agent entirely and to deal instead directly with the auto owner. Why, he asked himself, should there be any unnecessary and expensive links in the distribution mechanism when the product, auto insurance, was both mandatory and costly. Purchasers of business insurance, he reasoned, might well require professional advice, but most consumers knew what they needed in an auto policy. That was a powerful insight.

Originally, GEICO mailed its low-cost message to a limited audience of government employees. Later, it widened its horizons and shifted its marketing emphasis to the phone, working inquiries that came from broadcast and print advertising. And today the Internet is coming on strong.

Between 1936 and 1975, GEICO grew from a standing start to a 4% market share, becoming the country's fourth largest auto insurer. During most of this period, the company was superbly managed, achieving both excellent volume gains and high profits. It looked unstoppable. But after my friend and hero Lorimer Davidson retired as CEO in 1970, his successors soon made a huge mistake by under-reserving for losses. This produced faulty cost information, which in turn produced inadequate pricing. By 1976, GEICO was on the brink of failure.

Jack Byrne then joined GEICO as CEO and, almost single-handedly, saved the company by heroic efforts that included major price increases. Though GEICO's survival required these, policyholders fled the company, and by 1980 its market share had fallen to 1.8%. Subsequently, the company embarked on some unwise diversification moves. This shift of emphasis away from its extraordinary core business stunted GEICO's growth, and by 1993 its market share had grown only fractionally, to 1.9%. Then Tony Nicely took charge.

And what a difference that's made: In 2005 GEICO will probably secure a 6% market share. Better yet, Tony has matched growth with profitability. Indeed, GEICO delivers all of its constituents major benefits: In 2004 its customers saved \$1 billion or so compared to what they would otherwise have paid for coverage, its associates earned a \$191 million profit-sharing bonus that averaged 24.3% of salary, and its owner – that's us – enjoyed excellent financial returns.

There's more good news. When Jack Byrne was rescuing the company in 1976, New Jersey refused to grant him the rates he needed to operate profitably. He therefore promptly – and properly – withdrew from the state. Subsequently, GEICO avoided both New Jersey and Massachusetts, recognizing them as two jurisdictions in which insurers were destined to struggle.

In 2003, however, New Jersey took a new look at its chronic auto-insurance problems and enacted legislation that would curb fraud and allow insurers a fair playing field. Even so, one might have expected the state's bureaucracy to make change slow and difficult.

But just the opposite occurred. Holly Bakke, the New Jersey insurance commissioner, who would be a success in *any* line of work, was determined to turn the law's intent into reality. With her staff's cooperation, GEICO ironed out the details for re-entering the state and was licensed last August. Since then, we've received a response from New Jersey drivers that is multiples of my expectations.

We are now serving 140,000 policyholders – about 4% of the New Jersey market – and saving them substantial sums (as we do drivers everywhere). Word-of-mouth recommendations within the state are causing inquiries to pour in. And once we hear from a New Jersey prospect, our closure rate – the percentage of policies issued to inquiries received – is far higher in the state than it is nationally.

We make no claim, of course, that we can save *everyone* money. Some companies, using rating systems that are different from ours, will offer certain classes of drivers a lower rate than we do. But we believe GEICO offers the lowest price more often than any other national company that serves all segments of the public. In addition, in most states, including New Jersey, Berkshire shareholders receive an 8% discount. So gamble fifteen minutes of your time and go to GEICO.com – or call 800-847-7536 – to see

whether you can save big money (which you might want to use, of course, to buy other Berkshire products).

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Reinsurance – insurance sold to other insurers who wish to lay off part of the risks they have assumed – should *not* be a commodity product. At bottom, any insurance policy is simply a promise, and as everyone knows, promises vary enormously in their quality.

At the primary insurance level, nevertheless, just who makes the promise is often of minor importance. In personal-lines insurance, for example, states levy assessments on solvent companies to pay the policyholders of companies that go broke. In the business-insurance field, the same arrangement applies to workers' compensation policies. "Protected" policies of these types account for about 60% of the property-casualty industry's volume. Prudently-run insurers are irritated by the need to subsidize poor or reckless management elsewhere, but that's the way it is.

Other forms of business insurance at the primary level involve promises that carry greater risks for the insured. When Reliance Insurance and Home Insurance were run into the ground, for example, their promises proved to be worthless. Consequently, many holders of their business policies (other than those covering workers' compensation) suffered painful losses.

The solvency risk in primary policies, however, pales in comparison to that lurking in reinsurance policies. When a reinsurer goes broke, staggering losses almost always strike the primary companies it has dealt with. This risk is far from minor: GEICO has suffered tens of millions in losses from its careless selection of reinsurers in the early 1980s.

Were a true mega-catastrophe to occur in the next decade or two – and that's a real possibility – some reinsurers would not survive. The largest insured loss to date is the World Trade Center disaster, which cost the insurance industry an estimated \$35 billion. Hurricane Andrew cost insurers about \$15.5 billion in 1992 (though that loss would be far higher in today's dollars). Both events rocked the insurance and reinsurance world. But a \$100 billion event, or even a larger catastrophe, remains a possibility if either a particularly severe earthquake or hurricane hits just the wrong place. Four significant hurricanes struck Florida during 2004, causing an aggregate of \$25 billion or so in insured losses. Two of these – Charley and Ivan – could have done at least three times the damage they did had they entered the U.S. not far from their actual landing points.

Many insurers regard a \$100 billion industry loss as "unthinkable" and won't even plan for it. But at Berkshire, we are fully prepared. Our share of the loss would probably be 3% to 5%, and earnings from our investments and other businesses would comfortably exceed that cost. When "the day after" arrives, Berkshire's checks will clear.

Though the hurricanes hit us with a \$1.25 billion loss, our reinsurance operations did well last year. At General Re, Joe Brandon has restored a long-admired culture of underwriting discipline that, for a time, had lost its way. The excellent results he realized in 2004 on current business, however, were offset by adverse developments from the years before he took the helm. At NICO's reinsurance operation, Ajit Jain continues to successfully underwrite huge risks that no other reinsurer is willing or able to accept. Ajit's value to Berkshire is enormous.

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Our insurance managers, maximizing the competitive strengths I've mentioned in this section, again delivered first-class underwriting results last year. As a consequence, our float was better than costless. Here's the scorecard:

<i><u>Insurance Operations</u></i>	<i>(in \$ millions)</i>		
	<i><u>Underwriting Profit</u></i>	<i><u>2004</u></i>	<i><u>Yearend Float</u></i>
	<i><u>2004</u></i>	<i><u>2003</u></i>	
General Re	\$ 3	\$23,120	\$23,654
B-H Reinsurance	417	15,278	13,948
GEICO	970	5,960	5,287
Other Primary*.....	<u>161</u>	<u>1,736</u>	<u>1,331</u>
Total	<u><u>\$1,551</u></u>	<u><u>\$46,094</u></u>	<u><u>\$44,220</u></u>

*Includes, in addition to National Indemnity, a variety of other exceptional insurance businesses, run by Rod Eldred, John Kizer, Tom Nerney and Don Towle.

Berkshire's float increased \$1.9 billion in 2004, even though a few insureds opted to commute (that is, unwind) certain reinsurance contracts. We agree to such commutations only when we believe the economics are favorable to us (after giving due weight to what we might earn in the future on the money we are returning).

To summarize, last year we were paid more than \$1.5 billion to hold an average of about \$45.2 billion. In 2005 pricing will be less attractive than it has been. Nevertheless, absent a mega-catastrophe, we have a decent chance of achieving no-cost float again this year.

Finance and Finance Products

Last year in this section we discussed a potpourri of activities. In this report, we'll skip over several that are now of lesser importance: Berkadia is down to tag ends; Value Capital has added other investors, negating our expectation that we would need to consolidate its financials into ours; and the trading operation that I run continues to shrink.

- Both of Berkshire's leasing operations rebounded last year. At CORT (office furniture), earnings remain inadequate, but are trending upward. XTRA disposed of its container and intermodal businesses in order to concentrate on trailer leasing, long its strong suit. Overhead has been reduced, asset utilization is up and decent profits are now being achieved under Bill Franz, the company's new CEO.
- The wind-down of Gen Re Securities continues. We decided to exit this derivative operation three years ago, but getting out is easier said than done. Though derivative instruments are purported to be highly liquid – and though we have had the benefit of a benign market while liquidating ours – we still had 2,890 contracts outstanding at yearend, down from 23,218 at the peak. Like Hell, derivative trading is easy to enter but difficult to leave. (Other similarities come to mind as well.)

Gen Re's derivative contracts have always been required to be marked to market, and I believe the company's management conscientiously tried to make realistic "marks." The market prices of derivatives, however, can be very fuzzy in a world in which settlement of a transaction is sometimes decades away and often involves multiple variables as well. In the interim the marks influence the managerial and trading bonuses that are paid annually. It's small wonder that phantom profits are often recorded.

Investors should understand that in all types of financial institutions, rapid growth sometimes masks major underlying problems (and occasionally fraud). The real test of the earning power of a derivatives operation is what it achieves after operating for an extended period in a no-growth mode. You only learn who has been swimming naked when the tide goes out.

- After 40 years, we've finally generated a little synergy at Berkshire: Clayton Homes is doing well and that's in part due to its association with Berkshire. The manufactured home industry

continues to reside in the intensive care unit of Corporate America, having sold less than 135,000 new homes last year, about the same as in 2003. Volume in these years was the lowest since 1962, and it was also only about 40% of annual sales during the years 1995-99. That era, characterized by irresponsible financing and naïve funders, was a fool's paradise for the industry.

Because one major lender after another has fled the field, financing continues to bedevil manufacturers, retailers and purchasers of manufactured homes. Here Berkshire's support has proven valuable to Clayton. We stand ready to fund whatever makes sense, and last year Clayton's management found much that qualified.

As we explained in our 2003 report, we believe in using borrowed money to support profitable, interest-bearing receivables. At the beginning of last year, we had borrowed \$2 billion to relend to Clayton (at a one percentage-point markup) and by January 2005 the total was \$7.35 billion. Most of the dollars added were borrowed by us on January 4, 2005, to finance a seasoned portfolio that Clayton purchased on December 30, 2004 from a bank exiting the business.

We now have two additional portfolio purchases in the works, totaling about \$1.6 billion, but it's quite unlikely that we will secure others of any significance. Therefore, Clayton's receivables (in which originations will roughly offset payoffs) will probably hover around \$9 billion for some time and should deliver steady earnings. This pattern will be far different from that of the past, in which Clayton, like all major players in its industry, "securitized" its receivables, causing earnings to be front-ended. In the last two years, the securitization market has dried up. The limited funds available today come only at higher cost and with harsh terms. Had Clayton remained independent in this period, it would have had mediocre earnings as it struggled with financing.

In April, Clayton completed the acquisition of Oakwood Homes and is now the industry's largest producer and retailer of manufactured homes. We love putting more assets in the hands of Kevin Clayton, the company's CEO. He is a prototype Berkshire manager. Today, Clayton has 11,837 employees, up from 7,136 when we purchased it, and Charlie and I are pleased that Berkshire has been useful in facilitating this growth.

For simplicity's sake, we include all of Clayton's earnings in this sector, though a sizable portion of these are derived from areas other than consumer finance.

	(in \$ millions)			
	<i>Pre-Tax Earnings</i>		<i>Interest-Bearing Liabilities</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
Trading – ordinary income	\$ 264	\$ 355	\$5,751	\$7,826
Gen Re Securities	(44)	(99)	5,437*	8,041*
Life and annuity operation.....	(57)	85	2,467	2,331
Value Capital.....	30	31	N/A	N/A
Berkadia	1	101	—	525
Leasing operations.....	92	34	391	482
Manufactured housing finance (Clayton)	220	37**	3,636	2,032
Other.....	<u>78</u>	<u>75</u>	N/A	N/A
Income before capital gains.....	584	619		
Trading – capital gains	<u>1,750</u>	<u>1,215</u>		
Total	<u><u>\$2,334</u></u>	<u><u>\$1,834</u></u>		

* Includes all liabilities

** From date of acquisition, August 7, 2003

Manufacturing, Service and Retailing Operations

Our activities in this category cover the waterfront. But let's look at a summary balance sheet and earnings statement consolidating the entire group.

Balance Sheet 12/31/04 (in \$ millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 899	Notes payable	\$ 1,143
Accounts and notes receivable	3,074	Other current liabilities	<u>4,685</u>
Inventory	3,842	Total current liabilities	<u>5,828</u>
Other current assets	<u>254</u>		
Total current assets	8,069		
Goodwill and other intangibles.....	8,362	Deferred taxes.....	248
Fixed assets.....	6,161	Term debt and other liabilities	1,965
Other assets.....	<u>1,044</u>	Equity	<u>15,595</u>
	<u>\$23,636</u>		<u>\$23,636</u>

Earnings Statement (in \$ millions)

	<u>2004</u>	<u>2003</u>
Revenues	\$44,142	\$32,106
Operating expenses (including depreciation of \$676 in 2004 and \$605 in 2003).....	41,604	29,885
Interest expense (net).....	<u>57</u>	<u>64</u>
Pre-tax earnings	2,481	2,157
Income taxes.....	<u>941</u>	<u>813</u>
Net income	<u>\$ 1,540</u>	<u>\$ 1,344</u>

This eclectic group, which sells products ranging from Dilly Bars to fractional interests in Boeing 737s, earned a very respectable 21.7% on average tangible net worth last year, compared to 20.7% in 2003. It's noteworthy that these operations used only minor financial leverage in achieving these returns. Clearly, we own some very good businesses. We purchased many of them, however, at substantial premiums to net worth – a matter that is reflected in the goodwill item shown on the balance sheet – and that fact reduces the earnings on our average *carrying* value to 9.9%.

Here are the pre-tax earnings for the larger categories or units.

	<u>Pre-Tax Earnings</u> (in \$ millions)	
	<u>2004</u>	<u>2003</u>
Building Products	\$ 643	\$ 559
Shaw Industries	466	436
Apparel & Footwear	325	289
Retailing of Jewelry, Home Furnishings and Candy	215	224
Flight Services	191	72
McLane.....	228	150*
Other businesses	<u>413</u>	<u>427</u>
	<u>\$2,481</u>	<u>\$2,157</u>

* From date of acquisition, May 23, 2003.

- In the building-products sector and at Shaw, we've experienced staggering cost increases for both raw-materials and energy. By December, for example, steel costs at MiTek (whose primary business is connectors for roof trusses) were running 100% over a year earlier. And MiTek uses 665 million pounds of steel every year. Nevertheless, the company continues to be an outstanding performer.

Since we purchased MiTek in 2001, Gene Toombs, its CEO, has made some brilliant “bolt-on” acquisitions and is on his way to creating a mini-Berkshire.

Shaw fielded a barrage of price increases in its main fiber materials during the year, a hit that added more than \$300 million to its costs. (When you walk on carpet you are, in effect, stepping on processed oil.) Though we followed these hikes in costs with price increases of our own, there was an inevitable lag. Therefore, margins narrowed as the year progressed and remain under pressure today. Despite these roadblocks, Shaw, led by Bob Shaw and Julian Saul, earned an outstanding 25.6% on tangible equity in 2004. The company is a powerhouse and has a bright future.

- In apparel, Fruit of the Loom increased unit sales by 10 million dozen, or 14%, with shipments of intimate apparel for women and girls growing by 31%. Charlie, who is far more knowledgeable than I am on this subject, assures me that women are *not* wearing more underwear. With this expert input, I can only conclude that our market share in the women’s category must be growing rapidly. Thanks to John Holland, Fruit is on the move.

A smaller operation, Garan, also had an excellent year. Led by Seymour Lichtenstein and Jerry Kaniel, this company manufactures the popular Garanimals line for children. Next time you are in a Wal-Mart, check out this imaginative product.

- Among our retailers, Ben Bridge (jewelry) and R. C. Willey (home furnishings) were particular standouts last year.

At Ben Bridge same-store sales grew 11.4%, the best gain among the publicly-held jewelers whose reports I have seen. Additionally, the company’s profit margin widened. Last year was not a fluke: During the past decade, the same-store sales gains of the company have averaged 8.8%.

Ed and Jon Bridge are fourth-generation managers and run the business exactly as if it were their own – which it is in every respect except for Berkshire’s name on the stock certificates. The Bridges have expanded successfully by securing the right locations and, more importantly, by staffing these stores with enthusiastic and knowledgeable associates. We will move into Minneapolis-St. Paul this year.

At Utah-based R. C. Willey, the gains from expansion have been even more dramatic, with 41.9% of 2004 sales coming from out-of-state stores that didn’t exist before 1999. The company also improved its profit margin in 2004, propelled by its two new stores in Las Vegas.

I would like to tell you that these stores were my idea. In truth, I thought they were mistakes. I knew, of course, how brilliantly Bill Child had run the R. C. Willey operation in Utah, where its market share had long been huge. But I felt our closed-on-Sunday policy would prove disastrous away from home. Even our first out-of-state store in Boise, which was highly successful, left me unconvinced. I kept asking whether Las Vegas residents, conditioned to seven-day-a-week retailers, would adjust to us. Our first Las Vegas store, opened in 2001, answered this question in a resounding manner, immediately becoming our number one unit.

Bill and Scott Hymas, his successor as CEO, then proposed a second Las Vegas store, only about 20 minutes away. I felt this expansion would cannibalize the first unit, adding significant costs but only modest sales. The result? Each store is now doing about 26% more volume than any other store in the chain and is consistently showing large year-over-year gains.

R. C. Willey will soon open in Reno. Before making this commitment, Bill and Scott again asked for my advice. Initially, I was pretty puffed up about the fact that they were consulting me. But then it dawned on me that the opinion of someone who is *always* wrong has its own special utility to decision-makers.

- Earnings improved in flight services. At FlightSafety, the world's leader in pilot training, profits rose as corporate aviation rebounded and our business with regional airlines increased. We now operate 283 simulators with an original cost of \$1.2 billion. Pilots are trained one at a time on this expensive equipment. This means that as much as \$3.50 of capital investment is required to produce \$1 of annual revenue. With this level of capital intensity, FlightSafety requires very high operating margins in order to obtain reasonable returns on capital, which means that utilization rates are all-important. Last year, FlightSafety's return on tangible equity improved to 15.1% from 8.4% in 2003.

In another 2004 event, Al Ueltschi, who founded FlightSafety in 1951 with \$10,000, turned over the CEO position to Bruce Whitman, a 43-year veteran at the company. (But Al's not going anywhere; I won't let him.) Bruce shares Al's conviction that flying an aircraft is a privilege to be extended only to people who regularly receive the highest quality of training and are undeniably competent. A few years ago, Charlie was asked to intervene with Al on behalf of a tycoon friend whom FlightSafety had flunked. Al's reply to Charlie: "Tell your pal he belongs in the back of the plane, not the cockpit."

FlightSafety's number one customer is NetJets, our aircraft fractional-ownership subsidiary. Its 2,100 pilots spend an average of 18 days a year in training. Additionally, these pilots fly only one aircraft type whereas many flight operations juggle pilots among several types. NetJets' high standards on both fronts are two of the reasons I signed up with the company years before Berkshire bought it.

Fully as important in my decisions to both use and buy NetJets, however, was the fact that the company was managed by Rich Santulli, the creator of the fractional-ownership industry and a fanatic about safety and service. I viewed the selection of a flight provider as akin to picking a brain surgeon: you simply want the best. (Let someone else experiment with the low bidder.)

Last year NetJets again gained about 70% of the net new business (measured by dollar value) going to the four companies that dominate the industry. A portion of our growth came from the 25-hour card offered by Marquis Jet Partners. Marquis is not owned by NetJets, but is instead a customer that repackages the purchases it makes from us into smaller packages that it sells through its card. Marquis deals exclusively with NetJets, utilizing the power of our reputation in its marketing.

Our U.S. contracts, including Marquis customers, grew from 3,877 to 4,967 in 2004 (versus approximately 1,200 contracts when Berkshire bought NetJets in 1998). Some clients (including me) enter into multiple contracts because they wish to use more than one type of aircraft, selecting for any given trip whichever type best fits the mission at hand.

NetJets earned a modest amount in the U.S. last year. But what we earned domestically was largely offset by losses in Europe. We are now, however, generating real momentum abroad. Contracts (including 25-hour cards that we ourselves market in Europe) increased from 364 to 693 during the year. We will again have a very significant European loss in 2005, but domestic earnings will likely put us in the black overall.

Europe has been expensive for NetJets – far more expensive than I anticipated – but it is essential to building a flight operation that will forever be in a class by itself. Our U.S. owners already want a quality service wherever they travel and their wish for flight hours abroad is certain to grow dramatically in the decades ahead. Last year, U.S. owners made 2,003 flights in Europe, up 22% from the previous year and 137% from 2000. Just as important, our European owners made 1,067 flights in the U.S., up 65% from 2003 and 239% from 2000.

Investments

We show below our common stock investments. Those that had a market value of more than \$600 million at the end of 2004 are itemized.

			12/31/04	
<u>Shares</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>Cost*</u>	<u>Market (in \$ millions)</u>
151,610,700	American Express Company	12.1	\$1,470	\$ 8,546
200,000,000	The Coca-Cola Company	8.3	1,299	8,328
96,000,000	The Gillette Company	9.7	600	4,299
14,350,600	H&R Block, Inc.....	8.7	223	703
6,708,760	M&T Bank Corporation	5.8	103	723
24,000,000	Moody's Corporation	16.2	499	2,084
2,338,961,000	PetroChina "H" shares (or equivalents)...	1.3	488	1,249
1,727,765	The Washington Post Company	18.1	11	1,698
56,448,380	Wells Fargo & Company	3.3	463	3,508
1,724,200	White Mountains Insurance.....	16.0	369	1,114
	Others		<u>3,531</u>	<u>5,465</u>
	Total Common Stocks		<u>\$9,056</u>	<u>\$37,717</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

Some people may look at this table and view it as a list of stocks to be bought and sold based upon chart patterns, brokers' opinions, or estimates of near-term earnings. Charlie and I ignore such distractions and instead view our holdings as fractional ownerships in businesses. This is an important distinction. Indeed, this thinking has been the cornerstone of my investment behavior since I was 19. At that time I read Ben Graham's *The Intelligent Investor*, and the scales fell from my eyes. (Previously, I had been entranced by the stock market, but didn't have a clue about how to invest.)

Let's look at how the *businesses* of our "Big Four" – American Express, Coca-Cola, Gillette and Wells Fargo – have fared since we bought into these companies. As the table shows, we invested \$3.83 billion in the four, by way of multiple transactions between May 1988 and October 2003. On a composite basis, our dollar-weighted purchase date is July 1992. By yearend 2004, therefore, we had held these "business interests," on a weighted basis, about 12½ years.

In 2004, Berkshire's share of the group's earnings amounted to \$1.2 billion. These earnings might legitimately be considered "normal." True, they were swelled because Gillette and Wells Fargo omitted option costs in their presentation of earnings; but on the other hand they were reduced because Coke had a non-recurring write-off.

Our share of the earnings of these four companies has grown almost every year, and now amounts to about 31.3% of our cost. Their cash distributions to us have also grown consistently, totaling \$434 million in 2004, or about 11.3% of cost. All in all, the Big Four have delivered us a satisfactory, though far from spectacular, business result.

That's true as well of our experience in the market with the group. Since our original purchases, valuation gains have somewhat exceeded earnings growth because price/earnings ratios have increased. On a year-to-year basis, however, the business and market performances have often diverged, sometimes to an extraordinary degree. During The Great Bubble, market-value gains far outstripped the performance of the businesses. In the aftermath of the Bubble, the reverse was true.

Clearly, Berkshire's results would have been far better if I had caught this swing of the pendulum. That may seem easy to do when one looks through an always-clean, rear-view mirror. Unfortunately, however, it's the windshield through which investors must peer, and that glass is invariably fogged. Our huge positions add to the difficulty of our nimbly dancing in and out of holdings as valuations swing.

Nevertheless, I can properly be criticized for merely clucking about nose-bleed valuations during the Bubble rather than acting on my views. Though I said at the time that certain of the stocks we held were priced ahead of themselves, I underestimated just how severe the overvaluation was. I talked when I should have walked.

What Charlie and I would like is a little action now. We don't enjoy sitting on \$43 billion of cash equivalents that are earning paltry returns. Instead, we yearn to buy more fractional interests similar to those we now own or – better still – more large businesses outright. We will do either, however, only when purchases can be made at prices that offer us the prospect of a reasonable return on our investment.

* * * * *

We've repeatedly emphasized that the "realized" gains that we report quarterly or annually are meaningless for analytical purposes. We have a huge amount of unrealized gains on our books, and our thinking about when, and if, to cash them depends not at all on a desire to report earnings at one specific time or another. A further complication in our reported gains occurs because GAAP requires that foreign exchange contracts be marked to market, a stipulation that causes unrealized gains or losses in these holdings to flow through our published earnings as if we had sold our positions.

Despite the problems enumerated, you may be interested in a breakdown of the gains we reported in 2003 and 2004. The data reflect actual sales except in the case of currency gains, which are a combination of sales and marks to market.

<u>Category</u>	<u>Pre-Tax Gain (in \$ millions)</u>	
	<u>2004</u>	<u>2003</u>
Common Stocks	\$ 870	\$ 448
U.S. Government Bonds.....	104	1,485
Junk Bonds	730	1,138
Foreign Exchange Contracts.....	1,839	825
Other.....	(47)	<u>233</u>
Total	<u>\$3,496</u>	<u>\$4,129</u>

The junk bond profits include a foreign exchange component. When we bought these bonds in 2001 and 2002, we focused first, of course, on the credit quality of the issuers, all of which were American corporations. Some of these companies, however, had issued bonds denominated in foreign currencies. Because of our views on the dollar, we favored these for purchase when they were available.

As an example, we bought €254 million of Level 3 bonds (10 ¾% of 2008) in 2001 at 51.7% of par, and sold these at 85% of par in December 2004. This issue was traded in Euros that cost us 88¢ at the time of purchase but that brought \$1.29 when we sold. Thus, of our \$163 million overall gain, about \$85 million came from the market's revised opinion about Level 3's credit quality, with the remaining \$78 million resulting from the appreciation of the Euro. (In addition, we received cash interest during our holding period that amounted to about 25% annually on our dollar cost.)

* * * * *

The media continue to report that "Buffett buys" this or that stock. Statements like these are almost always based on filings Berkshire makes with the SEC and are therefore wrong. As I've said before, the stories should say "*Berkshire buys*."

Portrait of a Disciplined Investor
Lou Simpson

<u>Year</u>	<i>Return from GEICO Equities</i>	<i>S&P Return</i>	<i>Relative Results</i>
1980	23.7%	32.3%	(8.6%)
1981	5.4%	(5.0%)	10.4%
1982	45.8%	21.4%	24.4%
1983	36.0%	22.4%	13.6%
1984	21.8%	6.1%	15.7%
1985	45.8%	31.6%	14.2%
1986	38.7%	18.6%	20.1%
1987	(10.0%)	5.1%	(15.1%)
1988	30.0%	16.6%	13.4%
1989	36.1%	31.7%	4.4%
1990	(9.9%)	(3.1%)	(6.8%)
1991	56.5%	30.5%	26.0%
1992	10.8%	7.6%	3.2%
1993	4.6%	10.1%	(5.5%)
1994	13.4%	1.3%	12.1%
1995	39.8%	37.6%	2.2%
1996	29.2%	23.0%	6.2%
1997	24.6%	33.4%	(8.8%)
1998	18.6%	28.6%	(10.0%)
1999	7.2%	21.0%	(13.8%)
2000	20.9%	(9.1%)	30.0%
2001	5.2%	(11.9%)	17.1%
2002	(8.1%)	(22.1%)	14.0%
2003	38.3%	28.7%	9.6%
2004	16.9%	10.9%	6.0%
Average Annual Gain 1980-2004	20.3%	13.5%	6.8%

Even then, it is typically not I who make the buying decisions. Lou Simpson manages about \$2½ billion of equities that are held by GEICO, and it is his transactions that Berkshire is usually reporting. Customarily his purchases are in the \$200-\$300 million range and are in companies that are smaller than the ones I focus on. Take a look at the facing page to see why Lou is a cinch to be inducted into the investment Hall of Fame.

You may be surprised to learn that Lou does not necessarily inform me about what he is doing. When Charlie and I assign responsibility, we truly hand over the baton – and we give it to Lou just as we do to our operating managers. Therefore, I typically learn of Lou’s transactions about ten days after the end of each month. Sometimes, it should be added, I silently disagree with his decisions. But he’s usually right.

Foreign Currencies

Berkshire owned about \$21.4 billion of foreign exchange contracts at yearend, spread among 12 currencies. As I mentioned last year, holdings of this kind are a decided change for us. Before March 2002, neither Berkshire nor I had *ever* traded in currencies. But the evidence grows that our trade policies will put unremitting pressure on the dollar for many years to come – so since 2002 we’ve heeded that warning in setting our investment course. (As W.C. Fields once said when asked for a handout: “Sorry, son, all my money’s tied up in currency.”)

Be clear on one point: In no way does our thinking about currencies rest on doubts about America. We live in an extraordinarily rich country, the product of a system that values market economics, the rule of law and equality of opportunity. Our economy is far and away the strongest in the world and will continue to be. We are lucky to live here.

But as I argued in a November 10, 2003 [article](#) in *Fortune*, (available at berkshirehathaway.com), our country’s trade practices are weighing down the dollar. The decline in its value has already been substantial, but is nevertheless likely to continue. Without policy changes, currency markets could even become disorderly and generate spillover effects, both political and financial. No one knows whether these problems will materialize. But such a scenario is a far-from-remote possibility that policymakers should be considering *now*. Their bent, however, is to lean toward not-so-benign neglect: A 318-page Congressional study of the consequences of unremitting trade deficits was published in November 2000 and has been gathering dust ever since. The study was ordered after the deficit hit a then-alarming \$263 billion in 1999; by last year it had risen to \$618 billion.

Charlie and I, it should be emphasized, believe that true trade – that is, the exchange of goods and services with other countries – is enormously beneficial for both us and them. Last year we had \$1.15 trillion of such honest-to-God trade and the more of this, the better. But, as noted, our country also purchased an additional \$618 billion in goods and services from the rest of the world that was unreciprocated. That is a staggering figure and one that has important consequences.

The balancing item to this one-way pseudo-trade — in economics there is always an offset — is a transfer of wealth from the U.S. to the rest of the world. The transfer may materialize in the form of IOUs our private or governmental institutions give to foreigners, or by way of their assuming ownership of our assets, such as stocks and real estate. In either case, Americans end up owning a reduced portion of our country while non-Americans own a greater part. This force-feeding of American wealth to the rest of the world is now proceeding at the rate of \$1.8 billion daily, an increase of 20% since I wrote you last year. Consequently, other countries and their citizens now own a net of about \$3 trillion of the U.S. A decade ago their net ownership was negligible.

The mention of trillions numbs most brains. A further source of confusion is that the current account deficit (the sum of three items, the most important by far being the trade deficit) and our national budget deficit are often lumped as “twins.” They are anything but. They have different causes and different consequences.

A budget deficit in no way reduces the portion of the national pie that goes to Americans. As long as other countries and their citizens have no net ownership of the U.S., 100% of our country's output belongs to our citizens under *any* budget scenario, even one involving a huge deficit.

As a rich "family" awash in goods, Americans will argue through their legislators as to how government should redistribute the national output – that is who pays taxes and who receives governmental benefits. If "entitlement" promises from an earlier day have to be reexamined, "family members" will angrily debate among themselves as to who feels the pain. Maybe taxes will go up; maybe promises will be modified; maybe more internal debt will be issued. But when the fight is finished, *all* of the family's huge pie remains available for its members, however it is divided. No slice must be sent abroad.

Large and persisting current account deficits produce an entirely different result. As time passes, and as claims against us grow, we own less and less of what we produce. In effect, the rest of the world enjoys an ever-growing royalty on American output. Here, we are like a family that consistently overspends its income. As time passes, the family finds that it is working more and more for the "finance company" and less for itself.

Should we continue to run current account deficits comparable to those now prevailing, the net ownership of the U.S. by other countries and their citizens a decade from now will amount to roughly \$11 trillion. And, if foreign investors were to earn only 5% on that net holding, we would need to send a net of \$.55 trillion of goods and services abroad *every year* merely to service the U.S. investments then held by foreigners. At that date, a decade out, our GDP would probably total about \$18 trillion (assuming low inflation, which is far from a sure thing). Therefore, our U.S. "family" would then be delivering 3% of its annual output to the rest of the world simply as tribute for the overindulgences of the past. In this case, unlike that involving budget deficits, the sons would truly pay for the sins of their fathers.

This annual royalty paid the world – which would not disappear unless the U.S. massively underconsumed and began to run consistent and large trade surpluses – would undoubtedly produce significant political unrest in the U.S. Americans would still be living very well, indeed better than now because of the growth in our economy. But they would chafe at the idea of perpetually paying tribute to their creditors and owners abroad. A country that is now aspiring to an "Ownership Society" will not find happiness in – and I'll use hyperbole here for emphasis – a "Sharecropper's Society." But that's precisely where our trade policies, supported by Republicans and Democrats alike, are taking us.

Many prominent U.S. financial figures, both in and out of government, have stated that our current-account deficits cannot persist. For instance, the minutes of the Federal Reserve Open Market Committee of June 29-30, 2004 say: "The staff noted that outsized external deficits could not be sustained indefinitely." But, despite the constant handwringing by luminaries, they offer no substantive suggestions to tame the burgeoning imbalance.

In the article I wrote for *Fortune* 16 months ago, I warned that "a gently declining dollar would not provide the answer." And so far it hasn't. Yet policymakers continue to hope for a "soft landing," meanwhile counseling other countries to stimulate (read "inflate") their economies and Americans to save more. In my view these admonitions miss the mark: There are deep-rooted structural problems that will cause America to continue to run a huge current-account deficit unless trade policies either change materially or the dollar declines by a degree that could prove unsettling to financial markets.

Proponents of the trade status quo are fond of quoting Adam Smith: "What is prudence in the conduct of every family can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage."

I agree. Note, however, that Mr. Smith's statement refers to trade of *product* for product, not of *wealth* for product as our country is doing to the tune of \$.6 trillion annually. Moreover, I am sure that he would never have suggested that "prudence" consisted of his "family" selling off part of its farm every day

in order to finance its overconsumption. Yet that is just what the “great kingdom” called the United States is doing.

If the U.S. was running a \$.6 trillion current-account *surplus*, commentators worldwide would violently condemn our policy, viewing it as an extreme form of “mercantilism” – a long-discredited economic strategy under which countries fostered exports, discouraged imports, and piled up treasure. I would condemn such a policy as well. But, in effect if not in intent, the rest of the world is practicing mercantilism in respect to the U.S., an act made possible by our vast store of assets and our pristine credit history. Indeed, the world would never let any other country use a credit card denominated in its own currency to the insatiable extent we are employing ours. Presently, most foreign investors are sanguine: they may view us as spending junkies, but they know we are *rich* junkies as well.

Our spendthrift behavior won’t, however, be tolerated indefinitely. And though it’s impossible to forecast just when and how the trade problem will be resolved, it’s improbable that the resolution will foster an *increase* in the value of our currency relative to that of our trading partners.

We hope the U.S. adopts policies that will quickly and substantially reduce the current-account deficit. True, a prompt solution would likely cause Berkshire to record losses on its foreign-exchange contracts. But Berkshire’s resources remain heavily concentrated in dollar-based assets, and both a strong dollar and a low-inflation environment are very much in our interest.

If you wish to keep abreast of trade and currency matters, read *The Financial Times*. This London-based paper has long been the leading source for daily international financial news and now has an excellent American edition. Both its reporting and commentary on trade are first-class.

* * * * *

And, again, our usual caveat: macro-economics is a tough game in which few people, Charlie and I included, have demonstrated skill. We may well turn out to be wrong in our currency judgments. (Indeed, the fact that so many pundits now predict weakness for the dollar makes us uneasy.) If so, our mistake will be very public. The irony is that if we chose the opposite course, leaving all of Berkshire’s assets in dollars even as they declined significantly in value, no one would notice our mistake.

John Maynard Keynes said in his masterful *The General Theory*: “Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.” (Or, to put it in less elegant terms, lemmings as a class may be derided but never does an *individual* lemming get criticized.) From a reputational standpoint, Charlie and I run a clear risk with our foreign-exchange commitment. But we believe in managing Berkshire as if we owned 100% of it ourselves. And, were that the case, we would not be following a dollar-only policy.

Miscellaneous

- Last year I told you about a group of University of Tennessee finance students who played a key role in our \$1.7 billion acquisition of Clayton Homes. Earlier, they had been brought to Omaha by their professor, Al Auxier – he brings a class every year – to tour Nebraska Furniture Mart and Borsheim’s, eat at Gorat’s and have a Q&A session with me at Kiewit Plaza. These visitors, like those who come for our annual meeting, leave impressed by both the city and its friendly residents.

Other colleges and universities have now come calling. This school year we will have visiting classes, ranging in size from 30 to 100 students, from Chicago, Dartmouth (Tuck), Delaware State, Florida State, Indiana, Iowa, Iowa State, Maryland, Nebraska, Northwest Nazarene, Pennsylvania (Wharton), Stanford, Tennessee, Texas, Texas A&M, Toronto (Rotman), Union and Utah. Most of the students are MBA candidates, and I’ve been impressed by their quality. They are keenly interested in business and investments, but their questions indicate that they also have more on their minds than simply making money. I always feel good after meeting them.

At our sessions, I tell the newcomers the story of the Tennessee group and its spotting of Clayton Homes. I do this in the spirit of the farmer who enters his hen house with an ostrich egg and admonishes the flock: “I don’t like to complain, girls, but this is just a small sample of what the competition is doing.” To date, our new scouts have not brought us deals. But their mission in life has been made clear to them.

- You should be aware of an accounting rule that mildly distorts our financial statements in a pain-today, gain-tomorrow manner. Berkshire purchases life insurance policies from individuals and corporations who would otherwise surrender them for cash. As the new holder of the policies, we pay any premiums that become due and ultimately – when the original holder dies – collect the face value of the policies.

The original policyholder is usually in good health when we purchase the policy. Still, the price we pay for it is always well above its cash surrender value (“CSV”). Sometimes the original policyholder has borrowed against the CSV to make premium payments. In that case, the remaining CSV will be tiny and our purchase price will be a large multiple of what the original policyholder would have received, had he cashed out by surrendering it.

Under accounting rules, we must immediately charge as a realized capital loss the excess over CSV that we pay upon purchasing the policy. We also must make additional charges each year for the amount by which the premium we pay to keep the policy in force exceeds the increase in CSV. But obviously, we don’t think these bookkeeping charges represent economic losses. If we did, we wouldn’t buy the policies.

During 2004, we recorded net “losses” from the purchase of policies (and from the premium payments required to maintain them) totaling \$207 million, which was charged against realized investment gains in our earnings statement (included in “other” in the table on page 17). When the proceeds from these policies are received in the future, we will record as realized investment gain the excess over the then-CSV.

- Two post-bubble governance reforms have been particularly useful at Berkshire, and I fault myself for not putting them in place many years ago. The first involves regular meetings of directors without the CEO present. I’ve sat on 19 boards, and on many occasions this process would have led to dubious plans being examined more thoroughly. In a few cases, CEO changes that were needed would also have been made more promptly. There is no downside to this process, and there are many possible benefits.

The second reform concerns the “whistleblower line,” an arrangement through which employees can send information to me and the board’s audit committee without fear of reprisal. Berkshire’s extreme decentralization makes this system particularly valuable both to me and the committee. (In a sprawling “city” of 180,000 – Berkshire’s current employee count – not every sparrow that falls will be noticed at headquarters.) Most of the complaints we have received are of “the guy next to me has bad breath” variety, but on occasion I have learned of important problems at our subsidiaries that I otherwise would have missed. The issues raised are usually not of a type discoverable by audit, but relate instead to personnel and business practices. Berkshire would be more valuable today if I had put in a whistleblower line decades ago.

- Charlie and I love the idea of shareholders thinking and behaving like owners. Sometimes that requires them to be pro-active. And in this arena large institutional owners should lead the way.

So far, however, the moves made by institutions have been less than awe-inspiring. Usually, they’ve focused on minutiae and ignored the three questions that truly count. First, does the company have the right CEO? Second, is he/she overreaching in terms of compensation? Third, are proposed acquisitions more likely to create or destroy per-share value?

On such questions, the interests of the CEO may well differ from those of the shareholders. Directors, moreover, sometimes lack the knowledge or gumption to overrule the CEO. Therefore, it's vital that large owners focus on these three questions and speak up when necessary.

Instead many simply follow a "checklist" approach to the issue *du jour*. Last year I was on the receiving end of a judgment reached in that manner. Several institutional shareholders and their advisors decided I lacked "independence" in my role as a director of Coca-Cola. One group wanted me removed from the board and another simply wanted me booted from the audit committee.

My first impulse was to secretly fund the group behind the second idea. Why anyone would wish to be on an audit committee is beyond me. But since directors must be assigned to one committee or another, and since no CEO wants me on his compensation committee, it's often been my lot to get an audit committee assignment. As it turned out, the institutions that opposed me failed and I was re-elected to the audit job. (I fought off the urge to ask for a recount.)

Some institutions questioned my "independence" because, among other things, McLane and Dairy Queen buy lots of Coke products. (Do they want us to favor Pepsi?) But independence is defined in Webster's as "not subject to control by others." I'm puzzled how anyone could conclude that our Coke purchases would "control" my decision-making when the counterweight is the well-being of \$8 billion of Coke stock held by Berkshire. Assuming I'm even marginally rational, elementary arithmetic should make it clear that my heart and mind belong to the owners of Coke, not to its management.

I can't resist mentioning that Jesus understood the calibration of independence far more clearly than do the protesting institutions. In Matthew 6:21 He observed: "For where your treasure is, there will your heart be also." Even to an institutional investor, \$8 billion should qualify as "treasure" that dwarfs any profits Berkshire might earn on its routine transactions with Coke.

Measured by the biblical standard, the Berkshire board is a model: (a) *every* director is a member of a family owning at least \$4 million of stock; (b) *none* of these shares were acquired from Berkshire via options or grants; (c) *no* directors receive committee, consulting or board fees from the company that are more than a tiny portion of their annual income; and (d) although we have a standard corporate indemnity arrangement, we carry no liability insurance for directors.

At Berkshire, board members travel the same road as shareholders.

* * * * *

Charlie and I have seen much behavior confirming the Bible's "treasure" point. In our view, based on our considerable boardroom experience, the *least* independent directors are likely to be those who receive an important fraction of their annual income from the fees they receive for board service (and who hope as well to be recommended for election to other boards and thereby to boost their income further). Yet these are the very board members most often classed as "independent."

Most directors of this type are decent people and do a first-class job. But they wouldn't be human if they weren't tempted to thwart actions that would threaten their livelihood. Some may go on to succumb to such temptations.

Let's look at an example based upon circumstantial evidence. I have first-hand knowledge of a recent acquisition proposal (not from Berkshire) that was favored by management, blessed by the company's investment banker and slated to go forward at a price above the level at which the stock had sold for some years (or now sells for). In addition, a number of directors favored the transaction and wanted it proposed to shareholders.

Several of their brethren, however, each of whom received board and committee fees totaling about \$100,000 annually, scuttled the proposal, which meant that shareholders never learned of this multi-billion offer. Non-management directors owned little stock except for shares they had received from the company. Their open-market purchases in recent years had meanwhile been nominal, even though the stock had sold far below the acquisition price proposed. In other words, these directors didn't want the shareholders to be offered X even though they had consistently declined the opportunity to buy stock for their own account at a fraction of X.

I don't know which directors opposed letting shareholders see the offer. But I do know that \$100,000 is an important portion of the annual income of some of those deemed "independent," clearly meeting the Matthew 6:21 definition of "treasure." If the deal had gone through, these fees would have ended.

Neither the shareholders nor I will ever know what motivated the dissenters. Indeed they themselves will not likely know, given that self-interest inevitably blurs introspection. We do know one thing, though: At the same meeting at which the deal was rejected, the board voted itself a significant increase in directors' fees.

- While we are on the subject of self-interest, let's turn again to the most important accounting mechanism still available to CEOs who wish to overstate earnings: the non-expensing of stock options. The accomplices in perpetuating this absurdity have been many members of Congress who have defied the arguments put forth by all Big Four auditors, all members of the Financial Accounting Standards Board and virtually all investment professionals.

I'm enclosing an [op-ed piece](#) I wrote for *The Washington Post* describing a truly breathtaking bill that was passed 312-111 by the House last summer. Thanks to Senator Richard Shelby, the Senate didn't ratify the House's foolishness. And, to his great credit, Bill Donaldson, the investor-minded Chairman of the SEC, has stood firm against massive political pressure, generated by the check-waving CEOs who first muscled Congress in 1993 about the issue of option accounting and then repeated the tactic last year.

Because the attempts to obfuscate the stock-option issue continue, it's worth pointing out that no one – neither the FASB, nor investors generally, nor I – are talking about restricting the use of options in any way. Indeed, my successor at Berkshire may well receive much of his pay via options, albeit logically-structured ones in respect to 1) an appropriate strike price, 2) an escalation in price that reflects the retention of earnings, and 3) a ban on his quickly disposing of any shares purchased through options. We cheer arrangements that motivate managers, whether these be cash bonuses or options. And if a company is truly receiving value for the options it issues, we see no reason why recording their cost should cut down on their use.

The simple fact is that certain CEOs know their own compensation would be far more rationally determined if options were expensed. They also suspect that their stock would sell at a lower price if realistic accounting were employed, meaning that they would reap less in the market when they unloaded their personal holdings. To these CEOs such unpleasant prospects are a fate to be fought with all the resources they have at hand – even though the funds they use in that fight normally don't belong to them, but are instead put up by their shareholders.

Option-expensing is scheduled to become mandatory on June 15th. You can therefore expect intensified efforts to stall or emasculate this rule between now and then. Let your Congressman and Senators know what you think on this issue.

The Annual Meeting

There are two changes this year concerning the annual meeting. First, we have scheduled the meeting for the last Saturday in April (the 30th), rather than the usual first Saturday in May. This year Mother's Day falls on May 8, and it would be unfair to ask the employees of Borsheim's and Gorat's to take care of us at that special time – so we've moved everything up a week. Next year we'll return to our regular timing, holding the meeting on May 6, 2006.

Additionally, we are changing the sequence of events on meeting day, April 30. Just as always, the doors will open at the Qwest Center at 7 a.m. and the movie will be shown at 8:30. At 9:30, however, we will go directly to the question and answer period, which (allowing for lunch at the Qwest's stands) will last until 3:00. Then, after a short recess, Charlie and I will convene the annual meeting at 3:15.

We have made this change because a number of shareholders complained last year about the time consumed by two speakers who advocated proposals of limited interest to the majority of the audience – and who were no doubt relishing their chance to talk to a captive group of about 19,500. With our new procedure, those shareholders who wish to hear it all can stick around for the formal meeting and those who don't can leave – or better yet shop.

There will be plenty of opportunity for that pastime in the vast exhibition hall that adjoins the meeting area. Kelly Muchemore, the Flo Ziegfeld of Berkshire, put on a magnificent shopping extravaganza last year, and she says that was just a warm-up for this year. (Kelly, I am delighted to report, is getting married in October. I'm giving her away and suggested that she make a little history by holding the wedding at the annual meeting. She balked, however, when Charlie insisted that he be the ringbearer.)

Again we will showcase a 2,100 square foot Clayton home (featuring Acme brick, Shaw carpet, Johns Manville insulation, MiTek fasteners, Carefree awnings and NFM furniture). Take a tour through the home. Better yet, buy it.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a special shareholder discount (usually 8%). This special offer is permitted by 45 of the 50 jurisdictions in which we operate. Bring the details of your existing insurance and check out whether we can save you money.

On Saturday, at the Omaha airport, we will have the usual array of aircraft from NetJets® available for your inspection. Stop by the NetJets booth at the Qwest to learn about viewing these planes. Come to Omaha by bus; leave in your new plane.

The Bookworm shop did a terrific business last year selling Berkshire-related books. Displaying 18 titles, they sold 2,920 copies for \$61,000. Since we charge the shop no rent (I must be getting soft), it gives shareholders a 20% discount. This year I've asked The Bookworm to add Graham Allison's *Nuclear Terrorism: The Ultimate Preventable Catastrophe*, a must-read for those concerned with the safety of our country. In addition, the shop will premiere *Poor Charlie's Almanack*, a book compiled by Peter Kaufman. Scholars have for too long debated whether Charlie is the reincarnation of Ben Franklin. This book should settle the question.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. They do a terrific job for us each year, and I thank them for it.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" pricing. We initiated this special event at NFM eight years ago, and sales during the "Weekend" grew from \$5.3 million in 1997 to \$25.1 million in 2004 (up 45%

from a year earlier). Every year has set a new record, and on Saturday of last year, we had the largest single-day sales in NFM's history – \$6.1 million.

To get the discount, you must make your purchases between Thursday, April 28 and Monday, May 2 inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but that, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m. we are having a special affair for shareholders only. I'll be there, eating barbecue and drinking Coke.

Borsheim's – the largest jewelry store in the country except for Tiffany's Manhattan store – will have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, April 29. The second, the main gala, will be from 9 a.m. to 4 p.m. on Sunday, May 1. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheim's throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 25 through Saturday, May 7. During that period, just identify yourself as a shareholder through your meeting credentials or a brokerage statement.

Borsheim's operates on a gross margin that is fully twenty percentage points below that of its major rivals, even before the shareholders' discount. Last year, business over the weekend increased 73% from 2003, setting a record that will be tough to beat. Show me it can be done.

In a tent outside of Borsheim's, Patrick Wolff, twice U.S. chess champion, will take on all comers in groups of six – blindfolded. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play with our shareholders on Sunday afternoon. They plan to keep their eyes *open* – but Bob never sorts his cards, even when playing for a national championship.

Gorat's – my favorite steakhouse – will again be open exclusively for Berkshire shareholders on Sunday, May 1, and will be serving from 4 p.m. until 10 p.m. Please remember that to come to Gorat's on that day, you must have a reservation. To make one, call 402-551-3733 on April 1 (*but not before*). If Sunday is sold out, try Gorat's on one of the other evenings you will be in town. Enhance your reputation as an epicure by ordering, as I do, a rare T-bone with a double helping of hash browns.

We will again have a special reception from 4:00 to 5:30 on Saturday afternoon for shareholders who have come from outside of North America. Every year our meeting draws many people from around the globe, and Charlie and I want to be sure we personally greet those who have come so far. Last year we enjoyed meeting more than 400 of you including at least 100 from Australia. Any shareholder who comes from other than the U.S. or Canada will be given a special credential and instructions for attending this function.

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Charlie and I are lucky. We have jobs that we love and are helped every day in a myriad of ways by talented and cheerful associates. No wonder we tap-dance to work. But nothing is more fun for us than getting together with our shareholder-partners at Berkshire's annual meeting. So join us on April 30th at the Qwest for our annual Woodstock for Capitalists.

February 28, 2005

Warren E. Buffett
Chairman of the Board

Note: The following table appears in the printed Annual Report on the facing page of the Chairman's Letter

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in S&P 500 with Dividends Included	Relative Results (1)-(2)
(1)	(2)		
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
19995	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
Average Annual Gain — 1965-2005	21.5	10.3	11.2
Overall Gain — 1964-2005	305,134	5,583	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2005 was \$5.6 billion, which increased the per-share book value of both our Class A and Class B stock by 6.4%. Over the last 41 years (that is, since present management took over) book value has grown from \$19 to \$59,377, a rate of 21.5% compounded annually.*

Berkshire had a decent year in 2005. We initiated five acquisitions (two of which have yet to close) and most of our operating subsidiaries prospered. Even our insurance business in its entirety did well, though Hurricane Katrina inflicted record losses on both Berkshire and the industry. We estimate our loss from Katrina at \$2.5 billion – and her ugly sisters, Rita and Wilma, cost us an additional \$.9 billion.

Credit GEICO – and its brilliant CEO, Tony Nicely – for our stellar insurance results in a disaster-ridden year. One statistic stands out: In just two years, GEICO improved its productivity by 32%. Remarkably, employment fell by 4% even as policy count grew by 26% – and more gains are in store. When we drive unit costs down in such a dramatic manner, we can offer ever-greater value to our customers. The payoff: Last year, GEICO gained market-share, earned commendable profits and strengthened its brand. If you have a new son or grandson in 2006, name him Tony.

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My goal in writing this report is to give you the information you need to estimate Berkshire's intrinsic value. I say "estimate" because calculations of intrinsic value, though all-important, are necessarily imprecise and often seriously wrong. The more uncertain the future of a business, the more possibility there is that the calculation will be wildly off-base. (For an explanation of intrinsic value, see pages 77 – 78.) Here Berkshire has some advantages: a wide variety of relatively-stable earnings streams, combined with great liquidity and minimum debt. These factors mean that Berkshire's intrinsic value can be more precisely calculated than can the intrinsic value of most companies.

Yet if precision is aided by Berkshire's financial characteristics, the job of calculating intrinsic value has been made more complex by the mere presence of so many earnings streams. Back in 1965, when we owned only a small textile operation, the task of calculating intrinsic value was a snap. Now we own 68 distinct businesses with widely disparate operating and financial characteristics. This array of unrelated enterprises, coupled with our massive investment holdings, makes it impossible for you to simply examine our consolidated financial statements and arrive at an informed estimate of intrinsic value.

We have attempted to ease this problem by clustering our businesses into four logical groups, each of which we discuss later in this report. In these discussions, we will provide the key figures for both the group and its important components. Of course, the value of Berkshire may be either greater or less than the sum of these four parts. The outcome depends on whether our many units function better or worse by being part of a larger enterprise and whether capital allocation improves or deteriorates when it is under the direction of a holding company. In other words, does Berkshire ownership bring anything to the party, or would our shareholders be better off if they directly owned shares in each of our 68 businesses? These are important questions but ones that you will have to answer for yourself.

Before we look at our individual businesses, however, let's review two sets of figures that show where we've come from and where we are now. The first set is the amount of investments (including cash and cash-equivalents) we own on a per-share basis. In making this calculation, we exclude investments held in our finance operation because these are largely offset by borrowings:

*All figures used in this report apply to Berkshire's A shares, the successor to the only stock that the company had outstanding before 1996. The B shares have an economic interest equal to 1/30th that of the A.

<u>Year</u>	<u>Per-Share Investments*</u>
1965	\$ 4
1975	159
1985	2,407
1995	21,817
2005	<u>\$74,129</u>
Compound Growth Rate 1965-2005	28.0%
Compound Growth Rate 1995-2005	13.0%

*Net of minority interests

In addition to these marketable securities, which with minor exceptions are held in our insurance companies, we own a wide variety of non-insurance businesses. Below, we show the pre-tax earnings (excluding goodwill amortization) of these businesses, again on a per-share basis:

<u>Year</u>	<u>Per-Share Earnings*</u>
1965	\$ 4
1975	4
1985	52
1995	175
2005	<u>\$2,441</u>
Compound Growth Rate 1965-2005	17.2%
Compound Growth Rate 1995-2005	30.2%

*Pre-tax and net of minority interests

When growth rates are under discussion, it will pay you to be suspicious as to why the beginning and terminal years have been selected. If either year was aberrational, any calculation of growth will be distorted. In particular, a base year in which earnings were poor can produce a breathtaking, but meaningless, growth rate. In the table above, however, the base year of 1965 was abnormally *good*; Berkshire earned more money in that year than it did in all but one of the previous ten.

As you can see from the two tables, the comparative growth rates of Berkshire's two elements of value have changed in the last decade, a result reflecting our ever-increasing emphasis on business acquisitions. Nevertheless, Charlie Munger, Berkshire's Vice Chairman and my partner, and I want to increase the figures in *both* tables. In this ambition, we hope – metaphorically – to avoid the fate of the elderly couple who had been romantically challenged for some time. As they finished dinner on their 50th anniversary, however, the wife – stimulated by soft music, wine and candlelight – felt a long-absent tickle and demurely suggested to her husband that they go upstairs and make love. He agonized for a moment and then replied, "I can do one or the other, but not both."

Acquisitions

Over the years, our current businesses, in aggregate, should deliver modest growth in operating earnings. But they will not in themselves produce truly satisfactory gains. We will need major acquisitions to get that job done.

In this quest, 2005 was encouraging. We agreed to five purchases: two that were completed last year, one that closed after yearend and two others that we expect to close soon. None of the deals involve the issuance of Berkshire shares. That's a crucial, but often ignored, point: When a management proudly acquires another company for stock, the shareholders of the acquirer are concurrently selling part of their interest in everything they own. I've made this kind of deal a few times myself – and, on balance, my actions have cost you money.

Here are last year's purchases:

- On June 30 we bought Medical Protective Company ("MedPro"), a 106-year-old medical malpractice insurer based in Fort Wayne. Malpractice insurance is tough to underwrite and has proved to be a graveyard for many insurers. MedPro nevertheless should do well. It will have the attitudinal advantage that all Berkshire insurers share, wherein underwriting discipline trumps all other goals. Additionally, as part of Berkshire, MedPro has financial strength far exceeding that of its competitors, a quality assuring doctors that long-to-settle claims will not end up back on their doorstep because their insurer failed. Finally, the company has a smart and energetic CEO, Tim Kenesey, who instinctively thinks like a Berkshire manager.
- Forest River, our second acquisition, closed on August 31. A couple of months earlier, on June 21, I received a two-page fax telling me – point by point – why Forest River met the acquisition criteria we set forth on page 25 of this report. I had not before heard of the company, a recreational vehicle manufacturer with \$1.6 billion of sales, nor of Pete Liegl, its owner and manager. But the fax made sense, and I immediately asked for more figures. These came the next morning, and that afternoon I made Pete an offer. On June 28, we shook hands on a deal.

Pete is a remarkable entrepreneur. Some years back, he sold his business, then far smaller than today, to an LBO operator who promptly began telling him how to run the place. Before long, Pete left, and the business soon sunk into bankruptcy. Pete then repurchased it. You can be sure that *I* won't be telling Pete how to manage his operation.

Forest River has 60 plants, 5,400 employees and has consistently gained share in the RV business, while also expanding into other areas such as boats. Pete is 61 – and definitely in an acceleration mode. Read the piece from *RV Business* that accompanies this report, and you'll see why Pete and Berkshire are made for each other.

- On November 12, 2005, an article ran in The Wall Street Journal dealing with Berkshire's unusual acquisition and managerial practices. In it Pete declared, "It was easier to sell my business than to renew my driver's license."

In New York, Cathy Baron Tamraz read the article, and it struck a chord. On November 21, she sent me a letter that began, "As president of Business Wire, I'd like to introduce you to my company, as I believe it fits the profile of Berkshire Hathaway subsidiary companies as detailed in a recent Wall Street Journal article."

By the time I finished Cathy's two-page letter, I felt Business Wire and Berkshire were a fit. I particularly liked her penultimate paragraph: "We run a tight ship and keep unnecessary spending under wraps. No secretaries or management layers here. Yet we'll invest big dollars to gain a technological advantage and move the business forward."

I promptly gave Cathy a call, and before long Berkshire had reached agreement with Business Wire's controlling shareholder, Lorry Lokey, who founded the company in 1961 (and who had just made Cathy CEO). I love success stories like Lorry's. Today 78, he has built a company that disseminates information in 150 countries for 25,000 clients. His story, like those of many entrepreneurs who have selected Berkshire as a home for their life's work, is an example of what can happen when a good idea, a talented individual and hard work converge.

- In December we agreed to buy 81% of Applied Underwriters, a company that offers a combination of payroll services and workers' compensation insurance to small businesses. A majority of Applied's customers are located in California.

In 1998, though, when the company had 12 employees, it acquired an Omaha-based operation with 24 employees that offered a somewhat-similar service. Sid Ferenc and Steve Menzies, who have built Applied's remarkable business, concluded that Omaha had many advantages as an operational base – a brilliant insight, I might add – and today 400 of the company's 479 employees are located here.

Less than a year ago, Applied entered into a large reinsurance contract with Ajit Jain, the extraordinary manager of National Indemnity's reinsurance division. Ajit was impressed by Sid and Steve, and they liked Berkshire's method of operation. So we decided to join forces. We are pleased that Sid and Steve retain 19% of Applied. They started on a shoestring only 12 years ago, and it will be fun to see what they can accomplish with Berkshire's backing.

- Last spring, MidAmerican Energy, our 80.5% owned subsidiary, agreed to buy PacifiCorp, a major electric utility serving six Western states. An acquisition of this sort requires many regulatory approvals, but we've now obtained these and expect to close this transaction soon. Berkshire will then buy \$3.4 billion of MidAmerican's common stock, which MidAmerican will supplement with \$1.7 billion of borrowing to complete the purchase. You can't expect to earn outsized profits in regulated utilities, but the industry offers owners the opportunity to deploy large sums at fair returns – and therefore, it makes good sense for Berkshire. A few years back, I said that we hoped to make some very large purchases in the utility field. Note the plural – we'll be looking for more.

In addition to buying these new operations, we continue to make "bolt-on" acquisitions. Some aren't so small: Shaw, our carpet operation, spent about \$550 million last year on two purchases that furthered its vertical integration and should improve its profit margin in the future. XTRA and Clayton Homes also made value-enhancing acquisitions.

Unlike many business buyers, Berkshire has no "exit strategy." We buy to keep. We do, though, have an entrance strategy, looking for businesses in this country or abroad that meet our six criteria and are available at a price that will produce a reasonable return. If you have a business that fits, give me a call. Like a hopeful teenage girl, I'll be waiting by the phone.

Insurance

Let's now talk about our four sectors and start with insurance, our core business. What counts here is the amount of "float" and its cost over time.

For new readers, let me explain. "Float" is money that doesn't belong to us but that we temporarily hold. Most of our float arises because (1) premiums are paid upfront though the service we provide – insurance protection – is delivered over a period that usually covers a year and; (2) loss events that occur today do not always result in our immediately paying claims, because it sometimes takes many years for losses to be reported (asbestos losses would be an example), negotiated and settled. The \$20 million of float that came with our 1967 entry into insurance has now increased – both by way of internal growth and acquisitions – to \$49 billion.

Float is wonderful – *if* it doesn't come at a high price. Its cost is determined by underwriting results, meaning how the expenses and losses we will ultimately pay compare with the premiums we have received. When an insurer earns an underwriting profit – as has been the case at Berkshire in about half of the 39 years we have been in the insurance business – float is better than free. In such years, we are actually paid for holding other people's money. For most insurers, however, life has been far more difficult: In aggregate, the property-casualty industry almost invariably operates at an underwriting loss. When that loss is large, float becomes expensive, sometimes devastatingly so.

In 2004 our float cost us less than nothing, and I told you that we had a chance – absent a mega-catastrophe – of no-cost float in 2005. But we *had* the mega-cat, and as a specialist in that coverage, Berkshire suffered hurricane losses of \$3.4 billion. Nevertheless, our float was costless in 2005 because of the superb results we had in our other insurance activities, particularly at GEICO.

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Auto policies in force grew by 12.1% at GEICO, a gain increasing its market share of U.S. private passenger auto business from about 5.6% to about 6.1%. Auto insurance is a big business: Each share-point equates to \$1.6 billion in sales.

While our brand strength is not quantifiable, I believe it also grew significantly. When Berkshire acquired control of GEICO in 1996, its annual advertising expenditures were \$31 million. Last year we were up to \$502 million. And I can't wait to spend more.

Our advertising works because we have a great story to tell: More people can save money by insuring with us than is the case with any other national carrier offering policies to all comers. (Some specialized auto insurers do particularly well for applicants fitting into their niches; also, because our national competitors use rating systems that differ from ours, they will sometimes beat our price.) Last year, we achieved by far the highest conversion rate – the percentage of internet and phone quotes turned into sales – in our history. This is powerful evidence that our prices are more attractive relative to the competition than ever before. Test us by going to GEICO.com or by calling 800-847-7536. Be sure to indicate you are a shareholder because that fact will often qualify you for a discount.

I told you last year about GEICO's entry into New Jersey in August, 2004. Drivers in that state love us. Our retention rate there for new policyholders is running higher than in any other state, and by sometime in 2007, GEICO is likely to become the third largest auto insurer in New Jersey. There, as elsewhere, our low costs allow low prices that lead to steady gains in profitable business.

That simple formula immediately impressed me 55 years ago when I first discovered GEICO. Indeed, at age 21, I wrote an article about the company – it's reproduced on page 24 – when its market value was \$7 million. As you can see, I called GEICO "The Security I Like Best." And that's what I still call it.

* * * * *

We have major reinsurance operations at General Re and National Indemnity. The former is run by Joe Brandon and Tad Montross, the latter by Ajit Jain. Both units performed well in 2005 considering the extraordinary hurricane losses that battered the industry.

It's an open question whether atmospheric, oceanic or other causal factors have dramatically changed the frequency or intensity of hurricanes. Recent experience is worrisome. We know, for instance, that in the 100 years before 2004, about 59 hurricanes of Category 3 strength, or greater, hit the Southeastern and Gulf Coast states, and that only three of these were Category 5s. We further know that in 2004 there were three Category 3 storms that hammered those areas and that these were followed by four more in 2005, one of them, Katrina, the most destructive hurricane in industry history. Moreover, there were three Category 5s near the coast last year that fortunately weakened before landfall.

Was this onslaught of more frequent and more intense storms merely an anomaly? Or was it caused by changes in climate, water temperature or other variables we don't fully understand? And could these factors be developing in a manner that will soon produce disasters dwarfing Katrina?

Joe, Ajit and I don't know the answer to these all-important questions. What we do know is that our ignorance means we must follow the course prescribed by Pascal in his famous wager about the existence of God. As you may recall, he concluded that since he didn't know the answer, his personal gain/loss ratio dictated an affirmative conclusion.

So guided, we've concluded that we should now write mega-cat policies only at prices far higher than prevailed last year – and then only with an aggregate exposure that would not cause us distress if shifts in some important variable produce far more costly storms in the near future. To a lesser degree, we felt this way after 2004 – and cut back our writings when prices didn't move. Now our caution has intensified. If prices seem appropriate, however, we continue to have both the ability and the appetite to be the largest writer of mega-cat coverage in the world.

* * * * *

Our smaller insurers, with MedPro added to the fold, delivered truly outstanding results last year. However, what you see in the table below does not do full justice to their performance. That's because we increased the loss reserves of MedPro by about \$125 million immediately after our purchase.

No one knows with any precision what amount will be required to pay the claims we inherited. Medical malpractice insurance is a “long-tail” line, meaning that claims often take many years to settle. In addition, there are other losses that have occurred, but that we won't even hear about for some time. One thing, though, we have learned – the hard way – after many years in the business: Surprises in insurance are far from symmetrical. You are lucky if you get one that is pleasant for every ten that go the other way. Too often, however, insurers react to looming loss problems with optimism. They behave like the fellow in a switchblade fight who, after his opponent has taken a mighty swipe at his throat, exclaimed, “You never touched me.” His adversary's reply: “Just wait until you try to shake your head.”

Excluding the reserves we added for prior periods, MedPro wrote at an underwriting profit. And our other primary companies, in aggregate, had an underwriting profit of \$324 million on \$1,270 million of volume. This is an extraordinary result, and our thanks go to Rod Eldred of Berkshire Hathaway Homestate Companies, John Kizer of Central States Indemnity, Tom Nerney of U. S. Liability, Don Towle of Kansas Bankers Surety and Don Wurster of National Indemnity.

Here's the overall tally on our underwriting and float for each major sector of insurance:

<i><u>Insurance Operations</u></i>	<i>(in \$ millions)</i>			
	<i><u>Underwriting Profit (Loss)</u></i>	<i><u>Yearend Float</u></i>	<i><u>2005</u></i>	<i><u>2004</u></i>
General Re	\$(-334)	\$22,920	\$23,120	
B-H Reinsurance	(1,069)	16,233	15,278	
GEICO	1,221	6,692	5,960	
Other Primary.....	<u>235*</u>	<u>3,442</u>	<u>1,736</u>	
Total	<u>\$ 53</u>	<u>\$1,551</u>	<u>\$49,287</u>	<u>\$46,094</u>

*Includes MedPro from June 30, 2005.

Regulated Utility Business

We have an 80.5% (fully diluted) interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.7 million electric customers make it the third largest distributor of electricity in the U.K.; (2) MidAmerican Energy, which serves 706,000 electric customers, primarily in Iowa; and (3) Kern River and Northern Natural pipelines, which carry 7.8% of the natural gas consumed in the U.S. When our PacifiCorp acquisition closes, we will add 1.6 million electric customers in six Western states, with Oregon and Utah providing us the most business. This transaction will increase MidAmerican's revenues by \$3.3 billion and its assets by \$14.1 billion.

The Public Utility Holding Company Act (“PUHCA”) was repealed on August 8, 2005, a milestone that allowed Berkshire to convert its MidAmerican preferred stock into voting common shares on February 9, 2006. This conversion ended a convoluted corporate arrangement that PUHCA had forced upon us. Now we have 83.4% of both the common stock and the votes at MidAmerican, which allows us to consolidate the company’s income for financial accounting and tax purposes. Our true economic interest, however, is the aforementioned 80.5%, since there are options outstanding that are sure to be exercised within a few years and that upon exercise will dilute our ownership.

Though our voting power has increased dramatically, the dynamics of our four-party ownership have not changed at all. We view MidAmerican as a partnership among Berkshire, Walter Scott, and two terrific managers, Dave Sokol and Greg Abel. It’s unimportant how many votes each party has; we will make major moves only when we are unanimous in thinking them wise. Five years of working with Dave, Greg and Walter have underscored my original belief: Berkshire couldn’t have better partners.

You will notice that this year we have provided you with two balance sheets, one representing our actual figures per GAAP on December 31, 2005 (which does *not* consolidate MidAmerican) and one that reflects the subsequent conversion of our preferred. All future financial reports of Berkshire will include MidAmerican’s figures.

Somewhat incongruously, MidAmerican owns the second largest real estate brokerage firm in the U.S. And it’s a gem. The parent company’s name is HomeServices of America, but our 19,200 agents operate through 18 locally-branded firms. Aided by three small acquisitions, we participated in \$64 billion of transactions last year, up 6.5% from 2004.

Currently, the white-hot market in residential real estate of recent years is cooling down, and that should lead to additional acquisition possibilities for us. Both we and Ron Peltier, the company’s CEO, expect HomeServices to be far larger a decade from now.

Here are some key figures on MidAmerican’s operations:

	<i>Earnings (in \$ millions)</i>	
	<i>2005</i>	<i>2004</i>
U.K. utilities	\$ 308	\$ 326
Iowa utility	288	268
Pipelines	309	288
HomeServices.....	148	130
Other (net)	107	172
Income (loss) from discontinued zinc project	8	(579)
Earnings before corporate interest and taxes	1,168	605
Interest, other than to Berkshire	(200)	(212)
Interest on Berkshire junior debt	(157)	(170)
Income tax	(248)	(53)
Net earnings.....	<u>\$ 563</u>	<u>\$ 170</u>
Earnings applicable to Berkshire*	\$ 523	\$ 237
Debt owed to others.....	10,296	10,528
Debt owed to Berkshire	1,289	1,478

*Includes interest earned by Berkshire (net of related income taxes) of \$102 in 2005 and \$110 in 2004.

Finance and Financial Products

The star of our finance sector is Clayton Homes, masterfully run by Kevin Clayton. He does not owe his brilliant record to a rising tide: The manufactured-housing business has been disappointing since Berkshire purchased Clayton in 2003. Industry sales have stagnated at 40-year lows, and the recent uptick from Katrina-related demand will almost certainly be short-lived. In recent years, many industry participants have suffered losses, and only Clayton has earned significant money.

In this brutal environment Clayton has bought a large amount of manufactured-housing loans from major banks that found them unprofitable and difficult to service. Clayton's operating expertise and Berkshire's financial resources have made this an excellent business for us and one in which we are preeminent. We presently service \$17 billion of loans, compared to \$5.4 billion at the time of our purchase. Moreover, Clayton now owns \$9.6 billion of its servicing portfolio, a position built up almost entirely since Berkshire entered the picture.

To finance this portfolio, Clayton borrows money from Berkshire, which in turn borrows the same amount publicly. For the use of its credit, Berkshire charges Clayton a one percentage-point markup on its borrowing cost. In 2005, the cost to Clayton for this arrangement was \$83 million. That amount is included in "Other" income in the table on the facing page, and Clayton's earnings of \$416 million are after deducting this payment.

On the manufacturing side, Clayton has also been active. To its original base of twenty plants, it first added twelve more in 2004 by way of the bankruptcy purchase of Oakwood, which just a few years earlier was one of the largest companies in the business. Then in 2005 Clayton purchased Karsten, a four-plant operation that greatly strengthens Clayton's position on the West Coast.

* * * * *

Long ago, Mark Twain said: "A man who tries to carry a cat home by its tail will learn a lesson that can be learned in no other way." If Twain were around now, he might try winding up a derivatives business. After a few days, he would opt for cats.

We lost \$104 million pre-tax last year in our continuing attempt to exit Gen Re's derivative operation. Our aggregate losses since we began this endeavor total \$404 million.

Originally we had 23,218 contracts outstanding. By the start of 2005 we were down to 2,890. You might expect that our losses would have been stemmed by this point, but the blood has kept flowing. Reducing our inventory to 741 contracts last year cost us the \$104 million mentioned above.

Remember that the rationale for establishing this unit in 1990 was Gen Re's wish to meet the needs of insurance clients. Yet one of the contracts we liquidated in 2005 had a term of 100 years! It's difficult to imagine what "need" such a contract could fulfill except, perhaps, the need of a compensation-conscious trader to have a long-dated contract on his books. Long contracts, or alternatively those with multiple variables, are the most difficult to mark to market (the standard procedure used in accounting for derivatives) and provide the most opportunity for "imagination" when traders are estimating their value. Small wonder that traders promote them.

A business in which huge amounts of compensation flow from assumed numbers is obviously fraught with danger. When two traders execute a transaction that has several, sometimes esoteric, variables and a far-off settlement date, their respective firms must subsequently value these contracts whenever they calculate their earnings. A given contract may be valued at one price by Firm A and at another by Firm B. You can bet that the valuation differences – and I'm personally familiar with several that were *huge* – tend to be tilted in a direction favoring higher earnings at each firm. It's a strange world in which two parties can carry out a paper transaction that each can promptly report as profitable.

I dwell on our experience in derivatives each year for two reasons. One is personal and unpleasant. The hard fact is that I have cost you a lot of money by not moving immediately to close down

Gen Re's trading operation. Both Charlie and I knew at the time of the Gen Re purchase that it was a problem and told its management that we wanted to exit the business. It was my responsibility to make sure that happened. Rather than address the situation head on, however, I wasted several years while we attempted to sell the operation. That was a doomed endeavor because no realistic solution could have extricated us from the maze of liabilities that was going to exist for decades. Our obligations were particularly worrisome because their potential to explode could not be measured. Moreover, if severe trouble occurred, we knew it was likely to correlate with problems elsewhere in financial markets.

So I failed in my attempt to exit painlessly, and in the meantime more trades were put on the books. Fault me for dithering. (Charlie calls it thumb-sucking.) When a problem exists, whether in personnel or in business operations, the time to act is *now*.

The second reason I regularly describe our problems in this area lies in the hope that our experiences may prove instructive for managers, auditors and regulators. In a sense, we are a canary in this business coal mine and should sing a song of warning as we expire. The number and value of derivative contracts outstanding in the world continues to mushroom and is now a multiple of what existed in 1998, the last time that financial chaos erupted.

Our experience should be particularly sobering because we were a better-than-average candidate to exit gracefully. Gen Re was a relatively minor operator in the derivatives field. It has had the good fortune to unwind its supposedly liquid positions in a benign market, all the while free of financial or other pressures that might have forced it to conduct the liquidation in a less-than-efficient manner. Our accounting in the past was conventional and actually thought to be conservative. Additionally, we know of no bad behavior by anyone involved.

It could be a different story for others in the future. Imagine, if you will, one or more firms (troubles often spread) with positions that are many multiples of ours attempting to liquidate in chaotic markets and under extreme, and well-publicized, pressures. This is a scenario to which much attention should be given now rather than after the fact. The time to have considered – and improved – the reliability of New Orleans' levees was *before* Katrina.

When we finally wind up Gen Re Securities, my feelings about its departure will be akin to those expressed in a country song, "My wife ran away with my best friend, and I sure miss him a lot."

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Below are the results of our various finance and financial products activities:

	(in \$ millions)			
	<i>Pre-Tax Earnings</i>		<i>Interest-Bearing Liabilities</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
Trading – ordinary income	\$ 200	\$ 264	\$1,061	\$5,751
Gen Re Securities (loss)	(104)	(44)	2,617*	5,437*
Life and annuity operation	11	(57)	2,461	2,467
Value Capital (loss)	(33)	30	N/A	N/A
Leasing operations	173	92	370	391
Manufactured-housing finance (Clayton).....	416	192	9,299	3,636
Other.....	<u>159</u>	<u>107</u>	N/A	N/A
Income before capital gains.....	822	584		
Trading – capital gains (losses)	(234)	1,750		
Total	<u><u>\$ 588</u></u>	<u><u>\$2,334</u></u>		

*Includes all liabilities

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/05 (in \$ millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 1,004	Notes payable	\$ 1,469
Accounts and notes receivable	3,287	Other current liabilities.....	<u>5,371</u>
Inventory	4,143	Total current liabilities	<u>6,840</u>
Other current assets	<u>342</u>		
Total current assets	<u>8,776</u>		
Goodwill and other intangibles.....	9,260	Deferred taxes.....	338
Fixed assets.....	7,148	Term debt and other liabilities...	2,188
Other assets.....	<u>1,021</u>	Equity	<u>16,839</u>
	<u>\$26,205</u>		<u>\$26,205</u>

Earnings Statement (in \$ millions)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Revenues	\$46,896	\$44,142	\$32,106
Operating expenses (including depreciation of \$699 in 2005, \$676 in 2004 and \$605 in 2003).....	44,190	41,604	29,885
Interest expense (net).....	<u>83</u>	<u>57</u>	<u>64</u>
Pre-tax earnings.....	2,623	2,481	2,157
Income taxes.....	<u>977</u>	<u>941</u>	<u>813</u>
Net income	<u>\$ 1,646</u>	<u>\$ 1,540</u>	<u>\$ 1,344</u>

This eclectic collection, which sells products ranging from Dilly Bars to fractional interests in Boeing 737s, earned a very respectable 22.2% on average tangible net worth last year. It's noteworthy also that these operations used only minor financial leverage in achieving that return. Clearly, we own some terrific businesses. We purchased many of them, however, at substantial premiums to net worth – a point reflected in the goodwill item shown on the balance sheet – and that fact reduces the earnings on our average *carrying* value to 10.1%.

Here are the pre-tax earnings for the larger categories or units.

	<u>Pre-Tax Earnings</u> (in \$ millions)	
	<u>2005</u>	<u>2004</u>
Building Products	\$ 751	\$ 643
Shaw Industries	485	466
Apparel & Footwear	348	325
Retailing of Jewelry, Home Furnishings and Candy	257	215
Flight Services	120	191
McLane	217	228
Other businesses	<u>445</u>	<u>413</u>
	<u>\$2,623</u>	<u>\$2,481</u>

- In both our building-products companies and at Shaw, we continue to be hit by rising costs for raw materials and energy. Most of these operations are significant users of oil (or more specifically, petrochemicals) and natural gas. And prices for these commodities have soared.

We, likewise, have raised prices on many products, but there are often lags before increases become effective. Nevertheless, both our building-products operations and Shaw delivered respectable results in 2005, a fact attributable to their strong business franchises and able managements.

- In apparel, our largest unit, Fruit of the Loom, again increased earnings and market-share. You know, of course, of our leadership position in men's and boys' underwear, in which we account for about 48.7% of the sales recorded by mass-marketers (Wal-Mart, Target, etc.). That's up from 44.2% in 2002, when we acquired the company. Operating from a smaller base, we have made still greater gains in intimate apparel for women and girls that is sold by the mass-marketers, climbing from 13.7% of their sales in 2002 to 24.7% in 2005. A gain like that in a major category doesn't come easy. Thank John Holland, Fruit's extraordinary CEO, for making this happen.
- I told you last year that Ben Bridge (jewelry) and R. C. Willey (home furnishings) had same-store sales gains far above the average of their industries. You might think that blow-out figures in one year would make comparisons difficult in the following year. But Ed and Jon Bridge at their operation and Scott Hymas at R. C. Willey were more than up to this challenge. Ben Bridge had a 6.6% same-store gain in 2005, and R. C. Willey came in at 9.9%.

Our never-on-Sunday approach at R. C. Willey continues to overwhelm seven-day competitors as we roll out stores in new markets. The Boise store, about which I was such a skeptic a few years back, had a 21% gain in 2005, coming off a 10% gain in 2004. Our new Reno store, opened in November, broke out of the gate fast with sales that exceeded Boise's early pace, and we will begin business in Sacramento in June. If this store succeeds as I expect it to, Californians will see many more R. C. Willey stores in the years to come.

- In flight services, earnings improved at FlightSafety as corporate aviation continued its rebound. To support growth, we invest heavily in new simulators. Our most recent expansion, bringing us to 42 training centers, is a major facility at Farnborough, England that opened in September. When it is fully built out in 2007, we will have invested more than \$100 million in the building and its 15 simulators. Bruce Whitman, FlightSafety's able CEO, makes sure that no competitor comes close to offering the breadth and depth of services that we do.

Operating results at NetJets were a different story. I said last year that this business would earn money in 2005 – and I was dead wrong.

Our European operation, it should be noted, showed both excellent growth and a reduced loss. Customer contracts there increased by 37%. We are the only fractional-ownership operation of any size in Europe, and our now-pervasive presence there is a key factor in making NetJets the worldwide leader in this industry.

Despite a large increase in customers, however, our U.S. operation dipped far into the red. Its efficiency fell, and costs soared. We believe that our three largest competitors suffered similar problems, but each is owned by aircraft manufacturers that may think differently than we do about the necessity of making adequate profits. The *combined* value of the fleets managed by these three competitors, in any case, continues to be less valuable than the fleet that we operate.

Rich Santulli, one of the most dynamic managers I've ever met, will solve our revenue/expense problem. He won't do it, however, in a manner that impairs the quality of the NetJets experience. Both he and I are committed to a level of service, security and safety that can't be matched by others.

- Our retailing category includes See's Candies, a company we bought early in 1972 (a date making it our oldest non-insurance business). At that time, Charlie and I immediately decided to put Chuck Huggins, then 46, in charge. Though we were new at the game of selecting managers, Charlie and I hit a home run with this appointment. Chuck's love for the customer and the brand permeated the organization, which in his 34-year tenure produced a more-than-tenfold increase in profits. This gain was achieved in an industry growing at best slowly and perhaps not at all. (Volume figures in this industry are hard to pin down.)

At yearend, Chuck turned the reins at See's over to Brad Kinstler, who previously had served Berkshire well while running Cypress Insurance and Fechheimer's. It's unusual for us to move managers around, but Brad's record made him an obvious choice for the See's job. I hope Chuck and his wife, Donna, are at the annual meeting. If they are, shareholders can join Charlie and me in giving America's number one candy maker a richly-deserved round of applause.

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Every day, in countless ways, the competitive position of each of our businesses grows either weaker or stronger. If we are delighting customers, eliminating unnecessary costs and improving our products and services, we gain strength. But if we treat customers with indifference or tolerate bloat, our businesses will wither. On a daily basis, the effects of our actions are imperceptible; cumulatively, though, their consequences are enormous.

When our long-term competitive position improves as a result of these almost unnoticeable actions, we describe the phenomenon as "widening the moat." And doing that is essential if we are to have the kind of business we want a decade or two from now. We always, of course, hope to earn more money in the short-term. But when short-term and long-term conflict, widening the moat *must* take precedence. If a management makes bad decisions in order to hit short-term earnings targets, and consequently gets behind the eight-ball in terms of costs, customer satisfaction or brand strength, no amount of subsequent brilliance will overcome the damage that has been inflicted. Take a look at the dilemmas of managers in the auto and airline industries today as they struggle with the huge problems handed them by their predecessors. Charlie is fond of quoting Ben Franklin's "An ounce of prevention is worth a pound of cure." But sometimes no amount of cure will overcome the mistakes of the past.

Our managers focus on moat-widening – and are brilliant at it. Quite simply, they are passionate about their businesses. Usually, they were running those long before we came along; our only function since has been to stay out of the way. If you see these heroes – and our four heroines as well – at the annual meeting, thank them for the job they do for you.

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The attitude of our managers vividly contrasts with that of the young man who married a tycoon's only child, a decidedly homely and dull lass. Relieved, the father called in his new son-in-law after the wedding and began to discuss the future:

"Son, you're the boy I always wanted and never had. Here's a stock certificate for 50% of the company. You're my equal partner from now on."

"Thanks, dad."

"Now, what would you like to run? How about sales?"

"I'm afraid I couldn't sell water to a man crawling in the Sahara."

"Well then, how about heading human relations?"

"I really don't care for people."

"No problem, we have lots of other spots in the business. What would you like to do?"

"Actually, nothing appeals to me. Why don't you just buy me out?"

Investments

We show below our common stock investments. Those that had a market value of more than \$700 million at the end of 2005 are itemized.

<u>Shares</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost*</i> (in \$ millions)	<i>Market</i> (in \$ millions)
151,610,700	American Express Company	12.2	\$1,287	\$ 7,802
30,322,137	Ameriprise Financial, Inc.....	12.1	183	1,243
43,854,200	Anheuser-Busch Cos., Inc.....	5.6	2,133	1,884
200,000,000	The Coca-Cola Company	8.4	1,299	8,062
6,708,760	M&T Bank Corporation	6.0	103	732
48,000,000	Moody's Corporation	16.2	499	2,948
2,338,961,000	PetroChina "H" shares (or equivalents)...	1.3	488	1,915
100,000,000	The Procter & Gamble Company	3.0	940	5,788
19,944,300	Wal-Mart Stores, Inc.	0.5	944	933
1,727,765	The Washington Post Company	18.0	11	1,322
95,092,200	Wells Fargo & Company	5.7	2,754	5,975
1,724,200	White Mountains Insurance.....	16.0	369	963
	Others		<u>4,937</u>	<u>7,154</u>
	Total Common Stocks		<u>\$15,947</u>	<u>\$46,721</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

A couple of last year's changes in our portfolio occurred because of corporate events: Gillette was merged into Procter & Gamble, and American Express spun off Ameriprise. In addition, we substantially increased our holdings in Wells Fargo, a company that Dick Kovacevich runs brilliantly, and established positions in Anheuser-Busch and Wal-Mart.

Expect no miracles from our equity portfolio. Though we own major interests in a number of strong, highly-profitable businesses, they are not selling at anything like bargain prices. As a group, they may double in value in ten years. The likelihood is that their per-share earnings, in aggregate, will grow 6-8% per year over the decade and that their stock prices will more or less match that growth. (Their managers, of course, think my expectations are too modest – and I hope they're right.)

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The P&G-Gillette merger, closing in the fourth quarter of 2005, required Berkshire to record a \$5.0 billion pre-tax capital gain. This bookkeeping entry, dictated by GAAP, is meaningless from an economic standpoint, and you should ignore it when you are evaluating Berkshire's 2005 earnings. We didn't intend to sell our Gillette shares before the merger; we don't intend to sell our P&G shares now; and we incurred no tax when the merger took place.

It's hard to overemphasize the importance of who is CEO of a company. Before Jim Kilts arrived at Gillette in 2001, the company was struggling, having particularly suffered from capital-allocation blunders. In the major example, Gillette's acquisition of Duracell cost Gillette shareholders billions of dollars, a loss never made visible by conventional accounting. Quite simply, what Gillette received in business value in this acquisition was not equivalent to what it gave up. (Amazingly, this most fundamental of yardsticks is almost always ignored by both managements and their investment bankers when acquisitions are under discussion.)

Upon taking office at Gillette, Jim quickly instilled fiscal discipline, tightened operations and energized marketing, moves that dramatically increased the intrinsic value of the company. Gillette's merger with P&G then expanded the potential of both companies. For his accomplishments, Jim was paid very well – but he earned every penny. (This is no academic evaluation: As a 9.7% owner of Gillette, Berkshire in effect paid that proportion of his compensation.) Indeed, it's difficult to overpay the *truly* extraordinary CEO of a giant enterprise. But this species is rare.

Too often, executive compensation in the U.S. is ridiculously out of line with performance. That won't change, moreover, because the deck is stacked against investors when it comes to the CEO's pay. The upshot is that a mediocre-or-worse CEO – aided by his handpicked VP of human relations and a consultant from the ever-accommodating firm of Ratchet, Ratchet and Bingo – all too often receives gobs of money from an ill-designed compensation arrangement.

Take, for instance, ten year, fixed-price options (and who wouldn't?). If Fred Futile, CEO of Stagnant, Inc., receives a bundle of these – let's say enough to give him an option on 1% of the company – his self-interest is clear: He should skip dividends entirely and instead use all of the company's earnings to repurchase stock.

Let's assume that under Fred's leadership Stagnant lives up to its name. In each of the ten years after the option grant, it earns \$1 billion on \$10 billion of net worth, which initially comes to \$10 per share on the 100 million shares then outstanding. Fred eschews dividends and regularly uses all earnings to repurchase shares. If the stock constantly sells at ten times earnings per share, it will have appreciated 158% by the end of the option period. That's because repurchases would reduce the number of shares to 38.7 million by that time, and earnings per share would thereby increase to \$25.80. Simply by withholding earnings from owners, Fred gets very rich, making a cool \$158 million, despite the business itself improving not at all. Astonishingly, Fred could have made more than \$100 million if Stagnant's earnings had *declined* by 20% during the ten-year period.

Fred can also get a splendid result for himself by paying no dividends and deploying the earnings he withholds from shareholders into a variety of disappointing projects and acquisitions. Even if these initiatives deliver a paltry 5% return, Fred will still make a bundle. Specifically – with Stagnant's p/e ratio remaining unchanged at ten – Fred's option will deliver him \$63 million. Meanwhile, his shareholders will wonder what happened to the "alignment of interests" that was supposed to occur when Fred was issued options.

A "normal" dividend policy, of course – one-third of earnings paid out, for example – produces less extreme results but still can provide lush rewards for managers who achieve nothing.

CEOs understand this math and know that every dime paid out in dividends reduces the value of all outstanding options. I've never, however, seen this manager-owner conflict referenced in proxy materials that request approval of a fixed-priced option plan. Though CEOs invariably preach *internally* that capital comes at a cost, they somehow forget to tell shareholders that fixed-price options give them capital that is free.

It doesn't have to be this way: It's child's play for a board to design options that give effect to the automatic build-up in value that occurs when earnings are retained. But – surprise, surprise – options of that kind are almost never issued. Indeed, the very thought of options with strike prices that are adjusted for retained earnings seems foreign to compensation "experts," who are nevertheless encyclopedic about every management-friendly plan that exists. ("Whose bread I eat, his song I sing.")

Getting fired can produce a particularly bountiful payday for a CEO. Indeed, he can "earn" more in that single day, while cleaning out his desk, than an American worker earns in a lifetime of cleaning toilets. Forget the old maxim about nothing succeeding like success: Today, in the executive suite, the all-too-prevalent rule is that nothing succeeds like *failure*.

Huge severance payments, lavish perks and outsized payments for ho-hum performance often occur because comp committees have become slaves to comparative data. The drill is simple: Three or so directors – *not chosen by chance* – are bombarded for a few hours before a board meeting with pay statistics that perpetually ratchet upwards. Additionally, the committee is told about new perks that other managers are receiving. In this manner, outlandish “goodies” are showered upon CEOs simply because of a corporate version of the argument we all used when children: “But, Mom, all the other kids have one.” When comp committees follow this “logic,” yesterday’s most egregious excess becomes today’s baseline.

Comp committees should adopt the attitude of Hank Greenberg, the Detroit slugger and a boyhood hero of mine. Hank’s son, Steve, at one time was a player’s agent. Representing an outfielder in negotiations with a major league club, Steve sounded out his dad about the size of the signing bonus he should ask for. Hank, a true pay-for-performance guy, got straight to the point, “What did he hit last year?” When Steve answered “.246,” Hank’s comeback was immediate: “Ask for a uniform.”

(Let me pause for a brief confession: In criticizing comp committee behavior, I don’t speak as a true insider. Though I have served as a director of twenty public companies, only one CEO has put me on his comp committee. Hmmmm . . .)

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My views on America’s long-term problem in respect to trade imbalances, which I have laid out in previous reports, remain unchanged. My conviction, however, cost Berkshire \$955 million pre-tax in 2005. That amount is included in our earnings statement, a fact that illustrates the differing ways in which GAAP treats gains and losses. When we have a long-term position in stocks or bonds, year-to-year changes in value are reflected in our balance sheet but, as long as the asset is not sold, are rarely reflected in earnings. For example, our Coca-Cola holdings went from \$1 billion in value early on to \$13.4 billion at yearend 1998 and have since declined to \$8.1 billion – with none of these moves affecting our earnings statement. Long-term currency positions, however, are daily marked to market and therefore have an effect on earnings in every reporting period. From the date we first entered into currency contracts, we are \$2.0 billion in the black.

We reduced our direct position in currencies somewhat during 2005. We partially offset this change, however, by purchasing equities whose prices are denominated in a variety of foreign currencies and that earn a large part of their profits internationally. Charlie and I prefer this method of acquiring non-dollar exposure. That’s largely because of changes in interest rates: As U.S. rates have risen relative to those of the rest of the world, holding most foreign currencies now involves a significant negative “carry.” The carry aspect of our direct currency position indeed cost us money in 2005 and is likely to do so again in 2006. In contrast, the ownership of foreign equities is likely, over time, to create a positive carry – perhaps a substantial one.

The underlying factors affecting the U.S. current account deficit continue to worsen, and no letup is in sight. Not only did our trade deficit – the largest and most familiar item in the current account – hit an all-time high in 2005, but we also can expect a second item – the balance of investment income – to soon turn negative. As foreigners increase their ownership of U.S. assets (or of claims against us) relative to U.S. investments abroad, these investors will begin earning more on their holdings than we do on ours. Finally, the third component of the current account, unilateral transfers, is always negative.

The U.S., it should be emphasized, is extraordinarily rich and will get richer. As a result, the huge imbalances in its current account may continue for a long time without their having noticeable deleterious effects on the U.S. economy or on markets. I doubt, however, that the situation will forever remain benign. Either Americans address the problem soon in a way we select, or at some point the problem will likely address us in an unpleasant way of its own.

How to Minimize Investment Returns

It's been an easy matter for Berkshire and other owners of American equities to prosper over the years. Between December 31, 1899 and December 31, 1999, to give a really long-term example, the Dow rose from 66 to 11,497. (Guess what annual growth rate is required to produce this result; the surprising answer is at the end of this section.) This huge rise came about for a simple reason: Over the century American businesses did extraordinarily well and investors rode the wave of their prosperity. Businesses continue to do well. But now shareholders, through a series of self-inflicted wounds, are in a major way cutting the returns they will realize from their investments.

The explanation of how this is happening begins with a fundamental truth: With unimportant exceptions, such as bankruptcies in which some of a company's losses are borne by creditors, *the most that owners in aggregate can earn between now and Judgment Day is what their businesses in aggregate earn.* True, by buying and selling that is clever or lucky, investor A may take more than his share of the pie at the expense of investor B. And, yes, all investors *feel* richer when stocks soar. But an owner can exit only by having someone take his place. If one investor sells high, another must buy high. For owners as a whole, there is simply no magic – no shower of money from outer space – that will enable them to extract wealth from their companies beyond that created by the companies themselves.

Indeed, owners must earn less than their businesses earn because of "frictional" costs. And that's my point: These costs are now being incurred in amounts that will cause shareholders to earn *far* less than they historically have.

To understand how this toll has ballooned, imagine for a moment that all American corporations are, and always will be, owned by a single family. We'll call them the Gotrocks. After paying taxes on dividends, this family – generation after generation – becomes richer by the aggregate amount earned by its companies. Today that amount is about \$700 billion annually. Naturally, the family spends some of these dollars. But the portion it saves steadily compounds for its benefit. In the Gotrocks household everyone grows wealthier at the same pace, and all is harmonious.

But let's now assume that a few fast-talking Helpers approach the family and persuade each of its members to try to outsmart his relatives by buying certain of their holdings and selling them certain others. The Helpers – for a fee, of course – obligingly agree to handle these transactions. The Gotrocks still own all of corporate America; the trades just rearrange who owns what. So the family's annual gain in wealth diminishes, equaling the earnings of American business *minus* commissions paid. The more that family members trade, the smaller their share of the pie and the larger the slice received by the Helpers. This fact is not lost upon these broker-Helpers: Activity is their friend and, in a wide variety of ways, they urge it on.

After a while, most of the family members realize that they are not doing so well at this new "beat-my-brother" game. Enter another set of Helpers. These newcomers explain to each member of the Gotrocks clan that by himself he'll never outsmart the rest of the family. The suggested cure: "Hire a manager – yes, us – and get the job done professionally." These manager-Helpers continue to use the broker-Helpers to execute trades; the managers may even increase their activity so as to permit the brokers to prosper still more. Overall, a bigger slice of the pie now goes to the two classes of Helpers.

The family's disappointment grows. Each of its members is now employing professionals. Yet overall, the group's finances have taken a turn for the worse. The solution? More help, of course.

It arrives in the form of financial planners and institutional consultants, who weigh in to advise the Gotrocks on selecting manager-Helpers. The befuddled family welcomes this assistance. By now its members know they can pick neither the right stocks nor the right stock-pickers. Why, one might ask, should they expect success in picking the right consultant? But this question does not occur to the Gotrocks, and the consultant-Helpers certainly don't suggest it to them.

The Gotrocks, now supporting three classes of expensive Helpers, find that their results get worse, and they sink into despair. But just as hope seems lost, a fourth group – we'll call them the hyper-Helpers – appears. These friendly folk explain to the Gotrocks that their unsatisfactory results are occurring because the existing Helpers – brokers, managers, consultants – are not sufficiently motivated and are simply going through the motions. “What,” the new Helpers ask, “can you expect from such a bunch of zombies?”

The new arrivals offer a breathtakingly simple solution: *Pay more money*. Brimming with self-confidence, the hyper-Helpers assert that huge contingent payments – in addition to stiff fixed fees – are what each family member must fork over in order to *really* outmaneuver his relatives.

The more observant members of the family see that some of the hyper-Helpers are really just manager-Helpers wearing new uniforms, bearing sewn-on sexy names like HEDGE FUND or PRIVATE EQUITY. The new Helpers, however, assure the Gotrocks that this change of clothing is all-important, bestowing on its wearers magical powers similar to those acquired by mild-mannered Clark Kent when he changed into his Superman costume. Calmed by this explanation, the family decides to pay up.

And that's where we are today: A record portion of the earnings that would go in their entirety to owners – if they all just stayed in their rocking chairs – is now going to a swelling army of Helpers. Particularly expensive is the recent pandemic of profit arrangements under which Helpers receive large portions of the winnings when they are smart or lucky, and leave family members with all of the losses – and large fixed fees to boot – when the Helpers are dumb or unlucky (or occasionally crooked).

A sufficient number of arrangements like this – heads, the Helper takes much of the winnings; tails, the Gotrocks lose and pay dearly for the privilege of doing so – may make it more accurate to call the family the Hadrocks. Today, in fact, the family's frictional costs of all sorts may well amount to 20% of the earnings of American business. In other words, the burden of paying Helpers may cause American equity investors, overall, to earn only 80% or so of what they would earn if they just sat still and listened to no one.

Long ago, Sir Isaac Newton gave us three laws of motion, which were the work of genius. But Sir Isaac's talents didn't extend to investing: He lost a bundle in the South Sea Bubble, explaining later, “I can calculate the movement of the stars, but not the madness of men.” If he had not been traumatized by this loss, Sir Isaac might well have gone on to discover the Fourth Law of Motion: *For investors as a whole, returns decrease as motion increases*.

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Here's the answer to the question posed at the beginning of this section: To get very specific, the Dow increased from 65.73 to 11,497.12 in the 20th century, and that amounts to a gain of 5.3% compounded annually. (Investors would also have received dividends, of course.) To achieve an equal rate of gain in the 21st century, the Dow will have to rise by December 31, 2099 to – brace yourself – precisely 2,011,011.23. But I'm willing to settle for 2,000,000; six years into this century, the Dow has gained not at all.

Debt and Risk

As we consolidate MidAmerican, our new balance sheet may suggest that Berkshire has expanded its tolerance for borrowing. But that's not so. Except for token amounts, we shun debt, turning to it for only three purposes:

- 1) We occasionally use repos as a part of certain short-term investing strategies that incorporate ownership of U.S. government (or agency) securities. Purchases of this kind are highly opportunistic and involve only the most liquid of securities. A few years ago, we entered into several interesting transactions that have since been unwound or are running off. The offsetting debt has likewise been cut substantially and before long may be gone.

- 2) We borrow money against portfolios of interest-bearing receivables whose risk characteristics we understand. We did this in 2001 when we guaranteed \$5.6 billion of bank debt to take over, in partnership with Leucadia, a bankrupt Finova (which held a broad range of receivables). All of that debt has been repaid. More recently, we have borrowed to finance a widely-diversified, predictably-performing portfolio of manufactured-home receivables managed by Clayton. Alternatively, we could “securitize” – that is, sell – these receivables, but retain the servicing of them. If we followed this procedure, which is common in the industry, we would not show the debt that we do on our balance sheet, and we would also accelerate the earnings we report. In the end, however, we would earn less money. Were market variables to change so as to favor securitization (an unlikely event), we could sell part of our portfolio and eliminate the related debt. Until then, we prefer better profits to better cosmetics.
- 3) At MidAmerican, we have substantial debt, but it is that company’s obligation only. Though it will appear on our consolidated balance sheet, Berkshire does *not* guarantee it.

Even so, this debt is unquestionably secure because it is serviced by MidAmerican’s diversified stream of highly-stable utility earnings. If there were to be some bolt from the blue that hurt one of MidAmerican’s utility properties, earnings from the others would still be more than ample to cover all debt requirements. Moreover, MidAmerican retains all of its earnings, an equity-building practice that is rare in the utility field.

From a risk standpoint, it is far safer to have earnings from ten diverse and uncorrelated utility operations that cover interest charges by, say, a 2:1 ratio than it is to have far greater coverage provided by a single utility. A catastrophic event can render a single utility insolvent – witness what Katrina did to the local electric utility in New Orleans – no matter how conservative its debt policy. A geographical disaster – say, an earthquake in a Western state – can’t have the same effect on MidAmerican. And even a worrier like Charlie can’t think of an event that would systemically decrease utility earnings in any major way. Because of MidAmerican’s ever-widening diversity of regulated earnings, it will always utilize major amounts of debt.

And that’s about it. We are not interested in incurring any significant debt at Berkshire for acquisitions or operating purposes. Conventional business wisdom, of course, would argue that we are being too conservative and that there are added profits that could be safely earned if we injected moderate leverage into our balance sheet.

Maybe so. But many of Berkshire’s hundreds of thousands of investors have a large portion of their net worth in our stock (among them, it should be emphasized, a large number of our board and key managers) and a disaster for the company would be a disaster for them. Moreover, there are people who have been permanently injured to whom we owe insurance payments that stretch out for fifty years or more. To these and other constituencies we have promised total security, whatever comes: financial panics, stock-exchange closures (an extended one occurred in 1914) or even domestic nuclear, chemical or biological attacks.

We are quite willing to accept huge risks. Indeed, more than any other insurer, we write high-limit policies that are tied to single catastrophic events. We also own a large investment portfolio whose market value could fall dramatically and quickly under certain conditions (as happened on October 19, 1987). Whatever occurs, though, Berkshire will have the net worth, the earnings streams and the liquidity to handle the problem with ease.

Any other approach is dangerous. Over the years, a number of very smart people have learned the hard way that a long string of impressive numbers multiplied by a single zero always equals zero. That is not an equation whose effects I would like to experience personally, and I would like even less to be responsible for imposing its penalties upon others.

Management Succession

As owners, you are naturally concerned about whether I will insist on continuing as CEO after I begin to fade and, if so, how the board will handle that problem. You also want to know what happens if I should die tonight.

That second question is easy to answer. Most of our many businesses have strong market positions, significant momentum, and terrific managers. The special Berkshire culture is deeply ingrained throughout our subsidiaries, and these operations won't miss a beat when I die.

Moreover, we have three managers at Berkshire who are reasonably young and fully capable of being CEO. Any of the three would be much better at certain management aspects of my job than I. On the minus side, none has my crossover experience that allows me to be comfortable making decisions in either the business arena or in investments. That problem will be solved by having another person in the organization handle marketable securities. That's an interesting job at Berkshire, and the new CEO will have no problem in hiring a talented individual to do it. Indeed, that's what we have done at GEICO for 26 years, and our results have been terrific.

Berkshire's board has fully discussed each of the three CEO candidates and has unanimously agreed on the person who should succeed me if a replacement were needed today. The directors stay updated on this subject and could alter their view as circumstances change – new managerial stars may emerge and present ones will age. The important point is that the directors know now – and will always know in the future – exactly what they will do when the need arises.

The other question that must be addressed is whether the Board will be prepared to make a change if that need should arise not from my death but rather from my decay, particularly if this decay is accompanied by my delusionally thinking that I am reaching new peaks of managerial brilliance. That problem would not be unique to me. Charlie and I have faced this situation from time to time at Berkshire's subsidiaries. Humans age at greatly varying rates – but sooner or later their talents and vigor decline. Some managers remain effective well into their 80s – Charlie is a wonder at 82 – and others noticeably fade in their 60s. When their abilities ebb, so usually do their powers of self-assessment. Someone else often needs to blow the whistle.

When that time comes for me, our board will have to step up to the job. From a financial standpoint, its members are unusually motivated to do so. I know of no other board in the country in which the financial interests of directors are so completely aligned with those of shareholders. Few boards even come close. On a personal level, however, it is extraordinarily difficult for most people to tell someone, particularly a friend, that he or she is no longer capable.

If I become a candidate for that message, however, our board will be doing me a favor by delivering it. *Every* share of Berkshire that I own is destined to go to philanthropies, and I want society to reap the maximum good from these gifts and bequests. It would be a tragedy if the philanthropic potential of my holdings was diminished because my associates shirked their responsibility to (tenderly, I hope) show me the door. But don't worry about this. We have an outstanding group of directors, and they will always do what's right for shareholders.

And while we are on the subject, I feel terrific.

The Annual Meeting

Our meeting this year will be on Saturday, May 6. As always, the doors will open at the Qwest Center at 7 a.m., and the latest Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:00. Then, after a short recess, Charlie and I will convene the annual meeting at 3:15. This schedule worked well last year, because it let those who wanted to attend the formal session to do so, while freeing others to *shop*.

You certainly did your share in this respect last year. The 194,300 square foot hall adjoining the meeting area was filled with the products of Berkshire subsidiaries, and the 21,000 people who came to the meeting allowed every location to rack up sales records. Kelly Broz (néé Muchemore), the Flo Ziegfeld of Berkshire, orchestrates both this magnificent shopping extravaganza and the meeting itself. The exhibitors love her, and so do I. Kelly got married in October, and I gave her away. She asked me how I wanted to be listed in the wedding program. I replied “envious of the groom,” and that’s the way it went to press.

This year we will showcase two Clayton homes (featuring Acme brick, Shaw carpet, Johns Manville insulation, MiTek fasteners, Carefree awnings and NFM furniture). You will find that these homes, priced at \$79,000 and \$89,000, deliver excellent value. In fact, three shareholders came so firmly to that conclusion last year that they bought the \$119,000 model we then showcased. Flanking the Clayton homes on the exhibition floor will be RVs from Forest River.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a special shareholder discount (usually 8%). This special offer is permitted by 45 of the 50 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can. And while you’re at it, sign up for the new GEICO credit card. It’s the one I now use.

On Saturday, at the Omaha airport, we will have the usual array of aircraft from NetJets® available for your inspection. Stop by the NetJets booth at the Qwest to learn about viewing these planes. Come to Omaha by bus; leave in your new plane.

The Bookworm boutique at the Qwest broke all records last year selling Berkshire-related books. An amazing 3,500 of these were *Poor Charlie’s Almanack*, the collected wisdom of my partner. This means that a copy was sold every 9 seconds. And for good reason: You will never find a book with more useful ideas. Word-of-mouth recommendations have caused Charlie’s first printing of 20,500 copies to sell out, and we will therefore have a revised and expanded edition on sale at our meeting. Among the other 22 titles and DVDs available last year at the Bookworm, 4,597 copies were sold for \$84,746. Our shareholders are a bookseller’s dream.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” pricing. We initiated this special event at NFM nine years ago, and sales during the “Weekend” grew from \$5.3 million in 1997 to \$27.4 million in 2005 (up 9% from a year earlier). I get goose bumps just thinking about this volume.

To obtain the discount, you must make your purchases between Thursday, May 4 and Monday, May 8 inclusive, and also present your meeting credential. The period’s special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but that, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., we are having a special affair for shareholders only. I’ll be there, eating barbecue, drinking Coke, and counting sales.

Borsheim’s again will have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, May 5. The second, the main gala, will be from 9 a.m. to 4 p.m. on Sunday, May 7. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheim's throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, May 1 through Saturday, May 13. During that period, just identify yourself as a shareholder through your meeting credentials or a brokerage statement.

Borsheim's operates on a gross margin that, even before the shareholders' discount, is fully twenty percentage points below that of its major rivals. Last year, our shareholder-period business increased 9% from 2004, which came on top of a 73% gain the year before. The store sold 5,000 Berkshire Monopoly games – and then ran out. We've learned: Plenty will be in stock this year.

In a tent outside of Borsheim's, Patrick Wolff, twice U.S. chess champion, will take on all comers in groups of six – blindfolded. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play with our shareholders on Sunday afternoon. They plan to keep their eyes *open* – but Bob never sorts his cards, even when playing for a national championship.

Gorat's – my favorite steakhouse – will again be open exclusively for Berkshire shareholders on Sunday, May 7, and will be serving from 4 p.m. until 10 p.m. Please remember that to come to Gorat's on that day, you must have a reservation. To make one, call 402-551-3733 on April 1 (*but not before*).

In this school year, about 35 university classes will come to Omaha for sessions with me. I take almost all – in aggregate, perhaps 2,000 students – to lunch at Gorat's. And they love it. To learn why, come join us on Sunday.

We will again have a special reception from 4:00 to 5:30 on Saturday afternoon for shareholders who have come from outside of North America. Every year our meeting draws many people from around the globe, and Charlie and I want to be sure we personally greet those who have come so far. Last year we enjoyed meeting more than 400 of you from many dozens of countries. Any shareholder who comes from other than the U.S. or Canada will be given a special credential and instructions for attending this function.

* * * * *

Charlie and I are extraordinarily lucky. We were born in America; had terrific parents who saw that we got good educations; have enjoyed wonderful families and great health; and came equipped with a "business" gene that allows us to prosper in a manner hugely disproportionate to other people who contribute as much or more to our society's well-being. Moreover, we have long had jobs that we love, in which we are helped every day in countless ways by talented and cheerful associates. No wonder we tap-dance to work. But nothing is more fun for us than getting together with our shareholder-partners at Berkshire's annual meeting. So join us on May 6th at the Qwest for our annual Woodstock for Capitalists. We'll see you there.

February 28, 2006

Warren E. Buffett
Chairman of the Board

Note: The following table appears in the printed Annual Report on the facing page of the Chairman's Letter and is referred to in that letter.

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
1999	.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
Compounded Annual Gain – 1965-2006	21.4%	10.4%	11.0
Overall Gain – 1964-2006	361,156%	6,479%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2006 was \$16.9 billion, which increased the per-share book value of both our Class A and Class B stock by 18.4%. Over the last 42 years (that is, since present management took over) book value has grown from \$19 to \$70,281, a rate of 21.4% compounded annually.*

We believe that \$16.9 billion is a record for a one-year gain in net worth – more than has ever been booked by *any* American business, leaving aside boosts that have occurred because of mergers (e.g., AOL's purchase of Time Warner). Of course, Exxon Mobil and other companies earn far more than Berkshire, but their earnings largely go to dividends and/or repurchases, rather than to building net worth.

All that said, a confession about our 2006 gain is in order. Our most important business, insurance, benefited from a large dose of luck: Mother Nature, bless her heart, went on vacation. After hammering us with hurricanes in 2004 and 2005 – storms that caused us to lose a bundle on super-cat insurance – she just vanished. Last year, the red ink from this activity turned black – *very* black.

In addition, the great majority of our 73 businesses did outstandingly well in 2006. Let me focus for a moment on one of our largest operations, GEICO. What management accomplished there was simply extraordinary.

As I've told you before, Tony Nicely, GEICO's CEO, went to work at the company 45 years ago, two months after turning 18. He became CEO in 1992, and from then on the company's growth exploded. In addition, Tony has delivered staggering productivity gains in recent years. Between yearend 2003 and yearend 2006, the number of GEICO policies increased from 5.7 million to 8.1 million, a jump of 42%. Yet during that same period, the company's employees (measured on a fulltime-equivalent basis) *fell* 3.5%. So productivity grew 47%. And GEICO didn't start fat.

That remarkable gain has allowed GEICO to maintain its all-important position as a low-cost producer, even though it has dramatically increased advertising expenditures. Last year GEICO spent \$631 million on ads, up from \$238 million in 2003 (and up from \$31 million in 1995, when Berkshire took control). Today, GEICO spends far more on ads than any of its competitors, even those much larger. We will continue to raise the bar.

Last year I told you that if you had a new son or grandson to be sure to name him Tony. But Don Keough, a Berkshire director, recently had a better idea. After reviewing GEICO's performance in 2006, he wrote me, "Forget births. Tell the shareholders to immediately change the names of their *present* children to Tony or Antoinette." Don signed his letter "Tony."

* * * * *

Charlie Munger – my partner and Berkshire's vice chairman – and I run what has turned out to be a big business, one with 217,000 employees and annual revenues approaching \$100 billion. We certainly didn't plan it that way. Charlie began as a lawyer, and I thought of myself as a security analyst. Sitting in those seats, we both grew skeptical about the ability of big entities of any type to function well. Size seems to make many organizations slow-thinking, resistant to change and smug. In Churchill's words: "We shape our buildings, and afterwards our buildings shape us." Here's a telling fact: Of the ten non-oil companies having the largest market capitalization in 1965 – titans such as General Motors, Sears, DuPont and Eastman Kodak – only one made the 2006 list.

*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/30th of those shown for the A.

In fairness, we've seen plenty of successes as well, some truly outstanding. There are many giant-company managers whom I greatly admire; Ken Chenault of American Express, Jeff Immelt of G.E. and Dick Kovacevich of Wells Fargo come quickly to mind. But I don't think I could do the management job they do. And I know I wouldn't enjoy many of the duties that come with their positions – meetings, speeches, foreign travel, the charity circuit and governmental relations. For me, Ronald Reagan had it right: "It's probably true that hard work never killed anyone – but why take the chance?"

So I've taken the easy route, just sitting back and working through great managers who run their own shows. My only tasks are to cheer them on, sculpt and harden our corporate culture, and make major capital-allocation decisions. Our managers have returned this trust by working hard and effectively.

For their performance over the last 42 years – and particularly for 2006 – Charlie and I thank them.

Yardsticks

Charlie and I measure Berkshire's progress and evaluate its intrinsic value in a number of ways. No single criterion is effective in doing these jobs, and even an avalanche of statistics will not capture some factors that are important. For example, it's essential that we have managers much younger than I available to succeed me. Berkshire has never been in better shape in this regard – but I can't prove it to you with numbers.

There are two statistics, however, that are of real importance. The first is the amount of investments (including cash and cash-equivalents) that we own on a per-share basis. Arriving at this figure, we exclude investments held in our finance operation because these are largely offset by borrowings. Here's the record since present management acquired control of Berkshire:

<u>Year</u>	<u>Per-Share Investments*</u>
1965	\$ 4
1975	159
1985	2,407
1995	21,817
2006	<u>\$80,636</u>
Compound Growth Rate 1965-2006.....	27.5%
Compound Growth Rate 1995-2006.....	12.6%

*Net of minority interests

In our early years we put most of our retained earnings and insurance float into investments in marketable securities. Because of this emphasis, and because the securities we purchased generally did well, our growth rate in investments was for a long time quite high.

Over the years, however, we have focused more and more on the acquisition of operating businesses. Using our funds for these purchases has both slowed our growth in investments and accelerated our gains in pre-tax earnings from non-insurance businesses, the second yardstick we use. Here's how those earnings have looked:

<u>Year</u>	<u>Pre-Tax Earnings Per Share*</u>
1965	\$ 4
1975	4
1985	52
1995	175
2006	<u>\$3,625</u>
Compound Growth Rate 1965-2006	17.9%
Compound Growth Rate 1995-2006	31.7%

*Excluding purchase-accounting adjustments and net of minority interests

Last year we had a good increase in non-insurance earnings – 38%. Large gains from here on in, though, will come only if we are able to make major, *and sensible*, acquisitions. That will not be easy. We do, however, have one advantage: More and more, Berkshire has become “the buyer of choice” for business owners and managers. Initially, we were viewed that way only in the U.S. (and more often than not by private companies). We’ve long wanted, nonetheless, to extend Berkshire’s appeal beyond U.S. borders. And last year, our globe-trotting finally got underway.

Acquisitions

We began 2006 by completing the three acquisitions pending at yearend 2005, spending about \$6 billion for PacifiCorp, Business Wire and Applied Underwriters. All are performing very well.

The highlight of the year, however, was our July 5th acquisition of most of ISCAR, an Israeli company, and our new association with its chairman, Eitan Wertheimer, and CEO, Jacob Harpaz. The story here began on October 25, 2005, when I received a 1¼-page letter from Eitan, of whom I then knew nothing. The letter began, “I am writing to introduce you to ISCAR,” and proceeded to describe a cutting-tool business carried on in 61 countries. Then Eitan wrote, “We have for some time considered the issues of generational transfer and ownership that are typical for large family enterprises, and have given much thought to ISCAR’s future. Our conclusion is that Berkshire Hathaway would be the ideal home for ISCAR. We believe that ISCAR would continue to thrive as a part of your portfolio of businesses.”

Overall, Eitan’s letter made the quality of the company and the character of its management leap off the page. It also made me want to learn more, and in November, Eitan, Jacob and ISCAR’s CFO, Danny Goldman, came to Omaha. A few hours with them convinced me that if we were to make a deal, we would be teaming up with extraordinarily talented managers who could be trusted to run the business after a sale with all of the energy and dedication that they had exhibited previously. However, having never bought a business based outside of the U.S. (though I had bought a number of foreign stocks), I needed to get educated on some tax and jurisdictional matters. With that task completed, Berkshire purchased 80% of ISCAR for \$4 billion. The remaining 20% stays in the hands of the Wertheimer family, making it our valued partner.

ISCAR’s products are small, consumable cutting tools that are used in conjunction with large and expensive machine tools. It’s a business without magic except for that imparted by the people who run it. But Eitan, Jacob and their associates are true managerial magicians who constantly develop tools that make their customers’ machines more productive. The result: ISCAR makes money because it enables its customers to make *more* money. There is no better recipe for continued success.

In September, Charlie and I, along with five Berkshire associates, visited ISCAR in Israel. We – and I mean every one of us – have never been more impressed with any operation. At ISCAR, as throughout Israel, brains and energy are ubiquitous. Berkshire shareholders are lucky to have joined with Eitan, Jacob, Danny and their talented associates.

* * * * *

A few months later, Berkshire again became “the buyer of choice” in a deal brought to us by my friend, John Roach, of Fort Worth. John, many of you will remember, was Chairman of Justin Industries, which we bought in 2000. At that time John was helping John Justin, who was terminally ill, find a permanent home for his company. John Justin died soon after we bought Justin Industries, but it has since been run exactly as we promised him it would be.

Visiting me in November, John Roach brought along Paul Andrews, Jr., owner of about 80% of TTI, a Fort Worth distributor of electronic components. Over a 35-year period, Paul built TTI from \$112,000 of sales to \$1.3 billion. He is a remarkable entrepreneur and operator.

Paul, 64, loves running his business. But not long ago he happened to witness how disruptive the death of a founder can be both to a private company’s employees and the owner’s family. What starts out as disruptive, furthermore, often evolves into destructive. About a year ago, therefore, Paul began to think about selling TTI. His goal was to put his business in the hands of an owner he had carefully chosen, rather than allowing a trust officer or lawyer to conduct an auction after his death.

Paul rejected the idea of a “strategic” buyer, knowing that in the pursuit of “synergies,” an owner of that type would be apt to dismantle what he had so carefully built, a move that would uproot hundreds of his associates (and perhaps wound TTI’s business in the process). He also ruled out a private equity firm, which would very likely load the company with debt and then flip it as soon as possible.

That left Berkshire. Paul and I met on the morning of November 15th and made a deal before lunch. Later he wrote me: “After our meeting, I am confident that Berkshire is the right owner for TTI . . . I am proud of our past and excited about our future.” And so are Charlie and I.

* * * * *

We also made some “tuck-in” acquisitions during 2006 at Fruit of the Loom (“Fruit”), MiTek, CTB, Shaw and Clayton. Fruit made the largest purchases. First, it bought Russell Corp., a leading producer of athletic apparel and uniforms for about \$1.2 billion (including assumed debt) and in December it agreed to buy the intimate apparel business of VF Corp. Together, these acquisitions add about \$2.2 billion to Fruit’s sales and bring with them about 23,000 employees.

Charlie and I love it when we can acquire businesses that can be placed under managers, such as John Holland at Fruit, who have already shown their stuff at Berkshire. MiTek, for example, has made 14 acquisitions since we purchased it in 2001, and Gene Toombs has delivered results from these deals far in excess of what he had predicted. In effect, we leverage the managerial talent already with us by these tuck-in deals. We will make many more.

* * * * *

We continue, however, to need “elephants” in order for us to use Berkshire’s flood of incoming cash. Charlie and I must therefore ignore the pursuit of mice and focus our acquisition efforts on much bigger game.

Our exemplar is the older man who crashed his grocery cart into that of a much younger fellow while both were shopping. The elderly man explained apologetically that he had lost track of his wife and was preoccupied searching for her. His new acquaintance said that by coincidence his wife had also wandered off and suggested that it might be more efficient if they jointly looked for the two women. Agreeing, the older man asked his new companion what his wife looked like. “She’s a gorgeous blonde,” the fellow answered, “with a body that would cause a bishop to go through a stained glass window, and she’s wearing tight white shorts. How about yours?” The senior citizen wasted no words: “Forget her, we’ll look for yours.”

What we are looking for is described on page 25. If you have an acquisition candidate that fits, call me – day or night. And then watch me shatter a stained glass window.

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Now, let's examine the four major operating sectors of Berkshire. Lumping their financial figures together impedes analysis. So we'll look at them as four separate businesses, starting with the all-important insurance group.

Insurance

Next month marks the 40th anniversary of our entrance into the insurance business. It was on March 9, 1967, that Berkshire purchased National Indemnity and its companion company, National Fire & Marine, from Jack Ringwalt for \$8.6 million.

Jack was a long-time friend of mine and an excellent, but somewhat eccentric, businessman. For about ten minutes every year he would get the urge to sell his company. But those moods – perhaps brought on by a tiff with regulators or an unfavorable jury verdict – quickly vanished.

In the mid-1960s, I asked investment banker Charlie Heider, a mutual friend of mine and Jack's, to alert me the next time Jack was "in heat." When Charlie's call came, I sped to meet Jack. We made a deal in a few minutes, with me waiving an audit, "due diligence" or anything else that would give Jack an opportunity to reconsider. We just shook hands, and that was that.

When we were due to close the purchase at Charlie's office, Jack was late. Finally arriving, he explained that he had been driving around looking for a parking meter with some unexpired time. That was a magic moment for me. I knew then that Jack was going to be my kind of manager.

When Berkshire purchased Jack's two insurers, they had "float" of \$17 million. We've regularly offered a long explanation of float in earlier reports, which you can read on our website. Simply put, float is money we hold that is not ours but which we get to invest.

At the end of 2006, our float had grown to \$50.9 billion, and we have since written a huge retroactive reinsurance contract with Equitas – which I will describe in the next section – that boosts float by another \$7 billion. Much of the gain we've made has come through our acquisition of other insurers, but we've also had outstanding internal growth, particularly at Ajit Jain's amazing reinsurance operation. Naturally, I had no notion in 1967 that our float would develop as it has. There's much to be said for just putting one foot in front of the other every day.

The float from retroactive reinsurance contracts, of which we have many, automatically drifts down over time. Therefore, it will be difficult for us to increase float in the future unless we make new acquisitions in the insurance field. Whatever its size, however, the all-important *cost* of Berkshire's float over time is likely to be significantly below that of the industry, perhaps even falling to less than zero. Note the words "over time." There will be bad years periodically. You can be sure of that.

In 2006, though, everything went right in insurance – *really* right. Our managers – Tony Nicely (GEICO), Ajit Jain (B-H Reinsurance), Joe Brandon and Tad Montross (General Re), Don Wurster (National Indemnity Primary), Tom Nerney (U.S. Liability), Tim Kenesey (Medical Protective), Rod Eldred (Homestate Companies and Cypress), Sid Ferenc and Steve Menzies (Applied Underwriters), John Kizer (Central States) and Don Towle (Kansas Bankers Surety) – simply shot the lights out. When I recite their names, I feel as if I'm at Cooperstown, reading from the Hall of Fame roster. Of course, the overall insurance industry also had a terrific year in 2006. But our managers delivered results generally superior to those of their competitors.

Below is the tally on our underwriting and float for each major sector of insurance. Enjoy the view, because you won't soon see another like it.

<i><u>Insurance Operations</u></i>	(in \$ millions)			
	<i><u>Underwriting Profit (Loss)</u></i>	<i><u>2006</u></i>	<i><u>2005</u></i>	<i><u>Yearend Float</u></i>
	<i><u>2006</u></i>	<i><u>2005</u></i>	<i><u>2006</u></i>	<i><u>2005</u></i>
General Re	\$ 526	\$(334)	\$22,827	\$22,920
B-H Reinsurance	1,658	(1,069)	16,860	16,233
GEICO	1,314	1,221	7,171	6,692
Other Primary.....	340**	235*	4,029	3,442
Total	<u>\$3,838</u>	<u>\$ 53</u>	<u>\$50,887</u>	<u>\$49,287</u>

* Includes MedPro from June 30, 2005.

** Includes Applied Underwriters from May 19, 2006.

In 2007, our results from the bread-and-butter lines of insurance will deteriorate, though I think they will remain satisfactory. The big unknown is super-cat insurance. Were the terrible hurricane seasons of 2004-05 aberrations? Or were they our planet's first warning that the climate of the 21st Century will differ materially from what we've seen in the past? If the answer to the second question is yes, 2006 will soon be perceived as a misleading period of calm preceding a series of devastating storms. These could rock the insurance industry. It's naïve to think of Katrina as anything close to a worst-case event.

Neither Ajit Jain, who manages our super-cat operation, nor I know what lies ahead. We do know that it would be a huge mistake to bet that evolving atmospheric changes are benign in their implications for insurers.

Don't think, however, that we have lost our taste for risk. We remain prepared to lose \$6 billion in a single event, *if* we have been paid appropriately for assuming that risk. We are not willing, though, to take on even very small exposures at prices that don't reflect our evaluation of loss probabilities. Appropriate prices don't guarantee profits in any given year, but inappropriate prices most certainly guarantee eventual losses. Rates have recently fallen because a flood of capital has entered the super-cat field. We have therefore sharply reduced our wind exposures. Our behavior here parallels that which we employ in financial markets: Be fearful when others are greedy, and be greedy when others are fearful.

Lloyd's, Equitas and Retroactive Reinsurance

Last year – we are getting now to Equitas – Berkshire agreed to enter into a huge retroactive reinsurance contract, a policy that protects an insurer against losses that have already happened, but whose cost is not yet known. I'll give you details of the agreement shortly. But let's first take a journey through insurance history, following the route that led to our deal.

Our tale begins around 1688, when Edward Lloyd opened a small coffee house in London. Though no Starbucks, his shop was destined to achieve worldwide fame because of the commercial activities of its clientele – shipowners, merchants and venturesome British capitalists. As these parties sipped Edward's brew, they began to write contracts transferring the risk of a disaster at sea from the owners of ships and their cargo to the capitalists, who wagered that a given voyage would be completed without incident. These capitalists eventually became known as "underwriters at Lloyd's."

Though many people believe Lloyd's to be an insurance company, that is not the case. It is instead a *place* where many member-insurers transact business, just as they did centuries ago.

Over time, the underwriters solicited passive investors to join in syndicates. Additionally, the business broadened beyond marine risks into every imaginable form of insurance, including exotic coverages that spread the fame of Lloyd's far and wide. The underwriters left the coffee house, found grander quarters and formalized some rules of association. And those persons who passively backed the underwriters became known as "names."

Eventually, the names came to include many thousands of people from around the world, who joined expecting to pick up some extra change without effort or serious risk. True, prospective names were always solemnly told that they would have unlimited and everlasting liability for the consequences of their syndicate's underwriting – “down to the last cufflink,” as the quaint description went. But that warning came to be viewed as perfunctory. Three hundred years of retained cufflinks acted as a powerful sedative to the names poised to sign up.

Then came asbestos. When its prospective costs were added to the tidal wave of environmental and product claims that surfaced in the 1980s, Lloyd’s began to implode. Policies written decades earlier – and largely forgotten about – were developing huge losses. No one could intelligently estimate their total, but it was certain to be many tens of billions of dollars. The specter of unending and unlimited losses terrified existing names and scared away prospects. Many names opted for bankruptcy; some even chose suicide.

From these shambles, there came a desperate effort to resuscitate Lloyd’s. In 1996, the powers that be at the institution allotted £11.1 billion to a new company, Equitas, and made it responsible for paying all claims on policies written before 1993. In effect, this plan pooled the misery of the many syndicates in trouble. Of course, the money allotted could prove to be insufficient – and if that happened, the names remained liable for the shortfall.

But the new plan, by concentrating all of the liabilities in one place, had the advantage of eliminating much of the costly intramural squabbling that went on among syndicates. Moreover, the pooling allowed claims evaluation, negotiation and litigation to be handled more intelligently than had been the case previously. Equitas embraced Ben Franklin’s thinking: “We must all hang together, or assuredly we shall hang separately.”

From the start, many people predicted Equitas would eventually fail. But as Ajit and I reviewed the facts in the spring of 2006 – 13 years after the last exposed policy had been written and after the payment of £11.3 billion in claims – we concluded that the patient was likely to survive. And so we decided to offer a huge reinsurance policy to Equitas.

Because plenty of imponderables continue to exist, Berkshire could not provide Equitas, and its 27,972 names, unlimited protection. But we said – and I’m simplifying – that if Equitas would give us \$7.12 billion in cash and securities (this is the float I spoke about), we would pay all of its future claims and expenses up to \$13.9 billion. That amount was \$5.7 billion above what Equitas had recently guessed its ultimate liabilities to be. Thus the names received a huge – and almost certainly sufficient – amount of future protection against unpleasant surprises. Indeed the protection is so large that Equitas plans a cash payment to its thousands of names, an event few of them had ever dreamed possible.

And how will Berkshire fare? That depends on how much “known” claims will end up costing us, how many yet-to-be-presented claims will surface and what they will cost, how soon claim payments will be made and how much we earn on the cash we receive before it must be paid out. Ajit and I think the odds are in our favor. And should we be wrong, Berkshire can handle it.

Scott Moser, the CEO of Equitas, summarized the transaction neatly: “Names wanted to sleep easy at night, and we think we’ve just bought them the world’s best mattress.”

* * * * *

Warning: It’s time to eat your broccoli – I am now going to talk about accounting matters. I owe this to those Berkshire shareholders who love reading about debits and credits. I hope both of you find this discussion helpful. All others can skip this section; there will be no quiz.

Berkshire has done many retroactive transactions – in both number and amount a multiple of such policies entered into by any other insurer. We are the reinsurer of choice for these coverages because the obligations that are transferred to us – for example, lifetime indemnity and medical payments to be made to injured workers – may not be fully satisfied for 50 years or more. No other company can offer the certainty

that Berkshire can, in terms of guaranteeing the full and fair settlement of these obligations. This fact is important to the original insurer, policyholders and regulators.

The accounting procedure for retroactive transactions is neither well known nor intuitive. The best way for shareholders to understand it, therefore, is for us to simply lay out the debits and credits. Charlie and I would like to see this done more often. We sometimes encounter accounting footnotes about important transactions that leave us baffled, and we go away suspicious that the reporting company wished it that way. (For example, try comprehending transactions “described” in the old 10-Ks of Enron, even after you *know* how the movie ended.)

So let us summarize our accounting for the Equitas transaction. The major debits will be to Cash and Investments, Reinsurance Recoverable, and Deferred Charges for Reinsurance Assumed (“DCRA”). The major credit will be to Reserve for Losses and Loss Adjustment Expense. No profit or loss will be recorded at the inception of the transaction, but underwriting losses will thereafter be incurred annually as the DCRA asset is amortized downward. The amount of the annual amortization charge will be primarily determined by how our end-of-the-year estimates as to the timing and amount of future loss payments compare to the estimates made at the beginning of the year. Eventually, when the last claim has been paid, the DCRA account will be reduced to zero. That day is 50 years or more away.

What’s important to remember is that retroactive insurance contracts always produce underwriting losses for us. Whether these losses are worth experiencing depends on whether the cash we have received produces investment income that exceeds the losses. Recently our DCRA charges have annually delivered \$300 million or so of underwriting losses, which have been more than offset by the income we have realized through use of the cash we received as a premium. Absent new retroactive contracts, the amount of the annual charge would normally decline over time. After the Equitas transaction, however, the annual DCRA cost will initially increase to about \$450 million a year. This means that our other insurance operations must generate at least that much underwriting gain for our overall float to be cost-free. That amount is quite a hurdle but one that I believe we will clear in many, if not most, years.

Aren’t you glad that I promised you there would be no quiz?

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let’s look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/06 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 1,543	Notes payable	\$ 1,468
Accounts and notes receivable	3,793	Other current liabilities.....	<u>6,635</u>
Inventory	5,257	Total current liabilities	8,103
Other current assets	<u>363</u>		
Total current assets	10,956		
Goodwill and other intangibles.....	13,314	Deferred taxes.....	540
Fixed assets.....	8,934	Term debt and other liabilities...	3,014
Other assets.....	<u>1,168</u>	Equity	<u>22,715</u>
	<u>\$34,372</u>		<u>\$34,372</u>

	<u>Earnings Statement (in millions)</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Revenues	\$52,660	\$46,896	\$44,142
Operating expenses (including depreciation of \$823 in 2006, \$699 in 2005 and \$676 in 2004).....	49,002	44,190	41,604
Interest expense	<u>132</u>	<u>83</u>	<u>57</u>
Pre-tax earnings.....	3,526*	2,623*	2,481*
Income taxes and minority interests	<u>1,395</u>	<u>977</u>	<u>941</u>
Net income	<u><u>\$ 2,131</u></u>	<u><u>\$ 1,646</u></u>	<u><u>\$ 1,540</u></u>

*Does not include purchase-accounting adjustments.

This motley group, which sells products ranging from lollipops to motor homes, earned a pleasing 25% on average tangible net worth last year. It's noteworthy also that these operations used only minor financial leverage in achieving that return. Clearly we own some terrific businesses. We purchased many of them, however, at large premiums to net worth – a point reflected in the goodwill item shown on the balance sheet – and that fact reduces the earnings on our average *carrying* value to 10.8%.

Here are a few newsworthy items about companies in this sector:

- Bob Shaw, a remarkable entrepreneur who from a standing start built Shaw Industries into the country's largest carpet producer, elected last year, at age 75, to retire. To succeed him, Bob recommended Vance Bell, a 31-year veteran at Shaw, and Bob, as usual, made the right call. Weakness in housing has caused the carpet business to slow. Shaw, however, remains a powerhouse and a major contributor to Berkshire's earnings.
- MiTek, a manufacturer of connectors for roof trusses at the time we purchased it in 2001, is developing into a mini-conglomerate. At the rate it is growing, in fact, "mini" may soon be inappropriate. In purchasing MiTek for \$420 million, we lent the company \$200 million at 9% and bought \$198 million of stock, priced at \$10,000 per share. Additionally, 55 employees bought 2,200 shares for \$22 million. Each employee paid *exactly* the same price that we did, in most cases borrowing money to do so.

And are they ever glad they did! Five years later, MiTek's sales have tripled and the stock is valued at \$71,699 per share. Despite its making 14 acquisitions, at a cost of \$291 million, MiTek has paid off its debt to Berkshire and holds \$35 million of cash. We celebrated the fifth anniversary of our purchase with a party in July. I told the group that it would be embarrassing if MiTek's stock price soared beyond that of Berkshire "A" shares. Don't be surprised, however, if that happens (though Charlie and I will try to make our shares a moving target).

- Not all of our businesses are destined to increase profits. When an industry's underlying economics are crumbling, talented management may slow the rate of decline. Eventually, though, eroding fundamentals will overwhelm managerial brilliance. (As a wise friend told me long ago, "If you want to get a reputation as a good businessman, be sure to get into a good business.") And fundamentals are definitely eroding in the newspaper industry, a trend that has caused the profits of our Buffalo News to decline. The skid will almost certainly continue.

When Charlie and I were young, the newspaper business was as easy a way to make huge returns as existed in America. As one not-too-bright publisher famously said, "I owe my fortune to two great American institutions: monopoly and nepotism." No paper in a one-paper city, however bad the product or however inept the management, could avoid gushing profits.

The industry's staggering returns could be simply explained. For most of the 20th Century, newspapers were the primary source of information for the American public. Whether the subject was sports, finance, or politics, newspapers reigned supreme. Just as important, their ads were the easiest way to find job opportunities or to learn the price of groceries at your town's supermarkets.

The great majority of families therefore felt the need for a paper every day, but understandably most didn't wish to pay for two. Advertisers preferred the paper with the most circulation, and readers tended to want the paper with the most ads and news pages. This circularity led to a law of the newspaper jungle: Survival of the Fattest.

Thus, when two or more papers existed in a major city (which was almost universally the case a century ago), the one that pulled ahead usually emerged as the stand-alone winner. After competition disappeared, the paper's pricing power in both advertising and circulation was unleashed. Typically, rates for both advertisers and readers would be raised annually – and the profits rolled in. For owners this was economic heaven. (Interestingly, though papers regularly – and often in a disapproving way – reported on the profitability of, say, the auto or steel industries, they never enlightened readers about their own Midas-like situation. Hmmm . . .)

As long ago as my 1991 letter to shareholders, I nonetheless asserted that this insulated world was changing, writing that "the media businesses . . . will prove considerably less marvelous than I, the industry, or lenders thought would be the case only a few years ago." Some publishers took umbrage at both this remark and other warnings from me that followed. Newspaper properties, moreover, continued to sell as if they were indestructible slot machines. In fact, many intelligent newspaper executives who regularly chronicled and analyzed important worldwide events were either blind or indifferent to what was going on under their noses.

Now, however, almost all newspaper owners realize that they are constantly losing ground in the battle for eyeballs. Simply put, if cable and satellite broadcasting, as well as the internet, had come along first, newspapers as we know them probably would never have existed.

In Berkshire's world, Stan Lipsey does a terrific job running the Buffalo News, and I am enormously proud of its editor, Margaret Sullivan. The News' penetration of its market is the highest among that of this country's large newspapers. We also do better financially than most metropolitan newspapers, even though Buffalo's population and business trends are not good. Nevertheless, this operation faces unrelenting pressures that will cause profit margins to slide.

True, we have the leading online news operation in Buffalo, and it will continue to attract more viewers and ads. However, the economic potential of a newspaper internet site – given the many alternative sources of information and entertainment that are free and only a click away – is at best a small fraction of that existing in the past for a print newspaper facing no competition.

For a local resident, ownership of a city's paper, like ownership of a sports team, still produces instant prominence. With it typically comes power and influence. These are ruboffs that appeal to many people with money. Beyond that, civic-minded, wealthy individuals may feel that local ownership will serve their community well. That's why Peter Kiewit bought the Omaha paper more than 40 years ago.

We are likely therefore to see non-economic individual buyers of newspapers emerge, just as we have seen such buyers acquire major sports franchises. Aspiring press lords should be careful, however: There's no rule that says a newspaper's revenues can't fall below its expenses and that losses can't mushroom. Fixed costs are high in the newspaper business, and that's bad news when unit volume heads south. As the importance of newspapers diminishes, moreover, the "psychic" value of possessing one will wane, whereas owning a sports franchise will likely retain its cachet.

Unless we face an irreversible cash drain, we will stick with the News, just as we've said that we would. (Read economic principle 11, on page 76.) Charlie and I love newspapers – we each read five a day – and believe that a free and energetic press is a key ingredient for maintaining a great democracy. We hope that some combination of print and online will ward off economic doomsday for newspapers, and we will work hard in Buffalo to develop a sustainable business model. I think we will be successful. But the days of lush profits from our newspaper are over.

- A much improved situation is emerging at NetJets, which sells and manages fractionally-owned aircraft. This company has never had a problem growing: Revenues from flight operations have increased 596% since our purchase in 1998. But profits had been erratic.

Our move to Europe, which began in 1996, was particularly expensive. After five years of operation there, we had acquired only 80 customers. And by mid-year 2006 our cumulative pre-tax loss had risen to \$212 million. But European demand has now exploded, with a net of 589 customers having been added in 2005-2006. Under Mark Booth's brilliant leadership, NetJets is now operating profitably in Europe, and we expect the positive trend to continue.

Our U.S. operation also had a good year in 2006, which led to worldwide pre-tax earnings of \$143 million at NetJets last year. We made this profit even though we suffered a loss of \$19 million in the first quarter.

Credit Rich Santulli, along with Mark, for this turnaround. Rich, like many of our managers, has no financial need to work. But you'd never know it. He's absolutely tireless – monitoring operations, making sales, and traveling the globe to constantly widen the already-enormous lead that NetJets enjoys over its competitors. Today, the value of the fleet we manage is far greater than that managed by our three largest competitors *combined*.

There's a reason NetJets is the runaway leader: It offers the ultimate in safety and service. At Berkshire, and at a number of our subsidiaries, NetJets aircraft are an indispensable business tool. I also have a contract for personal use with NetJets and so do members of my family and most Berkshire directors. (None of us, I should add, gets a discount.) Once you've flown NetJets, returning to commercial flights is like going back to holding hands.

Regulated Utility Business

Berkshire has an 86.6% (fully diluted) interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.7 million electric customers make it the third largest distributor of electricity in the U.K.; (2) MidAmerican Energy, which serves 706,000 electric customers, primarily in Iowa; (3) Pacific Power and Rocky Mountain Power, serving about 1.7 million electric customers in six western states; and (4) Kern River and Northern Natural pipelines, which carry about 8% of the natural gas consumed in the U.S.

Our partners in ownership of MidAmerican are Walter Scott, and its two terrific managers, Dave Sokol and Greg Abel. It's unimportant how many votes each party has; we will make major moves only when we are unanimous in thinking them wise. Six years of working with Dave, Greg and Walter have underscored my original belief: Berkshire couldn't have better partners.

Somewhat incongruously, MidAmerican owns the second largest real estate brokerage firm in the U.S., HomeServices of America. This company operates through 20 locally-branded firms with 20,300 agents. Despite HomeServices' purchase of two operations last year, the company's overall volume fell 9% to \$58 billion, and profits fell 50%.

The slowdown in residential real estate activity stems in part from the weakened lending practices of recent years. The "optional" contracts and "teaser" rates that have been popular have allowed borrowers to make payments in the early years of their mortgages that fall far short of covering normal interest costs. Naturally, there are few defaults when virtually nothing is required of a borrower. As a cynic has said, "A rolling loan gathers no loss." But payments *not* made add to principal, and borrowers who can't afford normal monthly payments early on are hit later with *above-normal* monthly obligations. This is the Scarlett O'Hara scenario: "I'll think about that tomorrow." For many home owners, "tomorrow" has now arrived. Consequently there is a huge overhang of offerings in several of HomeServices' markets.

Nevertheless, we will be seeking to purchase additional brokerage operations. A decade from now, HomeServices will almost certainly be much larger.

Here are some key figures on MidAmerican's operations:

	<i>Earnings (in \$ millions)</i>	
	<i>2006</i>	<i>2005</i>
U.K. utilities	\$ 338	\$ 308
Iowa utility	348	288
Western utilities (acquired March 21, 2006)	356	N/A
Pipelines	376	309
HomeServices.....	74	148
Other (net)	<u>226</u>	<u>115</u>
Earnings before corporate interest and taxes	1,718	1,168
Interest, other than to Berkshire	(261)	(200)
Interest on Berkshire junior debt	(134)	(157)
Income tax	<u>(407)</u>	<u>(248)</u>
Net earnings.....	<u>\$ 916</u>	<u>\$ 563</u>
Earnings applicable to Berkshire*	\$ 885	\$ 523
Debt owed to others.....	16,946	10,296
Debt owed to Berkshire	1,055	1,289

*Includes interest earned by Berkshire (net of related income taxes) of \$87 in 2006 and \$102 in 2005.

Finance and Financial Products

You will be happy to hear – and I'm even happier – that this will be my last discussion of the losses at Gen Re's derivative operation. When we started to wind this business down early in 2002, we had 23,218 contracts outstanding. Now we have 197. Our cumulative pre-tax loss from this operation totals \$409 million, but only \$5 million occurred in 2006. Charlie says that if we had properly classified the \$409 million on our 2001 balance sheet, it would have been labeled "Good Until Reached For." In any event, a Shakespearean thought – slightly modified – seems appropriate for the tombstone of this derivative business: "All's well that ends."

We've also wound up our investment in Value Capital. So earnings or losses from these two lines of business are making their final appearance in the table that annually appears in this section.

Clayton Homes remains an anomaly in the manufactured-housing industry, which last year recorded its lowest unit sales since 1962. Indeed, the industry's volume last year was only about one-third that of 1999. Outside of Clayton, I doubt if the industry, overall, made *any* money in 2006.

Yet Clayton earned \$513 million pre-tax and paid Berkshire an additional \$86 million as a fee for our obtaining the funds to finance Clayton's \$10 billion portfolio of installment receivables. Berkshire's financial strength has clearly been of huge help to Clayton. But the driving force behind the company's success is Kevin Clayton. Kevin knows the business forward and backward, is a rational decision-maker and a joy to work with. Because of acquisitions, Clayton now employs 14,787 people, compared to 6,661 at the time of our purchase.

We have two leasing operations: CORT (furniture), run by Paul Arnold, and XTRA (truck trailers), run by Bill Franz. CORT's earnings improved significantly last year, and XTRA's remained at the high level attained in 2005. We continue to look for tuck-in acquisitions to be run by Paul or Bill, and also are open to ideas for new leasing opportunities.

Here's a breakdown of earnings in this sector:

	(in millions)			
	<i>Pre-Tax Earnings</i>		<i>Interest-Bearing Liabilities</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
Trading – ordinary income	\$ 274	\$ 200	\$ 600	\$1,061
Gen Re Securities (loss)	(5)	(104)	1,204*	2,617*
Life and annuity operation	29	11	2,459	2,461
Value Capital (loss)	6	(33)	N/A	N/A
Leasing operations	182	173	261	370
Manufactured-housing finance (Clayton).....	513	416	10,498	9,299
Other.....	<u>158</u>	<u>159</u>	N/A	N/A
Income before capital gains.....	1,157	822		
Trading – capital gains (losses)	938	<u>(234)</u>		
Total	<u>\$ 2,095</u>	<u>\$ 588</u>		

*Includes all liabilities

Investments

We show below our common stock investments. With two exceptions, those that had a market value of more than \$700 million at the end of 2006 are itemized. We don't itemize the two securities referred to, which have a market value of \$1.9 billion, because we continue to buy them. I could, of course, tell you their names. But then I would have to kill you.

12/31/06				
<u>Shares</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost*</i>	<i>Market (in millions)</i>
151,610,700	American Express Company	12.6	\$ 1,287	\$ 9,198
36,417,400	Anheuser-Busch Cos., Inc.	4.7	1,761	1,792
200,000,000	The Coca-Cola Company	8.6	1,299	9,650
17,938,100	Conoco Phillips	1.1	1,066	1,291
21,334,900	Johnson & Johnson.....	0.7	1,250	1,409
6,708,760	M&T Bank Corporation	6.1	103	820
48,000,000	Moody's Corporation	17.2	499	3,315
2,338,961,000	PetroChina "H" shares (or equivalents)...	1.3	488	3,313
3,486,006	POSCO	4.0	572	1,158
100,000,000	The Procter & Gamble Company	3.2	940	6,427
229,707,000	Tesco	2.9	1,340	1,820
31,033,800	US Bancorp	1.8	969	1,123
17,072,192	USG Corp.....	19.0	536	936
19,944,300	Wal-Mart Stores, Inc.	0.5	942	921
1,727,765	The Washington Post Company	18.0	11	1,288
218,169,300	Wells Fargo & Company.....	6.5	3,697	7,758
1,724,200	White Mountains Insurance.....	16.0	369	999
	Others		<u>5,866</u>	<u>8,315</u>
	Total Common Stocks		<u>\$22,995</u>	<u>\$61,533</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

We are delighted by the 2006 business performance of virtually all of our investees. Last year, we told you that our expectation was that these companies, in aggregate, would increase their earnings by 6% to 8% annually, a rate that would double their earnings every ten years or so. In 2006 American Express,

Coca-Cola, Procter & Gamble and Wells Fargo, our largest holdings, increased per-share earnings by 18%, 9%, 8% and 11%. These are stellar results, and we thank their CEOs.

* * * * *

We've come close to eliminating our direct foreign-exchange position, from which we realized about \$186 million in pre-tax profits in 2006 (earnings that were included in the Finance and Financial Products table shown earlier). That brought our total gain since inception of this position in 2002 to \$2.2 billion. Here's a breakdown by currency:

Total Gain (Loss) in Millions

Australian dollar	\$247.1	Mexican peso	\$106.1
British pound	287.2	New Zealand dollar	102.6
Canadian dollar	398.3	Singapore dollar	(2.6)
Chinese yuan	(12.7)	South Korean won	261.3
Euro	839.2	Swiss franc	9.6
Hong Kong dollar	(2.5)	Taiwan dollar	(45.3)
Japanese yen	1.9	Miscellaneous options	22.9

We've made large indirect currency profits as well, though I've never tallied the precise amount. For example, in 2002-2003 we spent about \$82 million buying – of all things – Enron bonds, some of which were denominated in Euros. Already we've received distributions of \$179 million from these bonds, and our remaining stake is worth \$173 million. That means our overall gain is \$270 million, part of which came from the appreciation of the Euro that took place after our bond purchase.

When we first began making foreign exchange purchases, interest-rate differentials between the U.S. and most foreign countries favored a direct currency position. But that spread turned negative in 2005. We therefore looked for other ways to gain foreign-currency exposure, such as the ownership of foreign equities or of U.S. stocks with major earnings abroad. The currency factor, we should emphasize, is not dominant in our selection of equities, but is merely one of many considerations.

As our U.S. trade problems worsen, the probability that the dollar will weaken over time continues to be high. I fervently believe in *real* trade – the more the better for both us and the world. We had about \$1.44 trillion of this honest-to-God trade in 2006. But the U.S. also had \$.76 trillion of *pseudo*-trade last year – imports for which we exchanged no goods or services. (Ponder, for a moment, how commentators would describe the situation if our imports were \$.76 trillion – a full 6% of GDP – and we had *no* exports.) Making these purchases that weren't reciprocated by sales, the U.S. necessarily transferred ownership of its assets or IOUs to the rest of the world. Like a very wealthy but self-indulgent family, we peeled off a bit of what we owned in order to consume more than we produced.

The U.S. can do a lot of this because we are an extraordinarily rich country that has behaved responsibly in the past. The world is therefore willing to accept our bonds, real estate, stocks and businesses. And we have a vast store of these to hand over.

These transfers will have consequences, however. Already the prediction I made last year about one fall-out from our spending binge has come true: The “investment income” account of our country – positive in every previous year since 1915 – turned negative in 2006. Foreigners now earn more on their U.S. investments than we do on our investments abroad. In effect, we've used up our bank account and turned to our credit card. And, like everyone who gets in hock, the U.S. will now experience “reverse compounding” as we pay ever-increasing amounts of interest on interest.

I want to emphasize that even though our course is unwise, Americans will live better ten or twenty years from now than they do today. Per-capita wealth will increase. But our citizens will also be forced every year to ship a significant portion of their current production abroad merely to service the cost of our huge debtor position. It won't be pleasant to work part of each day to pay for the over-consumption

of your ancestors. I believe that at some point in the future U.S. workers and voters will find this annual “tribute” so onerous that there will be a severe political backlash. How that will play out in markets is impossible to predict – but to expect a “soft landing” seems like wishful thinking.

* * * * *

I should mention that all of the direct currency profits we have realized have come from forward contracts, which are derivatives, and that we have entered into other types of derivatives contracts as well. That may seem odd, since you know of our expensive experience in unwinding the derivatives book at Gen Re and also have heard me talk of the systemic problems that could result from the enormous growth in the use of derivatives. Why, you may wonder, are we fooling around with such potentially toxic material?

The answer is that derivatives, just like stocks and bonds, are sometimes wildly mispriced. For many years, accordingly, we have selectively written derivative contracts – few in number but sometimes for large dollar amounts. We currently have 62 contracts outstanding. I manage them personally, and they are free of counterparty credit risk. So far, these derivative contracts have worked out well for us, producing pre-tax profits in the hundreds of millions of dollars (above and beyond the gains I’ve itemized from forward foreign-exchange contracts). Though we will experience losses from time to time, we are likely to continue to earn – overall – significant profits from mispriced derivatives.

* * * * *

I have told you that Berkshire has three outstanding candidates to replace me as CEO and that the Board knows exactly who should take over if I should die tonight. Each of the three is much younger than I. The directors believe it’s important that my successor have the prospect of a long tenure.

Frankly, we are not as well-prepared on the investment side of our business. There’s a history here: At one time, Charlie was my potential replacement for investing, and more recently Lou Simpson has filled that slot. Lou is a top-notch investor with an outstanding long-term record of managing GEICO’s equity portfolio. But he is only six years younger than I. If I were to die soon, he would fill in magnificently for a short period. For the long-term, though, we need a different answer.

At our October board meeting, we discussed that subject fully. And we emerged with a plan, which I will carry out with the help of Charlie and Lou.

Under this plan, I intend to hire a younger man or woman with the potential to manage a very large portfolio, who we hope will succeed me as Berkshire’s chief investment officer when the need for someone to do that arises. As part of the selection process, we may in fact take on several candidates.

Picking the right person(s) will not be an easy task. It’s not hard, of course, to find smart people, among them individuals who have impressive investment records. But there is far more to successful long-term investing than brains and performance that has recently been good.

Over time, markets will do extraordinary, even bizarre, things. A single, big mistake could wipe out a long string of successes. We therefore need someone genetically programmed to recognize and avoid serious risks, *including those never before encountered*. Certain perils that lurk in investment strategies cannot be spotted by use of the models commonly employed today by financial institutions.

Temperament is also important. Independent thinking, emotional stability, and a keen understanding of both human and institutional behavior is vital to long-term investment success. I’ve seen a lot of very smart people who have lacked these virtues.

Finally, we have a special problem to consider: our ability to keep the person we hire. Being able to list Berkshire on a resume would materially enhance the marketability of an investment manager. We will need, therefore, to be sure we can retain our choice, even though he or she could leave and make much more money elsewhere.

There are surely people who fit what we need, but they may be hard to identify. In 1979, Jack Byrne and I felt we had found such a person in Lou Simpson. We then made an arrangement with him whereby he would be paid well for sustained overperformance. Under this deal, he has earned large amounts. Lou, however, could have left us long ago to manage far greater sums on more advantageous terms. If money alone had been the object, that's exactly what he would have done. But Lou never considered such a move. We need to find a younger person or two made of the same stuff.

* * * * *

The good news: At 76, I feel terrific and, according to all measurable indicators, am in excellent health. It's amazing what Cherry Coke and hamburgers will do for a fellow.

Some Changes on Berkshire's Board

The composition of our board will change in two ways this spring. One change will involve the Chace family, which has been connected to Berkshire and its predecessor companies for more than a century. In 1929, the first Malcolm G. Chace played an important role in merging four New England textile operations into Berkshire Fine Spinning Associates. That company merged with Hathaway Manufacturing in 1955 to form Berkshire Hathaway, and Malcolm G. Chace, Jr. became its chairman.

Early in 1965, Malcolm arranged for Buffett Partnership Ltd. to buy a key block of Berkshire shares and welcomed us as the new controlling shareholder of the company. Malcolm continued as non-executive chairman until 1969. He was both a wonderful gentleman and helpful partner.

That description also fits his son, Malcolm "Kim" Chace, who succeeded his father on Berkshire's board in 1992. But last year Kim, now actively and successfully running a community bank that he founded in 1996, suggested that we find a younger person to replace him on our board. We have done so, and Kim will step down as a director at the annual meeting. I owe much to the Chaces and wish to thank Kim for his many years of service to Berkshire.

In selecting a new director, we were guided by our long-standing criteria, which are that board members be owner-oriented, business-savvy, interested and truly independent. I say "truly" because many directors who are now deemed independent by various authorities and observers are far from that, relying heavily as they do on directors' fees to maintain their standard of living. These payments, which come in many forms, often range between \$150,000 and \$250,000 annually, compensation that may approach or even exceed all other income of the "independent" director. And – surprise, surprise – director compensation has soared in recent years, pushed up by recommendations from corporate America's favorite consultant, Ratchet, Ratchet and Bingo. (The name may be phony, but the action it conveys is not.)

Charlie and I believe our four criteria are essential if directors are to do their job – which, by law, is to faithfully represent *owners*. Yet these criteria are usually ignored. Instead, consultants and CEOs seeking board candidates will often say, "We're looking for a woman," or "a Hispanic," or "someone from abroad," or what have you. It sometimes sounds as if the mission is to stock Noah's ark. Over the years I've been queried many times about potential directors and have yet to hear *anyone* ask, "Does he think like an intelligent owner?"

The questions I instead get would sound ridiculous to someone seeking candidates for, say, a football team, or an arbitration panel or a military command. In those cases, the selectors would look for people who had the specific talents and attitudes that were required for a specialized job. At Berkshire, we are in the specialized activity of running a business well, and therefore we seek *business* judgment.

That's exactly what we've found in Susan Decker, CFO of Yahoo!, who will join our board at the annual meeting. We are lucky to have her: She scores very high on our four criteria and additionally, at 44, is young – an attribute, as you may have noticed, that your Chairman has long lacked. We will seek more young directors in the future, but never by slighting the four qualities that we insist upon.

This and That

Berkshire will pay about \$4.4 billion in federal income tax on its 2006 earnings. In its last fiscal year the U.S. Government spent \$2.6 trillion, or about \$7 billion per day. Thus, for more than half of one day, Berkshire picked up the tab for *all* federal expenditures, ranging from Social Security and Medicare payments to the cost of our armed services. Had there been only 600 taxpayers like Berkshire, no one else in America would have needed to pay *any* federal income or payroll taxes.

* * * * *

Our federal return last year, we should add, ran to 9,386 pages. To handle this filing, state and foreign tax returns, a myriad of SEC requirements, and all of the other matters involved in running Berkshire, we have gone all the way up to 19 employees at World Headquarters.

This crew occupies 9,708 square feet of space, and Charlie – at World Headquarters West in Los Angeles – uses another 655 square feet. Our home-office payroll, including benefits and counting both locations, totaled \$3,531,978 last year. We're careful when spending your money.

Corporate bigwigs often complain about government spending, criticizing bureaucrats who they say spend taxpayers' money differently from how they would if it were their own. But sometimes the financial behavior of executives will also vary based on whose wallet is getting depleted. Here's an illustrative tale from my days at Salomon. In the 1980s the company had a barber, Jimmy by name, who came in weekly to give free haircuts to the top brass. A manicurist was also on tap. Then, because of a cost-cutting drive, patrons were told to pay their own way. One top executive (not the CEO) who had previously visited Jimmy weekly went immediately to a once-every-three-weeks schedule.

* * * * *

Every now and then Charlie and I catch on early to a tide-like trend, one brimming over with commercial promise. For example, though American Airlines (with its "miles") and American Express (with credit card points) are credited as being trailblazers in granting customers "rewards," Charlie and I were far ahead of them in spotting the appeal of this powerful idea. Excited by our insight, the two of us jumped into the reward business way back in 1970 by buying control of a trading stamp operation, Blue Chip Stamps. In that year, Blue Chip had sales of \$126 million, and its stamps papered California.

In 1970, indeed, about 60 *billion* of our stamps were licked by savers, pasted into books, and taken to Blue Chip redemption stores. Our catalog of rewards was 116 pages thick and chock full of tantalizing items. When I was told that even certain brothels and mortuaries gave stamps to their patrons, I felt I had finally found a sure thing.

Well, not quite. From the day Charlie and I stepped into the Blue Chip picture, the business went straight downhill. By 1980, sales had fallen to \$19.4 million. And, by 1990, sales were bumping along at \$1.5 million. No quitter, I redoubled my managerial efforts.

Sales then fell another 98%. Last year, in Berkshire's \$98 billion of revenues, all of \$25,920 (*no* zeros omitted) came from Blue Chip. Ever hopeful, Charlie and I soldier on.

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I mentioned last year that in my service on 19 corporate boards (not counting Berkshire or other controlled companies), I have been the Typhoid Mary of compensation committees. At only one company was I assigned to comp committee duty, and then I was promptly outvoted on the most crucial decision that we faced. My ostracism has been peculiar, considering that I certainly haven't lacked experience in setting CEO pay. At Berkshire, after all, I am a one-man compensation committee who determines the salaries and incentives for the CEOs of around 40 significant operating businesses.

How much time does this aspect of my job take? Virtually none. How many CEOs have voluntarily left us for other jobs in our 42-year history? Precisely none.

Berkshire employs many different incentive arrangements, with their terms depending on such elements as the economic potential or capital intensity of a CEO's business. Whatever the compensation arrangement, though, I try to keep it both simple and fair.

When we use incentives – and these can be large – they are always tied to the operating results for which a given CEO has authority. We issue no lottery tickets that carry payoffs unrelated to business performance. If a CEO bats .300, he gets paid for being a .300 hitter, even if circumstances outside of his control cause Berkshire to perform poorly. And if he bats .150, he doesn't get a payoff just because the successes of others have enabled Berkshire to prosper mightily. An example: We now own \$61 billion of equities at Berkshire, whose value can easily rise or fall by 10% in a given year. Why in the world should the pay of our operating executives be affected by such \$6 billion swings, however important the gain or loss may be for shareholders?

You've read loads about CEOs who have received astronomical compensation for mediocre results. Much less well-advertised is the fact that America's CEOs also generally live the good life. Many, it should be emphasized, are exceptionally able, and almost all work far more than 40 hours a week. But they are usually treated like royalty in the process. (And we're certainly going to keep it that way at Berkshire. Though Charlie still favors sackcloth and ashes, I prefer to be spoiled rotten. Berkshire owns The Pampered Chef; our wonderful office group has made me The Pampered Chief.)

CEO perks at one company are quickly copied elsewhere. "All the other kids have one" may seem a thought too juvenile to use as a rationale in the boardroom. But consultants employ precisely this argument, phrased more elegantly of course, when they make recommendations to comp committees.

Irrational and excessive comp practices will not be materially changed by disclosure or by "independent" comp committee members. Indeed, I think it's likely that the reason I was rejected for service on so many comp committees was that I was regarded as *too* independent. Compensation reform will only occur if the largest institutional shareholders – it would only take a few – demand a *fresh* look at the whole system. The consultants' present drill of deftly selecting "peer" companies to compare with their clients will only perpetuate present excesses.

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Last year I arranged for the bulk of my Berkshire holdings to go to five charitable foundations, thus carrying out part of my lifelong plan to eventually use all of my shares for philanthropic purposes. Details of the commitments I made, as well as the rationale for them, are posted on our website, www.berkshirehathaway.com. Taxes, I should note, had nothing to do with my decision or its timing. My federal and state income taxes in 2006 were exactly what they would have been had I not made my first contributions last summer, and the same point will apply to my 2007 contributions.

In my will I've stipulated that the proceeds from all Berkshire shares I still own at death are to be used for philanthropic purposes within ten years after my estate is closed. Because my affairs are not complicated, it should take three years at most for this closing to occur. Adding this 13-year period to my expected lifespan of about 12 years (though, naturally, I'm aiming for more) means that proceeds from *all* of my Berkshire shares will likely be distributed for societal purposes over the next 25 years or so.

I've set this schedule because I want the money to be spent relatively promptly by people I *know* to be capable, vigorous and motivated. These managerial attributes sometimes wane as institutions – particularly those that are exempt from market forces – age. Today, there are terrific people in charge at the five foundations. So at my death, why should they not move with dispatch to judiciously spend the money that remains?

Those people favoring perpetual foundations argue that in the future there will most certainly be large and important societal problems that philanthropy will need to address. I agree. But there will then also be many super-rich individuals and families whose wealth will exceed that of today's Americans and to whom philanthropic organizations can make their case for funding. These funders can *then* judge firsthand which operations have both the vitality and the focus to best address the major societal problems that *then* exist. In this way, a market test of ideas and effectiveness can be applied. Some organizations will deserve major support while others will have outlived their usefulness. Even if the people above ground make their decisions imperfectly, they should be able to allocate funds more rationally than a decent six feet under will have ordained decades earlier. Wills, of course, can always be rewritten, but it's very unlikely that my thinking will change in a material way.

A few shareholders have expressed concern that sales of Berkshire by the foundations receiving shares will depress the stock. These fears are unwarranted. The annual trading volume of many stocks exceeds 100% of the outstanding shares, but nevertheless these stocks usually sell at prices approximating their intrinsic value. Berkshire also tends to sell at an appropriate price, but with annual volume that is only 15% of shares outstanding. At most, sales by the foundations receiving my shares will add three percentage points to annual trading volume, which will still leave Berkshire with a turnover ratio that is the lowest around.

Overall, Berkshire's business performance will determine the price of our stock, and most of the time it will sell in a zone of reasonableness. It's important that the foundations receive appropriate prices as they periodically sell Berkshire shares, but it's also important that incoming shareholders don't overpay. (See economic principle 14 on page 77.) By both our policies and shareholder communications, Charlie and I will do our best to ensure that Berkshire sells at neither a large discount nor large premium to intrinsic value.

The existence of foundation ownership will in no way influence our board's decisions about dividends, repurchases, or the issuance of shares. We will follow exactly the same rule that has guided us in the past: What action will be likely to deliver the best result for shareholders over time?

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In last year's report I allegorically described the Gotrocks family – a clan that owned all of America's businesses and that counterproductively attempted to increase its investment returns by paying ever-greater commissions and fees to "helpers." Sad to say, the "family" continued its self-destructive ways in 2006.

In part the family persists in this folly because it harbors unrealistic expectations about obtainable returns. Sometimes these delusions are self-serving. For example, private pension plans can temporarily overstate their earnings, and public pension plans can defer the need for increased taxes, by using investment assumptions that are likely to be out of reach. Actuaries and auditors go along with these tactics, and it can be decades before the chickens come home to roost (at which point the CEO or public official who misled the world is apt to be gone).

Meanwhile, Wall Street's Pied Pipers of Performance will have encouraged the futile hopes of the family. The hapless Gotrocks will be assured that they *all* can achieve above-average investment performance – but only by paying ever-higher fees. Call this promise the adult version of Lake Woebegon.

In 2006, promises and fees hit new highs. A flood of money went from institutional investors to the 2-and-20 crowd. For those innocent of this arrangement, let me explain: It's a lopsided system whereby 2% of your *principal* is paid each year to the manager even if he accomplishes nothing – or, for that matter, loses you a bundle – and, additionally, 20% of your profit is paid to him if he succeeds, even if his success is due simply to a rising tide. For example, a manager who achieves a gross return of 10% in a year will keep 3.6 percentage points – two points off the top plus 20% of the residual 8 points – leaving only 6.4 percentage points for his investors. On a \$3 billion fund, this 6.4% net "performance" will deliver the manager a cool \$108 million. He will receive this bonanza even though an index fund might have returned 15% to investors in the same period and charged them only a token fee.

The inexorable math of this grotesque arrangement is certain to make the Gotrocks family poorer over time than it would have been had it never heard of these “hyper-helpers.” Even so, the 2-and-20 action spreads. Its effects bring to mind the old adage: When someone with experience proposes a deal to someone with money, too often the fellow with money ends up with the experience, and the fellow with experience ends up with the money.

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Let me end this section by telling you about one of the good guys of Wall Street, my long-time friend Walter Schloss, who last year turned 90. From 1956 to 2002, Walter managed a remarkably successful investment partnership, from which he took not a dime unless his investors made money. My admiration for Walter, it should be noted, is not based on hindsight. A full fifty years ago, Walter was my sole recommendation to a St. Louis family who wanted an honest and able investment manager.

Walter did not go to business school, or for that matter, college. His office contained one file cabinet in 1956; the number mushroomed to four by 2002. Walter worked without a secretary, clerk or bookkeeper, his only associate being his son, Edwin, a graduate of the North Carolina School of the Arts. Walter and Edwin never came within a mile of inside information. Indeed, they used “outside” information only sparingly, generally selecting securities by certain simple statistical methods Walter learned while working for Ben Graham. When Walter and Edwin were asked in 1989 by *Outstanding Investors Digest*, “How would you summarize your approach?” Edwin replied, “We try to buy stocks cheap.” So much for Modern Portfolio Theory, technical analysis, macroeconomic thoughts and complex algorithms.

Following a strategy that involved no real risk – defined as permanent loss of capital – Walter produced results over his 47 partnership years that dramatically surpassed those of the S&P 500. It’s particularly noteworthy that he built this record by investing in about 1,000 securities, mostly of a lackluster type. A few big winners did not account for his success. It’s safe to say that had millions of investment managers made trades by a) drawing stock names from a hat; b) purchasing these stocks in comparable amounts when Walter made a purchase; and then c) selling when Walter sold his pick, the *luckiest* of them would not have come close to equaling his record. There is simply *no* possibility that what Walter achieved over 47 years was due to chance.

I first publicly discussed Walter’s remarkable record in 1984. At that time “efficient market theory” (EMT) was the centerpiece of investment instruction at most major business schools. This theory, as then most commonly taught, held that the price of any stock at any moment is not demonstrably mispriced, which means that no investor can be *expected* to overperform the stock market averages using only publicly-available information (though some will do so by luck). When I talked about Walter 23 years ago, his record forcefully contradicted this dogma.

And what did members of the academic community do when they were exposed to this new and important evidence? Unfortunately, they reacted in all-too-human fashion: Rather than opening their minds, they closed their eyes. To my knowledge *no* business school teaching EMT made any attempt to study Walter’s performance and what it meant for the school’s cherished theory.

Instead, the faculties of the schools went merrily on their way presenting EMT as having the certainty of scripture. Typically, a finance instructor who had the nerve to question EMT had about as much chance of major promotion as Galileo had of being named Pope.

Tens of thousands of students were therefore sent out into life believing that on every day the price of every stock was “right” (or, more accurately, not demonstrably wrong) and that attempts to evaluate businesses – that is, stocks – were useless. Walter meanwhile went on overperforming, his job made easier by the misguided instructions that had been given to those young minds. After all, if you are in the shipping business, it’s helpful to have all of your potential competitors be taught that the earth is flat.

Maybe it was a good thing for his investors that Walter didn’t go to college.

The Annual Meeting

Our meeting this year will be held on Saturday, May 5th. As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:00. Then, after a short recess, Charlie and I will convene the annual meeting at 3:15. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course is to *shop*. We will help you do that by filling the 194,300 square foot hall that adjoins the meeting area with the products of Berkshire subsidiaries. Last year, the 24,000 people who came to the meeting did their part, and almost every location racked up record sales. But records are made to be broken, and I know you can do better.

This year we will again showcase a Clayton home (featuring Acme brick, Shaw carpet, Johns Manville insulation, MiTek fasteners, Carefree awnings and NFM furniture). You will find that the home, priced at \$139,900, delivers excellent value. Last year, a helper at the Qwest bought one of two homes on display well before we opened the doors to shareholders. Flanking the Clayton home on the exhibition floor this year will be an RV and pontoon boat from Forest River.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a special shareholder discount (usually 8%). This special offer is permitted by 45 of the 50 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can. And while you're at it, sign up for the new GEICO credit card. It's the one I now use (sparingly, of course).

On Saturday, at the Omaha airport, we will have the usual array of aircraft from NetJets available for your inspection. Stop by the NetJets booth at the Qwest to learn about viewing these planes. Come to Omaha by bus; leave in your new plane. And take all the hair gel that you wish on board with you.

In the Bookworm's corner of our bazaar, there will be about 25 books and DVDs – all discounted – led again by *Poor Charlie's Almanack*. (One hapless soul last year asked Charlie what he should do if he didn't enjoy the book. Back came a Mungerism: "No problem – just give it to someone more intelligent.") We've added a few titles this year. Among them are *Seeking Wisdom: From Darwin to Munger* by Peter Bevelin, a long-time Swedish shareholder of Berkshire, and Fred Schwed's classic, *Where are the Customers' Yachts?* This book was first published in 1940 and is now in its 4th edition. The funniest book ever written about investing, it lightly delivers many truly important messages on the subject.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. We initiated this special event at NFM ten years ago, and sales during the "Weekend" grew from \$5.3 million in 1997 to \$30 million in 2006. I get goose bumps just thinking about this volume.

To obtain the Berkshire discount, you must make your purchases between Thursday, May 3rd and Monday, May 7th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m.

to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a special shareholder picnic featuring chicken and beef tacos (and hamburgers for traditionalists like me).

At a remodeled and expanded Borsheim's, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, May 4th. The second, the main gala, will be held on Sunday, May 6th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheim's throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 30th through Saturday, May 12th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in a tent outside of Borsheim's, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Last year I carried on a conversation with Patrick while he played in this manner. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon.

To add to the Sunday fun at Borsheim's, Ariel Hsing will play table tennis (ping-pong to the uninitiated) from 1 p.m. to 4 p.m. against anyone brave enough to take her on. Ariel, though only 11, is ranked number one among girls under 16 in the U.S. (and number 1 among both boys and girls under 12). The week I turned 75 I played Ariel, then 9 and barely tall enough to see across the table, thinking I would take it easy on her so as not to crush her young spirit. Instead she crushed me. I've since devised a plan that will give me a chance against her. At 1 p.m. on Sunday, I will initiate play with a *2-point* game against Ariel. If I somehow win the first point, I will then feign injury and claim victory. After this strenuous encounter wears Ariel down, our shareholders can then try their luck against her.

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 6th, and will be serving from 4 p.m. until 10 p.m. Please remember that to come to Gorat's on that day, you must have a reservation. To make one, call 402-551-3733 on April 1st (*but not before*).

In the 2006-2007 school year, 35 university classes, including one from IBMEC in Brazil, will come to Omaha for sessions with me. I take almost all – in aggregate, more than 2,000 students – to lunch at Gorat's. And they love it. To learn why, come join us on Sunday.

We will again have a reception at 4 p.m. on Saturday afternoon for shareholders who have come from outside of North America. Every year our meeting draws many people from around the globe, and Charlie and I want to be sure we personally greet those who have come so far. Last year we enjoyed meeting more than 400 of you from many dozens of countries. Any shareholder who comes from other than the U.S. or Canada will be given a special credential and instructions for attending this function.

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Charlie and I are extraordinarily lucky. We were born in America; had terrific parents who saw that we got good educations; have enjoyed wonderful families and great health; and came equipped with a "business" gene that allows us to prosper in a manner hugely disproportionate to other people who contribute as much or more to our society's well-being. Moreover, we have long had jobs that we love, in which we are helped every day in countless ways by talented and cheerful associates. No wonder we tap-dance to work. But nothing is more fun for us than getting together with our shareholder-partners at Berkshire's annual meeting. So join us on May 5th at the Qwest for our annual Woodstock for Capitalists. We'll see you there.

February 28, 2007

Warren E. Buffett
Chairman of the Board

Note: The following table appears in the printed Annual Report on the facing page of the Chairman's Letter and is referred to in that letter.

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in S&P 500 with Dividends Included	Relative Results (1)-(2)
	(1)	(2)	
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
1999	.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
Compounded Annual Gain – 1965-2007	21.1%	10.3%	10.8
Overall Gain – 1964-2007	400,863%	6,840%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2007 was \$12.3 billion, which increased the per-share book value of both our Class A and Class B stock by 11%. Over the last 43 years (that is, since present management took over) book value has grown from \$19 to \$78,008, a rate of 21.1% compounded annually.*

Overall, our 76 operating businesses did well last year. The few that had problems were primarily those linked to housing, among them our brick, carpet and real estate brokerage operations. Their setbacks are minor and temporary. Our competitive position in these businesses remains strong, and we have first-class CEOs who run them right, in good times or bad.

Some major financial institutions have, however, experienced staggering problems because they engaged in the “weakened lending practices” I described in last year’s letter. John Stumpf, CEO of Wells Fargo, aptly dissected the recent behavior of many lenders: “It is interesting that the industry has invented new ways to lose money when the old ways seemed to work just fine.”

You may recall a 2003 Silicon Valley bumper sticker that implored, “Please, God, Just One More Bubble.” Unfortunately, this wish was promptly granted, as just about all Americans came to believe that house prices would forever rise. That conviction made a borrower’s income and cash equity seem unimportant to lenders, who shoveled out money, confident that HPA – house price appreciation – would cure all problems. Today, our country is experiencing widespread pain because of that erroneous belief. As house prices fall, a huge amount of financial folly is being exposed. You only learn who has been swimming naked when the tide goes out – and what we are witnessing at some of our largest financial institutions is an ugly sight.

Turning to happier thoughts, we can report that Berkshire’s newest acquisitions of size, TTI and Iscar, led by their CEOs, Paul Andrews and Jacob Harpaz respectively, performed magnificently in 2007. Iscar is as impressive a manufacturing operation as I’ve seen, a view I reported last year and that was confirmed by a visit I made in the fall to its extraordinary plant in Korea.

Finally, our insurance business – the cornerstone of Berkshire – had an excellent year. Part of the reason is that we have the best collection of insurance managers in the business – more about them later. But we also were very lucky in 2007, the second year in a row free of major insured catastrophes.

That party is over. It’s a *certainty* that insurance-industry profit margins, including ours, will fall significantly in 2008. Prices are down, and exposures inexorably rise. Even if the U.S. has its third consecutive catastrophe-light year, industry profit margins will probably shrink by four percentage points or so. If the winds roar or the earth trembles, results could be *far* worse. So be prepared for lower insurance earnings during the next few years.

Yardsticks

Berkshire has two major areas of value. The first is our investments: stocks, bonds and cash equivalents. At yearend these totaled \$141 billion (not counting those in our finance or utility operations, which we assign to our second bucket of value).

*All per-share figures used in this report apply to Berkshire’s A shares. Figures for the B shares are 1/30th of those shown for the A.

Insurance float – money we temporarily hold in our insurance operations that does not belong to us – funds \$59 billion of our investments. This float is “free” as long as insurance underwriting breaks even, meaning that the premiums we receive equal the losses and expenses we incur. Of course, insurance underwriting is volatile, swinging erratically between profits and losses. Over our entire history, however, we’ve been profitable, and I expect we will average breakeven results or better in the future. If we do that, our investments can be viewed as an unencumbered source of value for Berkshire shareholders.

Berkshire’s second component of value is earnings that come from sources other than investments and insurance. These earnings are delivered by our 66 non-insurance companies, itemized on page 76. In our early years, we focused on the investment side. During the past two decades, however, we have put ever more emphasis on the development of earnings from non-insurance businesses.

The following tables illustrate this shift. In the first we tabulate per-share investments at 14-year intervals. We exclude those applicable to minority interests.

<u>Year</u>	<i>Per-Share Investments</i>	<u>Years</u>	<i>Compounded Annual Gain in Per-Share Investments</i>
1965	\$ 4		
1979	577	1965-1979	42.8%
1993	13,961	1979-1993	25.6%
2007	90,343	1993-2007	14.3%

For the entire 42 years, our compounded annual gain in per-share investments was 27.1%. But the trend has been downward as we increasingly used our available funds to buy operating businesses.

Here’s the record on how earnings of our non-insurance businesses have grown, again on a per-share basis and after applicable minority interests.

<u>Year</u>	<i>Per Share Pre-Tax Earnings</i>	<u>Years</u>	<i>Compounded Annual Gain in Per-Share Pre-Tax Earnings</i>
1965	\$ 4		
1979	18	1965-1979	11.1%
1993	212	1979-1993	19.1%
2007	4,093	1993-2007	23.5%

For the entire period, the compounded annual gain was 17.8%, with gains accelerating as our focus shifted.

Though these tables may help you gain historical perspective and be useful in valuation, they are completely misleading in predicting future possibilities. *Berkshire’s past record can’t be duplicated or even approached. Our base of assets and earnings is now far too large for us to make outsized gains in the future.*

Charlie Munger, my partner at Berkshire, and I will continue to measure our progress by the two yardsticks I have just described and will regularly update you on the results. Though we can’t come close to duplicating the past, we will do our best to make sure the future is not disappointing.

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In our efforts, we will be aided enormously by the managers who have joined Berkshire. This is an unusual group in several ways. First, most of them have no financial need to work. Many sold us their businesses for large sums and run them because they love doing so, not because they need the money. Naturally they wish to be paid fairly, but money alone is not the reason they work hard and productively.

A second, somewhat related, point about these managers is that they have exactly the job they want for the rest of their working years. At almost any other company, key managers below the top aspire to keep climbing the pyramid. For them, the subsidiary or division they manage today is a way station – or so they hope. Indeed, if they are in their present positions five years from now, they may well feel like failures.

Conversely, our CEOs' scorecards for success are not whether they obtain my job but instead are the long-term performances of their businesses. Their decisions flow from a here-today, here-forever mindset. I think our rare and hard-to-replicate managerial structure gives Berkshire a real advantage.

Acquisitions

Though our managers may be the best, we will need large and sensible acquisitions to get the growth in operating earnings we wish. Here, we made little progress in 2007 until very late in the year. Then, on Christmas day, Charlie and I finally earned our paychecks by contracting for the largest cash purchase in Berkshire's history.

The seeds of this transaction were planted in 1954. That fall, only three months into a new job, I was sent by my employers, Ben Graham and Jerry Newman, to a shareholders' meeting of Rockwood Chocolate in Brooklyn. A young fellow had recently taken control of this company, a manufacturer of assorted cocoa-based items. He had then initiated a one-of-a-kind tender, offering 80 pounds of cocoa beans for each share of Rockwood stock. I described this transaction in a section of the 1988 annual report that explained arbitrage. I also told you that Jay Pritzker – the young fellow mentioned above – was the business genius behind this tax-efficient idea, the possibilities for which had escaped all the other experts who had thought about buying Rockwood, including my bosses, Ben and Jerry.

At the meeting, Jay was friendly and gave me an education on the 1954 tax code. I came away very impressed. Thereafter, I avidly followed Jay's business dealings, which were many and brilliant. His valued partner was his brother, Bob, who for nearly 50 years ran Marmon Group, the home for most of the Pritzker businesses.

Jay died in 1999, and Bob retired early in 2002. Around then, the Pritzker family decided to gradually sell or reorganize certain of its holdings, including Marmon, a company operating 125 businesses, managed through nine sectors. Marmon's largest operation is Union Tank Car, which together with a Canadian counterpart owns 94,000 rail cars that are leased to various shippers. The original cost of this fleet is \$5.1 billion. All told, Marmon has \$7 billion in sales and about 20,000 employees.

We will soon purchase 60% of Marmon and will acquire virtually all of the balance within six years. Our initial outlay will be \$4.5 billion, and the price of our later purchases will be based on a formula tied to earnings. Prior to our entry into the picture, the Pritzker family received substantial consideration from Marmon's distribution of cash, investments and certain businesses.

This deal was done in the way Jay would have liked. We arrived at a price using only Marmon's financial statements, employing no advisors and engaging in no nit-picking. I knew that the business would be exactly as the Pritzkers represented, and they knew that we would close on the dot, however chaotic financial markets might be. During the past year, many large deals have been renegotiated or killed entirely. With the Pritzkers, as with Berkshire, a deal is a deal.

Marmon's CEO, Frank Ptak, works closely with a long-time associate, John Nichols. John was formerly the highly successful CEO of Illinois Tool Works (ITW), where he teamed with Frank to run a mix of industrial businesses. Take a look at their ITW record; you'll be impressed.

Byron Trott of Goldman Sachs – whose praises I sang in the 2003 report – facilitated the Marmon transaction. Byron is the rare investment banker who puts himself in his client’s shoes. Charlie and I trust him completely.

You’ll like the code name that Goldman Sachs assigned the deal. Marmon entered the auto business in 1902 and exited it in 1933. Along the way it manufactured the Wasp, a car that won the first Indianapolis 500 race, held in 1911. So this deal was labeled “Indy 500.”

* * * * *

In May 2006, I spoke at a lunch at Ben Bridge, our Seattle-based jewelry chain. The audience was a number of its vendors, among them Dennis Ulrich, owner of a company that manufactured gold jewelry.

In January 2007, Dennis called me, suggesting that with Berkshire’s support he could build a large jewelry supplier. We soon made a deal for his business, simultaneously purchasing a supplier of about equal size. The new company, Richline Group, has since made two smaller acquisitions. Even with those, Richline is far below the earnings threshold we normally require for purchases. I’m willing to bet, however, that Dennis – with the help of his partner, Dave Meleski – will build a large operation, earning good returns on capital employed.

Businesses – The Great, the Good and the Gruesome

Let’s take a look at what kind of businesses turn us on. And while we’re at it, let’s also discuss what we wish to avoid.

Charlie and I look for companies that have a) a business we understand; b) favorable long-term economics; c) able and trustworthy management; and d) a sensible price tag. We like to buy the whole business or, if management is our partner, at least 80%. When control-type purchases of quality aren’t available, though, we are also happy to simply buy small portions of great businesses by way of stock-market purchases. It’s better to have a part interest in the Hope Diamond than to own all of a rhinestone.

A truly great business must have an enduring “moat” that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business “castle” that is earning high returns. Therefore a formidable barrier such as a company’s being the low-cost producer (GEICO, Costco) or possessing a powerful world-wide brand (Coca-Cola, Gillette, American Express) is essential for sustained success. Business history is filled with “Roman Candles,” companies whose moats proved illusory and were soon crossed.

Our criterion of “enduring” causes us to rule out companies in industries prone to rapid and continuous change. Though capitalism’s “creative destruction” is highly beneficial for society, it precludes investment certainty. A moat that must be continuously rebuilt will eventually be no moat at all.

Additionally, this criterion eliminates the business whose success *depends* on having a great manager. Of course, a terrific CEO is a huge asset for any enterprise, and at Berkshire we have an abundance of these managers. Their abilities have created billions of dollars of value that would never have materialized if typical CEOs had been running their businesses.

But if a business *requires* a superstar to produce great results, the business itself cannot be deemed great. A medical partnership led by your area’s premier brain surgeon may enjoy outsized and growing earnings, but that tells little about its future. The partnership’s moat will go when the surgeon goes. You can count, though, on the moat of the Mayo Clinic to endure, even though you can’t name its CEO.

Long-term competitive advantage in a stable industry is what we seek in a business. If that comes with rapid organic growth, great. But even without organic growth, such a business is rewarding. We will simply take the lush earnings of the business and use them to buy similar businesses elsewhere. There's no rule that you have to invest money where you've earned it. Indeed, it's often a mistake to do so: Truly great businesses, earning huge returns on tangible assets, *can't* for any extended period reinvest a large portion of their earnings internally at high rates of return.

Let's look at the prototype of a dream business, our own See's Candy. The boxed-chocolates industry in which it operates is unexciting: Per-capita consumption in the U.S. is extremely low and doesn't grow. Many once-important brands have disappeared, and only three companies have earned more than token profits over the last forty years. Indeed, I believe that See's, though it obtains the bulk of its revenues from only a few states, accounts for nearly half of the entire industry's earnings.

At See's, annual sales were 16 million pounds of candy when Blue Chip Stamps purchased the company in 1972. (Charlie and I controlled Blue Chip at the time and later merged it into Berkshire.) Last year See's sold 31 million pounds, a growth rate of only 2% annually. Yet its durable competitive advantage, built by the See's family over a 50-year period, and strengthened subsequently by Chuck Huggins and Brad Kinstler, has produced extraordinary results for Berkshire.

We bought See's for \$25 million when its sales were \$30 million and pre-tax earnings were less than \$5 million. The capital then required to conduct the business was \$8 million. (Modest seasonal debt was also needed for a few months each year.) Consequently, the company was earning 60% pre-tax on invested capital. Two factors helped to minimize the funds required for operations. First, the product was sold for cash, and that eliminated accounts receivable. Second, the production and distribution cycle was short, which minimized inventories.

Last year See's sales were \$383 million, and pre-tax profits were \$82 million. The capital now required to run the business is \$40 million. This means we have had to reinvest only \$32 million since 1972 to handle the modest physical growth – and somewhat immodest financial growth – of the business. In the meantime pre-tax earnings have totaled \$1.35 billion. *All of that*, except for the \$32 million, has been sent to Berkshire (or, in the early years, to Blue Chip). After paying corporate taxes on the profits, we have used the rest to buy other attractive businesses. Just as Adam and Eve kick-started an activity that led to six billion humans, See's has given birth to multiple new streams of cash for us. (The biblical command to "be fruitful and multiply" is one we take seriously at Berkshire.)

There aren't many See's in Corporate America. Typically, companies that increase their earnings from \$5 million to \$82 million require, say, \$400 million or so of capital investment to finance their growth. That's because growing businesses have both working capital needs that increase in proportion to sales growth and significant requirements for fixed asset investments.

A company that needs large increases in capital to engender its growth may well prove to be a satisfactory investment. There is, to follow through on our example, nothing shabby about earning \$82 million pre-tax on \$400 million of net tangible assets. But that equation for the owner is vastly different from the See's situation. It's far better to have an ever-increasing stream of earnings with virtually no major capital requirements. Ask Microsoft or Google.

One example of good, but far from sensational, business economics is our own FlightSafety. This company delivers benefits to its customers that are the equal of those delivered by any business that I know of. It also possesses a durable competitive advantage: Going to any other flight-training provider than the best is like taking the low bid on a surgical procedure.

Nevertheless, this business requires a significant reinvestment of earnings if it is to grow. When we purchased FlightSafety in 1996, its pre-tax operating earnings were \$111 million, and its net investment in fixed assets was \$570 million. Since our purchase, depreciation charges have totaled \$923 million. But capital expenditures have totaled \$1.635 billion, most of that for simulators to match the new airplane models that are constantly being introduced. (A simulator can cost us more than \$12 million, and we have 273 of them.) Our fixed assets, after depreciation, now amount to \$1.079 billion. Pre-tax operating earnings in 2007 were \$270 million, a gain of \$159 million since 1996. That gain gave us a good, but far from See's-like, return on our incremental investment of \$509 million.

Consequently, if measured only by economic returns, FlightSafety is an excellent but not extraordinary business. Its put-up-more-to-earn-more experience is that faced by most corporations. For example, our large investment in regulated utilities falls squarely in this category. We will earn considerably more money in this business ten years from now, but we will invest many billions to make it.

Now let's move to the gruesome. The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a *durable* competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down.

The airline industry's demand for capital ever since that first flight has been insatiable. Investors have poured money into a bottomless pit, attracted by growth when they should have been repelled by it. And I, to my shame, participated in this foolishness when I had Berkshire buy U.S. Air preferred stock in 1989. As the ink was drying on our check, the company went into a tailspin, and before long our preferred dividend was no longer being paid. But we then got very lucky. In one of the recurrent, but always misguided, bursts of optimism for airlines, we were actually able to sell our shares in 1998 for a hefty gain. In the decade following our sale, the company went bankrupt. Twice.

To sum up, think of three types of "savings accounts." The great one pays an extraordinarily high interest rate that will rise as the years pass. The good one pays an attractive rate of interest that will be earned also on deposits that are added. Finally, the gruesome account both pays an inadequate interest rate and requires you to keep adding money at those disappointing returns.

* * * * *

And now it's confession time. It should be noted that no consultant, board of directors or investment banker pushed me into the mistakes I will describe. In tennis parlance, they were all unforced errors.

To begin with, I almost blew the See's purchase. The seller was asking \$30 million, and I was adamant about not going above \$25 million. Fortunately, he caved. Otherwise I would have balked, and that \$1.35 billion would have gone to somebody else.

About the time of the See's purchase, Tom Murphy, then running Capital Cities Broadcasting, called and offered me the Dallas-Fort Worth NBC station for \$35 million. The station came with the Fort Worth paper that Capital Cities was buying, and under the "cross-ownership" rules Murph had to divest it. I knew that TV stations were See's-like businesses that required virtually no capital investment and had excellent prospects for growth. They were simple to run and showered cash on their owners.

Moreover, Murph, then as now, was a close friend, a man I admired as an extraordinary manager and outstanding human being. He knew the television business forward and backward and would not have called me unless he felt a purchase was certain to work. In effect Murph whispered "buy" into my ear. But I didn't listen.

In 2006, the station earned \$73 million pre-tax, bringing its total earnings since I turned down the deal to at least \$1 billion – almost all available to its owner for other purposes. Moreover, the property now has a capital value of about \$800 million. Why did I say “no”? The only explanation is that my brain had gone on vacation and forgot to notify me. (My behavior resembled that of a politician Molly Ivins once described: “If his I.Q. was any lower, you would have to water him twice a day.”)

Finally, I made an even worse mistake when I said “yes” to Dexter, a shoe business I bought in 1993 for \$433 million in Berkshire stock (25,203 shares of A). What I had assessed as durable competitive advantage vanished within a few years. But that’s just the beginning: By using Berkshire stock, I compounded this error hugely. That move made the cost to Berkshire shareholders not \$400 million, but rather \$3.5 billion. In essence, I gave away 1.6% of a wonderful business – one now valued at \$220 billion – to buy a worthless business.

To date, Dexter is the worst deal that I’ve made. But I’ll make more mistakes in the future – you can bet on that. A line from Bobby Bare’s country song explains what too often happens with acquisitions: “I’ve never gone to bed with an ugly woman, but I’ve sure woke up with a few.”

* * * * *

Now, let’s examine the four major operating sectors of Berkshire. Each sector has vastly different balance sheet and income account characteristics. Therefore, lumping them together impedes analysis. So we’ll present them as four separate businesses, which is how Charlie and I view them.

Insurance

The best anecdote I’ve heard during the current presidential campaign came from Mitt Romney, who asked his wife, Ann, “When we were young, did you ever in your wildest dreams think I might be president?” To which she replied, “Honey, you weren’t *in* my wildest dreams.”

When we first entered the property/casualty insurance business in 1967, my wildest dreams did not envision our current operation. Here’s how we did in the first five years after purchasing National Indemnity:

<u>Year</u>	<u>Underwriting Profit (Loss)</u>	<u>Float</u>
	(in millions)	
1967	\$ 0.4	\$18.5
1968	0.6	21.3
1969	0.1	25.4
1970	(0.4)	39.4
1971	1.4	65.6

To put it charitably, we were a slow starter. But things changed. Here’s the record of the last five years:

<u>Year</u>	<u>Underwriting Profit (Loss)</u>	<u>Float</u>
	(in millions)	
2003	\$1,718	\$44,220
2004	1,551	46,094
2005	53	49,287
2006	3,838	50,887
2007	3,374	58,698

This metamorphosis has been accomplished by some extraordinary managers. Let’s look at what each has achieved.

- GEICO possesses the widest moat of any of our insurers, one carefully protected and expanded by Tony Nicely, its CEO. Last year – again – GEICO had the best growth record among major auto insurers, increasing its market share to 7.2%. When Berkshire acquired control in 1995, that share was 2.5%. Not coincidentally, annual ad expenditures by GEICO have increased from \$31 million to \$751 million during the same period.

Tony, now 64, joined GEICO at 18. Every day since, he has been passionate about the company – proud of how it could both save money for its customers and provide growth opportunities for its associates. Even now, with sales at \$12 billion, Tony feels GEICO is just getting started. So do I.

Here's some evidence. In the last three years, GEICO has increased its share of the motorcycle market from 2.1% to 6%. We've also recently begun writing policies on ATVs and RVs. And in November we wrote our first *commercial* auto policy. GEICO and National Indemnity are working together in the commercial field, and early results are very encouraging.

Even in aggregate, these lines will remain a small fraction of our personal auto volume. Nevertheless, they should deliver a growing stream of underwriting profits and float.

- General Re, our international reinsurer, is by far our largest source of "home-grown" float – \$23 billion at yearend. This operation is now a huge asset for Berkshire. Our ownership, however, had a shaky start.

For decades, General Re was the Tiffany of reinsurers, admired by all for its underwriting skills and discipline. This reputation, unfortunately, outlived its factual underpinnings, a flaw that I completely missed when I made the decision in 1998 to merge with General Re. The General Re of 1998 was not operated as the General Re of 1968 or 1978.

Now, thanks to Joe Brandon, General Re's CEO, and his partner, Tad Montross, the luster of the company has been restored. Joe and Tad have been running the business for six years and have been doing first-class business in a first-class way, to use the words of J. P. Morgan. They have restored discipline to underwriting, reserving and the selection of clients.

Their job was made more difficult by costly and time-consuming legacy problems, both in the U.S. and abroad. Despite that diversion, Joe and Tad have delivered excellent underwriting results while skillfully repositioning the company for the future.

- Since joining Berkshire in 1986, Ajit Jain has built a truly great specialty reinsurance operation from scratch. For one-of-a-kind mammoth transactions, the world now turns to him.

Last year I told you in detail about the Equitas transfer of huge, but capped, liabilities to Berkshire for a single premium of \$7.1 billion. At this very early date, our experience has been good. But this doesn't tell us much because it's just one straw in a fifty-year-or-more wind. What we know for sure, however, is that the London team who joined us, headed by Scott Moser, is first-rate and has become a valuable asset for our insurance business.

- Finally, we have our smaller operations, which serve specialized segments of the insurance market. In aggregate, these companies have performed extraordinarily well, earning above-average underwriting profits and delivering valuable float for investment.

Last year BoatU.S., headed by Bill Oakerson, was added to the group. This company manages an association of about 650,000 boat owners, providing them services similar to those offered by AAA auto clubs to drivers. Among the association's offerings is boat insurance. Learn more about this operation by visiting its display at the annual meeting.

Below we show the record of our four categories of property/casualty insurance.

<i><u>Insurance Operations</u></i>	<i><u>Underwriting Profit</u></i>		<i><u>Yearend Float</u></i>	
	<i><u>2007</u></i>	<i><u>2006</u></i>	<i><u>2007</u></i>	<i><u>2006</u></i>
General Re	\$ 555	\$ 526	\$23,009	\$22,827
BH Reinsurance	1,427	1,658	23,692	16,860
GEICO	1,113	1,314	7,768	7,171
Other Primary.....	<u>279</u>	<u>340*</u>	<u>4,229</u>	<u>4,029*</u>
	<u>\$3,374</u>	<u>\$3,838</u>	<u>\$58,698</u>	<u>\$50,887</u>

* Includes Applied Underwriters from May 19, 2006.

Regulated Utility Business

Berkshire has an 87.4% (diluted) interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.8 million electric customers make it the third largest distributor of electricity in the U.K.; (2) MidAmerican Energy, which serves 720,000 electric customers, primarily in Iowa; (3) Pacific Power and Rocky Mountain Power, serving about 1.7 million electric customers in six western states; and (4) Kern River and Northern Natural pipelines, which carry about 8% of the natural gas consumed in the U.S.

Our partners in ownership of MidAmerican are Walter Scott, and its two terrific managers, Dave Sokol and Greg Abel. It's unimportant how many votes each party has; we make major moves only when we are unanimous in thinking them wise. Eight years of working with Dave, Greg and Walter have underscored my original belief: Berkshire couldn't have better partners.

Somewhat incongruously, MidAmerican also owns the second largest real estate brokerage firm in the U.S., HomeServices of America. This company operates through 20 locally-branded firms with 18,800 agents. Last year was a slow year for residential sales, and 2008 will probably be slower. We will continue, however, to acquire quality brokerage operations when they are available at sensible prices.

Here are some key figures on MidAmerican's operation:

	<i><u>Earnings (in millions)</u></i>	
	<i><u>2007</u></i>	<i><u>2006</u></i>
U.K. utilities	\$ 337	\$ 338
Iowa utility	412	348
Western utilities (acquired March 21, 2006)	692	356
Pipelines	473	376
HomeServices.....	42	74
Other (net)	<u>130</u>	<u>245</u>
Earnings before corporate interest and taxes	2,086	1,737
Interest, other than to Berkshire	(312)	(261)
Interest on Berkshire junior debt	(108)	(134)
Income tax	<u>(477)</u>	<u>(426)</u>
Net earnings.....	<u>\$ 1,189</u>	<u>\$ 916</u>
Earnings applicable to Berkshire*	\$ 1,114	\$ 885
Debt owed to others.....	19,002	16,946
Debt owed to Berkshire	821	1,055

*Includes interest earned by Berkshire (net of related income taxes) of \$70 in 2007 and \$87 in 2006.

We agreed to purchase 35,464,337 shares of MidAmerican at \$35.05 per share in 1999, a year in which its per-share earnings were \$2.59. Why the odd figure of \$35.05? I originally decided the business was worth \$35.00 per share to Berkshire. Now, I'm a "one-price" guy (remember See's?) and for several days the investment bankers representing MidAmerican had no luck in getting me to increase Berkshire's offer. But, finally, they caught me in a moment of weakness, and I caved, telling them I would go to \$35.05. With that, I explained, they could tell their client they had wrung the last nickel out of me. At the time, it hurt.

Later on, in 2002, Berkshire purchased 6,700,000 shares at \$60 to help finance the acquisition of one of our pipelines. Lastly, in 2006, when MidAmerican bought PacifiCorp, we purchased 23,268,793 shares at \$145 per share.

In 2007, MidAmerican earned \$15.78 per share. However, 77¢ of that was non-recurring – a reduction in deferred tax at our British utility, resulting from a lowering of the U.K. corporate tax rate. So call normalized earnings \$15.01 per share. And yes, I'm glad I wilted and offered the extra nickel.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/07 (in millions)

<i><u>Assets</u></i>	<i><u>Liabilities and Equity</u></i>		
Cash and equivalents	\$ 2,080	Notes payable	\$ 1,278
Accounts and notes receivable	4,488	Other current liabilities	<u>7,652</u>
Inventory	5,793	Total current liabilities	8,930
Other current assets	<u>470</u>		
Total current assets	12,831		
Goodwill and other intangibles.....	14,201	Deferred taxes.....	828
Fixed assets.....	9,605	Term debt and other liabilities...	3,079
Other assets.....	<u>1,685</u>	Equity	<u>25,485</u>
	<u>\$38,322</u>		<u>\$38,322</u>

Earnings Statement (in millions)

	<i><u>2007</u></i>	<i><u>2006</u></i>	<i><u>2005</u></i>
Revenues	\$59,100	\$52,660	\$46,896
Operating expenses (including depreciation of \$955 in 2007, \$823 in 2006 and \$699 in 2005).....	55,026	49,002	44,190
Interest expense	<u>127</u>	<u>132</u>	<u>83</u>
Pre-tax earnings	3,947*	3,526*	2,623*
Income taxes and minority interests	<u>1,594</u>	<u>1,395</u>	<u>977</u>
Net income	<u>\$ 2,353</u>	<u>\$ 2,131</u>	<u>\$ 1,646</u>

*Does not include purchase-accounting adjustments.

This motley group, which sells products ranging from lollipops to motor homes, earned a pleasing 23% on average tangible net worth last year. It's noteworthy also that these operations used only minor financial leverage in achieving that return. Clearly we own some terrific businesses. We purchased many of them, however, at large premiums to net worth – a point reflected in the goodwill item shown on the balance sheet – and that fact reduces the earnings on our average *carrying* value to 9.8%.

Here are a few newsworthy items about companies in this sector:

- Shaw, Acme Brick, Johns Manville and MiTek were all hurt in 2007 by the sharp housing downturn, with their pre-tax earnings declining 27%, 41%, 38%, and 9% respectively. Overall, these companies earned \$941 million pre-tax compared to \$1.296 billion in 2006.

Last year, Shaw, MiTek and Acme contracted for tuck-in acquisitions that will help future earnings. You can be sure they will be looking for more of these.

- In a tough year for retailing, our standouts were See's, Borsheims and Nebraska Furniture Mart.

Two years ago Brad Kinstler was made CEO of See's. We very seldom move managers from one industry to another at Berkshire. But we made an exception with Brad, who had previously run our uniform company, Fechheimer, and Cypress Insurance. The move could not have worked out better. In his two years, profits at See's have increased more than 50%.

At Borsheims, sales increased 15.1%, helped by a 27% gain during Shareholder Weekend. Two years ago, Susan Jacques suggested that we remodel and expand the store. I was skeptical, but Susan was right.

Susan came to Borsheims 25 years ago as a \$4-an-hour saleswoman. Though she lacked a managerial background, I did not hesitate to make her CEO in 1994. She's smart, she loves the business, and she loves her associates. That beats having an MBA degree any time.

(An aside: Charlie and I are not big fans of resumes. Instead, we focus on brains, passion and integrity. Another of our great managers is Cathy Baron Tamraz, who has significantly increased Business Wire's earnings since we purchased it early in 2006. She is an owner's dream. It is positively *dangerous* to stand between Cathy and a business prospect. Cathy, it should be noted, began her career as a cab driver.)

Finally, at Nebraska Furniture Mart, earnings hit a record as our Omaha and Kansas City stores each had sales of about \$400 million. These, by some margin, are the two top home furnishings stores in the country. In a disastrous year for many furniture retailers, sales at Kansas City increased 8%, while in Omaha the gain was 6%.

Credit the remarkable Blumkin brothers, Ron and Irv, for this performance. Both are close personal friends of mine and great businessmen.

- Iscar continues its wondrous ways. Its products are small carbide cutting tools that make large and very expensive machine tools more productive. The raw material for carbide is tungsten, mined in China. For many decades, Iscar moved tungsten to Israel, where brains turned it into something far more valuable. Late in 2007, Iscar opened a large plant in Dalian, China. In effect, we've now moved the brains to the tungsten. Major opportunities for growth await Iscar. Its management team, led by Eitan Wertheimer, Jacob Harpaz, and Danny Goldman, is certain to make the most of them.
- Flight services set a record in 2007 with pre-tax earnings increasing 49% to \$547 million. Corporate aviation had an extraordinary year worldwide, and both of our companies – as runaway leaders in their fields – fully participated.

FlightSafety, our pilot training business, gained 14% in revenues and 20% in pre-tax earnings. We estimate that we train about 58% of U.S. corporate pilots. Bruce Whitman, the company's CEO, inherited this leadership position in 2003 from Al Ueltschi, the father of advanced flight training, and has proved to be a worthy successor.

At NetJets, the inventor of fractional-ownership of jets, we also remain the unchallenged leader. We now operate 487 planes in the U.S. and 135 in Europe, a fleet more than twice the size of that operated by our three major competitors *combined*. Because our share of the large-cabin market is near 90%, our lead in value terms is far greater.

The NetJets brand – with its promise of safety, service and security – grows stronger every year. Behind this is the passion of one man, Richard Santulli. If you were to pick someone to join you in a foxhole, you couldn't do better than Rich. No matter what the obstacles, he just doesn't stop.

Europe is the best example of how Rich's tenacity leads to success. For the first ten years we made little financial progress there, actually running up cumulative losses of \$212 million. After Rich brought Mark Booth on board to run Europe, however, we began to gain traction. Now we have real momentum, and last year earnings tripled.

In November, our directors met at NetJets headquarters in Columbus and got a look at the sophisticated operation there. It is responsible for 1,000 or so flights a day in all kinds of weather, with customers expecting top-notch service. Our directors came away impressed by the facility and its capabilities – but even more impressed by Rich and his associates.

Finance and Finance Products

Our major operation in this category is Clayton Homes, the largest U.S. manufacturer and marketer of manufactured homes. Clayton's market share hit a record 31% last year. But industry volume continues to shrink: Last year, manufactured home sales were 96,000, down from 131,000 in 2003, the year we bought Clayton. (At the time, it should be remembered, some commentators criticized its directors for selling at a cyclical bottom.)

Though Clayton earns money from both manufacturing and retailing its homes, most of its earnings come from an \$11 billion loan portfolio, covering 300,000 borrowers. That's why we include Clayton's operation in this finance section. Despite the many problems that surfaced during 2007 in real estate finance, the Clayton portfolio is performing well. Delinquencies, foreclosures and losses during the year were at rates similar to those we experienced in our previous years of ownership.

Clayton's loan portfolio is financed by Berkshire. For this funding, we charge Clayton one percentage point over Berkshire's borrowing cost – a fee that amounted to \$85 million last year. Clayton's 2007 pre-tax earnings of \$526 million are *after* its paying this fee. The flip side of this transaction is that Berkshire recorded \$85 million as income, which is included in "other" in the following table.

	<u>Pre-Tax Earnings</u> (in millions)	
	<u>2007</u>	<u>2006</u>
Trading – ordinary income.....	\$ 272	\$ 274
Life and annuity operation	(60)	29
Leasing operations	111	182
Manufactured-housing finance (Clayton).....	526	513
Other.....	<u>157</u>	<u>159</u>
Income before capital gains.....	1,006	1,157
Trading – capital gains	<u>105</u>	<u>938</u>
	<u>\$1,111</u>	<u>\$2,095</u>

The leasing operations tabulated are XTRA, which rents trailers, and CORT, which rents furniture. Utilization of trailers was down considerably in 2007 and that led to a drop in earnings at XTRA. That company also borrowed \$400 million last year and distributed the proceeds to Berkshire. The resulting higher interest it is now paying further reduced XTRA's earnings.

Clayton, XTRA and CORT are all good businesses, very ably run by Kevin Clayton, Bill Franz and Paul Arnold. Each has made tuck-in acquisitions during Berkshire's ownership. More will come.

Investments

We show below our common stock investments at yearend, itemizing those with a market value of at least \$600 million.

<u>Shares</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>Cost*</u> (in millions)	<u>Market</u>
151,610,700	American Express Company	13.1	\$ 1,287	\$ 7,887
35,563,200	Anheuser-Busch Companies, Inc.....	4.8	1,718	1,861
60,828,818	Burlington Northern Santa Fe.....	17.5	4,731	5,063
200,000,000	The Coca-Cola Company	8.6	1,299	12,274
17,508,700	Conoco Phillips	1.1	1,039	1,546
64,271,948	Johnson & Johnson.....	2.2	3,943	4,287
124,393,800	Kraft Foods Inc.....	8.1	4,152	4,059
48,000,000	Moody's Corporation	19.1	499	1,714
3,486,006	POSCO	4.5	572	2,136
101,472,000	The Procter & Gamble Company	3.3	1,030	7,450
17,170,953	Sanofi-Aventis.....	1.3	1,466	1,575
227,307,000	Tesco plc.....	2.9	1,326	2,156
75,176,026	U.S. Bancorp	4.4	2,417	2,386
17,072,192	USG Corp	17.2	536	611
19,944,300	Wal-Mart Stores, Inc.	0.5	942	948
1,727,765	The Washington Post Company	18.2	11	1,367
303,407,068	Wells Fargo & Company	9.2	6,677	9,160
1,724,200	White Mountains Insurance Group Ltd. ..	16.3	369	886
	Others		<u>5,238</u>	<u>7,633</u>
	Total Common Stocks		<u>\$39,252</u>	<u>\$74,999</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

Overall, we are delighted by the business performance of our investees. In 2007, American Express, Coca-Cola and Procter & Gamble, three of our four largest holdings, increased per-share earnings by 12%, 14% and 14%. The fourth, Wells Fargo, had a small decline in earnings because of the popping of the real estate bubble. Nevertheless, I believe its intrinsic value increased, even if only by a minor amount.

In the strange world department, note that American Express and Wells Fargo were both organized by Henry Wells and William Fargo, Amex in 1850 and Wells in 1852. P&G and Coke began business in 1837 and 1886 respectively. Start-ups are not our game.

I should emphasize that we do not measure the progress of our investments by what their market prices do during any given year. Rather, we evaluate their performance by the two methods we apply to the businesses we own. The first test is improvement in earnings, with our making due allowance for industry conditions. The second test, more subjective, is whether their "moats" – a metaphor for the superiorities they possess that make life difficult for their competitors – have widened during the year. All of the "big four" scored positively on that test.

We made one large sale last year. In 2002 and 2003 Berkshire bought 1.3% of PetroChina for \$488 million, a price that valued the entire business at about \$37 billion. Charlie and I then felt that the company was worth about \$100 billion. By 2007, two factors had materially increased its value: the price of oil had climbed significantly, and PetroChina's management had done a great job in building oil and gas reserves. In the second half of last year, the market value of the company rose to \$275 billion, about what we thought it was worth compared to other giant oil companies. So we sold our holdings for \$4 billion.

A footnote: We paid the IRS tax of \$1.2 billion on our PetroChina gain. This sum paid *all* costs of the U.S. government – defense, social security, you name it – for about four hours.

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Last year I told you that Berkshire had 62 derivative contracts that I manage. (We also have a few left in the General Re runoff book.) Today, we have 94 of these, and they fall into two categories.

First, we have written 54 contracts that require us to make payments if certain bonds that are included in various high-yield indices default. These contracts expire at various times from 2009 to 2013. At yearend we had received \$3.2 billion in premiums on these contracts; had paid \$472 million in losses; and in the worst case (though it is extremely unlikely to occur) could be required to pay an additional \$4.7 billion.

We are certain to make many more payments. But I believe that on premium revenues alone, these contracts will prove profitable, leaving aside what we can earn on the large sums we hold. Our yearend liability for this exposure was recorded at \$1.8 billion and is included in "Derivative Contract Liabilities" on our balance sheet.

The second category of contracts involves various put options we have sold on four stock indices (the S&P 500 plus three foreign indices). These puts had original terms of either 15 or 20 years and were struck at the market. We have received premiums of \$4.5 billion, and we recorded a liability at yearend of \$4.6 billion. The puts in these contracts are exercisable *only* at their expiration dates, which occur between 2019 and 2027, and Berkshire will then need to make a payment only if the index in question is quoted at a level below that existing on the day that the put was written. Again, I believe these contracts, in aggregate, will be profitable and that we will, in addition, receive substantial income from our investment of the premiums we hold during the 15- or 20-year period.

Two aspects of our derivative contracts are particularly important. First, in all cases we hold the money, which means that we have *no* counterparty risk.

Second, accounting rules for our derivative contracts differ from those applying to our investment portfolio. In that portfolio, changes in value are applied to the net worth shown on Berkshire's balance sheet, but do not affect earnings unless we sell (or write down) a holding. Changes in the value of a derivative contract, however, must be applied each quarter to earnings.

Thus, our derivative positions will sometimes cause large swings in reported earnings, even though Charlie and I might believe the intrinsic value of these positions has changed little. He and I will not be bothered by these swings – even though they could easily amount to \$1 billion or more in a quarter – and we hope you won't be either. You will recall that in our catastrophe insurance business, we are always ready to trade increased volatility in reported earnings in the short run for greater gains in net worth in the long run. That is our philosophy in derivatives as well.

* * * * *

The U.S. dollar weakened further in 2007 against major currencies, and it's no mystery why: Americans like buying products made elsewhere more than the rest of the world likes buying products made in the U.S. Inevitably, that causes America to ship about \$2 billion of IOUs and assets *daily* to the rest of the world. And over time, that puts pressure on the dollar.

When the dollar falls, it both makes our products cheaper for foreigners to buy and their products more expensive for U.S. citizens. That's why a falling currency is supposed to cure a trade deficit. Indeed, the U.S. deficit has undoubtedly been tempered by the large drop in the dollar. But ponder this: In 2002 when the Euro averaged 94.6¢, our trade deficit with Germany (the fifth largest of our trading partners) was \$36 billion, whereas in 2007, with the Euro averaging \$1.37, our deficit with Germany was up to \$45 billion. Similarly, the Canadian dollar averaged 64¢ in 2002 and 93¢ in 2007. Yet our trade deficit with Canada rose as well, from \$50 billion in 2002 to \$64 billion in 2007. So far, at least, a plunging dollar has not done much to bring our trade activity into balance.

There's been much talk recently of sovereign wealth funds and how they are buying large pieces of American businesses. This is *our* doing, not some nefarious plot by foreign governments. Our trade equation guarantees massive foreign investment in the U.S. When we force-feed \$2 billion daily to the rest of the world, they must invest in *something* here. Why should we complain when they choose stocks over bonds?

Our country's weakening currency is not the fault of OPEC, China, etc. Other developed countries rely on imported oil and compete against Chinese imports just as we do. In developing a sensible trade policy, the U.S. should not single out countries to punish or industries to protect. Nor should we take actions likely to evoke retaliatory behavior that will reduce America's exports, true trade that benefits both our country and the rest of the world.

Our legislators should recognize, however, that the current imbalances are unsustainable and should therefore adopt policies that will materially reduce them sooner rather than later. Otherwise our \$2 billion daily of force-fed dollars to the rest of the world may produce global indigestion of an unpleasant sort. (For other comments about the unsustainability of our trade deficits, see Alan Greenspan's comments on November 19, 2004, the Federal Open Market Committee's minutes of June 29, 2004, and Ben Bernanke's statement on September 11, 2007.)

* * * * *

At Berkshire we held only one direct currency position during 2007. That was in – hold your breath – the Brazilian real. Not long ago, swapping dollars for reals would have been unthinkable. After all, during the past century *five* versions of Brazilian currency have, in effect, turned into confetti. As has been true in many countries whose currencies have periodically withered and died, wealthy Brazilians sometimes stashed large sums in the U.S. to preserve their wealth.

But any Brazilian who followed this apparently prudent course would have lost *half* his net worth over the past five years. Here's the year-by-year record (indexed) of the real versus the dollar from the end of 2002 to yearend 2007: 100; 122; 133; 152; 166; 199. Every year the real went up and the dollar fell. Moreover, during much of this period the Brazilian government was actually holding down the value of the real and supporting *our* currency by buying dollars in the market.

Our direct currency positions have yielded \$2.3 billion of pre-tax profits over the past five years, and in addition we have profited by holding bonds of U.S. companies that are denominated in other currencies. For example, in 2001 and 2002 we purchased €310 million Amazon.com, Inc. 6 7/8 of 2010 at 57% of par. At the time, Amazon bonds were priced as “junk” credits, though they were anything but. (Yes, Virginia, you can occasionally find markets that are ridiculously inefficient – or at least you can find them anywhere except at the finance departments of some leading business schools.)

The Euro denomination of the Amazon bonds was a further, and important, attraction for us. The Euro was at 95¢ when we bought in 2002. Therefore, our cost in dollars came to only \$169 million. Now the bonds sell at 102% of par and the Euro is worth \$1.47. In 2005 and 2006 some of our bonds were called and we received \$253 million for them. Our remaining bonds were valued at \$162 million at yearend. Of our \$246 million of realized and unrealized gain, about \$118 million is attributable to the fall in the dollar. Currencies do matter.

At Berkshire, we will attempt to further increase our stream of direct and indirect foreign earnings. Even if we are successful, however, our assets and earnings will always be concentrated in the U.S. Despite our country's many imperfections and unrelenting problems of one sort or another, America's rule of law, market-responsive economic system, and belief in meritocracy are almost certain to produce ever-growing prosperity for its citizens.

* * * * *

As I have told you before, we have for some time been well-prepared for CEO succession because we have three outstanding internal candidates. The board knows exactly whom it would pick if I were to become unavailable, either because of death or diminishing abilities. And that would still leave the board with two backups.

Last year I told you that we would also promptly complete a succession plan for the investment job at Berkshire, and we have indeed now identified four candidates who could succeed me in managing investments. All manage substantial sums currently, and all have indicated a strong interest in coming to Berkshire if called. The board knows the strengths of the four and would expect to hire one or more if the need arises. The candidates are young to middle-aged, well-to-do to rich, and all wish to work for Berkshire for reasons that go beyond compensation.

(I've reluctantly discarded the notion of my continuing to manage the portfolio after my death – abandoning my hope to give new meaning to the term "thinking outside the box.")

Fanciful Figures – How Public Companies Juice Earnings

Former Senator Alan Simpson famously said: "Those who travel the high road in Washington need not fear heavy traffic." If he had sought truly deserted streets, however, the Senator should have looked to Corporate America's accounting.

An important referendum on which road businesses prefer occurred in 1994. America's CEOs had just strong-armed the U.S. Senate into ordering the Financial Accounting Standards Board to shut up, by a vote that was 88-9. Before that rebuke the FASB had shown the audacity – by unanimous agreement, no less – to tell corporate chieftains that the stock options they were being awarded represented a form of compensation and that their value should be recorded as an expense.

After the senators voted, the FASB – now educated on accounting principles by the Senate's 88 closet CPAs – decreed that companies could choose between two methods of reporting on options. The *preferred* treatment would be to expense their value, but it would also be allowable for companies to ignore the expense as long as their options were issued at market value.

A moment of truth had now arrived for America's CEOs, and their reaction was not a pretty sight. During the next six years, exactly *two* of the 500 companies in the S&P chose the preferred route. CEOs of the rest opted for the low road, thereby ignoring a large and obvious expense in order to report higher "earnings." I'm sure some of them also felt that if they opted for expensing, their directors might in future years think twice before approving the mega-grants the managers longed for.

It turned out that for many CEOs even the low road wasn't good enough. Under the weakened rule, there remained earnings consequences if options were issued with a strike price below market value. No problem. To avoid that bothersome rule, a number of companies surreptitiously backdated options to falsely indicate that they were granted at current market prices, when in fact they were dished out at prices well below market.

Decades of option-accounting nonsense have now been put to rest, but other accounting choices remain – important among these the investment-return assumption a company uses in calculating pension expense. It will come as no surprise that many companies continue to choose an assumption that allows them to report less-than-solid "earnings." For the 363 companies in the S&P that have pension plans, this assumption in 2006 averaged 8%. Let's look at the chances of that being achieved.

The average holdings of bonds and cash for all pension funds is about 28%, and on these assets returns can be expected to be no more than 5%. Higher yields, of course, are obtainable but they carry with them a risk of commensurate (or greater) loss.

This means that the remaining 72% of assets – which are mostly in equities, either held directly or through vehicles such as hedge funds or private-equity investments – must earn 9.2% in order for the fund overall to achieve the postulated 8%. And that return must be delivered *after* all fees, which are now far higher than they have ever been.

How realistic is this expectation? Let's revisit some data I mentioned two years ago: During the 20th Century, the Dow advanced from 66 to 11,497. This gain, though it appears huge, shrinks to 5.3% when compounded annually. An investor who owned the Dow throughout the century would also have received generous dividends for much of the period, but only about 2% or so in the final years. It was a wonderful century.

Think now about *this* century. For investors to merely match that 5.3% market-value gain, the Dow – recently below 13,000 – would need to close at about 2,000,000 on December 31, 2099. We are now eight years into this century, and we have racked up less than 2,000 of the 1,988,000 Dow points the market needed to travel in this hundred years to equal the 5.3% of the last.

It's amusing that commentators regularly hyperventilate at the prospect of the Dow crossing an even number of thousands, such as 14,000 or 15,000. If they keep reacting that way, a 5.3% annual gain for the century will mean they experience at least 1,986 seizures during the next 92 years. While anything is possible, does anyone really believe this is the most likely outcome?

Dividends continue to run about 2%. Even if stocks were to average the 5.3% annual appreciation of the 1900s, the equity portion of plan assets – allowing for expenses of .5% – would produce no more than 7% or so. And .5% may well underestimate costs, given the presence of layers of consultants and high-priced managers (“helpers”).

Naturally, everyone expects to be above average. And those helpers – bless their hearts – will certainly encourage their clients in this belief. But, as a class, the helper-aided group must be *below* average. The reason is simple: 1) Investors, overall, will necessarily earn an average return, minus costs they incur; 2) Passive and index investors, through their very inactivity, will earn that average minus costs that are very low; 3) With that group earning average returns, so must the remaining group – the active investors. But this group will incur high transaction, management, and advisory costs. Therefore, the active investors will have their returns diminished by a far greater percentage than will their inactive brethren. That means that the passive group – the “know-nothings” – must win.

I should mention that people who expect to earn 10% annually from equities during this century – envisioning that 2% of that will come from dividends and 8% from price appreciation – are implicitly forecasting a level of about 24,000,000 on the Dow by 2100. If your adviser talks to you about double-digit returns from equities, explain this math to him – not that it will faze him. Many helpers are apparently direct descendants of the queen in Alice in Wonderland, who said: “Why, sometimes I’ve believed as many as six impossible things before breakfast.” Beware the glib helper who fills your head with fantasies while he fills his pockets with fees.

Some companies have pension plans in Europe as well as in the U.S. and, in their accounting, almost all assume that the U.S. plans will earn more than the non-U.S. plans. This discrepancy is puzzling: Why should these companies not put their U.S. managers in charge of the non-U.S. pension assets and let them work their magic on these assets as well? I’ve never seen this puzzle explained. But the auditors and actuaries who are charged with vetting the return assumptions seem to have no problem with it.

What is no puzzle, however, is why CEOs opt for a high investment assumption: It lets them report higher earnings. And if they are wrong, as I believe they are, the chickens won't come home to roost until long after they retire.

After decades of pushing the envelope – or worse – in its attempt to report the highest number possible for current earnings, Corporate America should ease up. It should listen to my partner, Charlie: “If you’ve hit three balls out of bounds to the left, aim a little to the right on the next swing.”

* * * * *

Whatever pension-cost surprises are in store for shareholders down the road, these jolts will be surpassed many times over by those experienced by taxpayers. Public pension promises are huge and, in many cases, funding is woefully inadequate. Because the fuse on this time bomb is long, politicians flinch from inflicting tax pain, given that problems will only become apparent long after these officials have departed. Promises involving very early retirement – sometimes to those in their low 40s – and generous cost-of-living adjustments are easy for these officials to make. In a world where people are living longer and inflation is certain, those promises will be anything but easy to keep.

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Having laid out the failures of an “honor system” in American accounting, I need to point out that this is exactly the system existing at Berkshire for a truly huge balance-sheet item. In every report we make to you, we must guesstimate the loss reserves for our insurance units. If our estimate is wrong, it means that both our balance sheet and our earnings statement will be wrong. So naturally we do our best to make these guesses accurate. *Nevertheless, in every report our estimate is sure to be wrong.*

At yearend 2007, we show an insurance liability of \$56 billion that represents our guess as to what we will eventually pay for all loss events that occurred before yearend (except for about \$3 billion of the reserve that has been discounted to present value). We know of many thousands of events and have put a dollar value on each that reflects what we believe we will pay, including the associated costs (such as attorney’s fees) that we will incur in the payment process. In some cases, among them claims for certain serious injuries covered by worker’s compensation, payments will be made for 50 years or more.

We also include a large reserve for losses that occurred before yearend but that we have yet to hear about. Sometimes, the insured itself does not know that a loss has occurred. (Think of an embezzlement that remains undiscovered for years.) We sometimes hear about losses from policies that covered our insured many decades ago.

A story I told you some years back illustrates our problem in accurately estimating our loss liability: A fellow was on an important business trip in Europe when his sister called to tell him that their dad had died. Her brother explained that he couldn’t get back but said to spare nothing on the funeral, whose cost he would cover. When he returned, his sister told him that the service had been beautiful and presented him with bills totaling \$8,000. He paid up but a month later received a bill from the mortuary for \$10. He paid that, too – and still another \$10 charge he received a month later. When a third \$10 invoice was sent to him the following month, the perplexed man called his sister to ask what was going on. “Oh,” she replied, “I forgot to tell you. We buried Dad in a rented suit.”

At our insurance companies we have an unknown, but most certainly large, number of “rented suits” buried around the world. We try to estimate the bill for them accurately. In ten or twenty years, we will even be able to make a good guess as to how inaccurate our present guess is. But even *that* guess will be subject to surprises. I personally believe our stated reserves are adequate, but I’ve been wrong several times in the past.

The Annual Meeting

Our meeting this year will be held on Saturday, May 3rd. As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:00. Then, after a short recess, Charlie and I will convene the annual meeting at 3:15. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course is to *shop*. We will help you do that by filling the 194,300-square-foot hall that adjoins the meeting area with the products of Berkshire subsidiaries. Last year, the 27,000 people who came to the meeting did their part, and almost every location racked up record sales. But you can do better. (If necessary, I'll lock the doors.)

This year we will again showcase a Clayton home (featuring Acme brick, Shaw carpet, Johns Manville insulation, MiTek fasteners, Carefree awnings and NFM furniture). You will find that this 1,550-square-foot home, priced at \$69,500, delivers exceptional value. And after you purchase the house, consider also acquiring the Forest River RV and pontoon boat on display nearby.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a special shareholder discount (usually 8%). This special offer is permitted by 45 of the 50 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can.

On Saturday, at the Omaha airport, we will have the usual array of aircraft from NetJets available for your inspection. Stop by the NetJets booth at the Qwest to learn about viewing these planes. Come to Omaha by bus; leave in your new plane. And take all the hair gel and scissors that you wish on board with you.

Next, if you have any money left, visit the Bookworm, where you will find about 25 books and DVDs – all discounted – led again by *Poor Charlie's Almanack*. Without any advertising or bookstore placement, Charlie's book has now remarkably sold nearly 50,000 copies. For those of you who can't make the meeting, go to poorcharliesalmanack.com to order a copy.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. We initiated this special event at NFM eleven years ago, and sales during the "Weekend" grew from \$5.3 million in 1997 to \$30.9 million in 2007. This is more volume than most furniture stores register in a year.

To obtain the Berkshire discount, you must make your purchases between Thursday, May 1st and Monday, May 5th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a Baja Beach Bash featuring beef and chicken tacos.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, May 2nd. The second, the main gala, will be held on Sunday, May 4th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 28th through Saturday, May 10th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in a tent outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon.

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 4th, and will be serving from 4 p.m. until 10 p.m. Last year Gorat's, which seats 240, served 915 dinners on Shareholder Sunday. The three-day total was 2,487 including 656 T-bone steaks, the entrée preferred by the *cognoscenti*. Please remember that to come to Gorat's on that day, you must have a reservation. To make one, call 402-551-3733 on April 1st (*but not before*).

We will again have a reception at 4 p.m. on Saturday afternoon for shareholders who have come from outside of North America. Every year our meeting draws many people from around the globe, and Charlie and I want to be sure we personally greet those who have come so far. Last year we enjoyed meeting more than 400 of you from many dozens of countries. Any shareholder who comes from other than the U.S. or Canada will be given a special credential and instructions for attending this function.

* * * * *

At 84 and 77, Charlie and I remain lucky beyond our dreams. We were born in America; had terrific parents who saw that we got good educations; have enjoyed wonderful families and great health; and came equipped with a “business” gene that allows us to prosper in a manner hugely disproportionate to that experienced by many people who contribute as much or more to our society’s well-being. Moreover, we have long had jobs that we love, in which we are helped in countless ways by talented and cheerful associates. Every day is exciting to us; no wonder we tap-dance to work. But nothing is more fun for us than getting together with our shareholder-partners at Berkshire’s annual meeting. So join us on May 3rd at the Qwest for our annual Woodstock for Capitalists. We’ll see you there.

February 2008

Warren E. Buffett
Chairman of the Board

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
19995	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
Compounded Annual Gain – 1965-2008	20.3%	8.9%	11.4
Overall Gain – 1964-2008	362,319%	4,276%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our *decrease* in net worth during 2008 was \$11.5 billion, which reduced the per-share book value of both our Class A and Class B stock by 9.6%. Over the last 44 years (that is, since present management took over) book value has grown from \$19 to \$70,530, a rate of 20.3% compounded annually.*

The table on the preceding page, recording both the 44-year performance of Berkshire's book value and the S&P 500 index, shows that 2008 was the worst year for each. The period was devastating as well for corporate and municipal bonds, real estate and commodities. By yearend, investors of all stripes were bloodied and confused, much as if they were small birds that had strayed into a badminton game.

As the year progressed, a series of life-threatening problems within many of the world's great financial institutions was unveiled. This led to a dysfunctional credit market that in important respects soon turned non-functional. The watchword throughout the country became the creed I saw on restaurant walls when I was young: "In God we trust; all others pay cash."

By the fourth quarter, the credit crisis, coupled with tumbling home and stock prices, had produced a paralyzing fear that engulfed the country. A freefall in business activity ensued, accelerating at a pace that I have never before witnessed. The U.S. – and much of the world – became trapped in a vicious negative-feedback cycle. Fear led to business contraction, and that in turn led to even greater fear.

This debilitating spiral has spurred our government to take massive action. In poker terms, the Treasury and the Fed have gone "all in." Economic medicine that was previously meted out by the cupful has recently been dispensed by the barrel. These once-unthinkable dosages will almost certainly bring on unwelcome aftereffects. Their precise nature is anyone's guess, though one likely consequence is an onslaught of inflation. Moreover, major industries have become dependent on Federal assistance, and they will be followed by cities and states bearing mind-boggling requests. Weaning these entities from the public teat will be a political challenge. They won't leave willingly.

Whatever the downsides may be, strong and immediate action by government was essential last year if the financial system was to avoid a total breakdown. Had one occurred, the consequences for every area of our economy would have been cataclysmic. Like it or not, the inhabitants of Wall Street, Main Street and the various Side Streets of America were all in the same boat.

Amid this bad news, however, never forget that our country has faced far worse travails in the past. In the 20th Century alone, we dealt with two great wars (one of which we initially appeared to be losing); a dozen or so panics and recessions; virulent inflation that led to a 21½% prime rate in 1980; and the Great Depression of the 1930s, when unemployment ranged between 15% and 25% for many years. America has had no shortage of challenges.

Without fail, however, we've overcome them. In the face of those obstacles – and many others – the real standard of living for Americans improved nearly *seven-fold* during the 1900s, while the Dow Jones Industrials rose from 66 to 11,497. Compare the record of this period with the dozens of centuries during which humans secured only tiny gains, if any, in how they lived. Though the path has not been smooth, our economic system has worked extraordinarily well over time. It has unleashed human potential as no other system has, and it will continue to do so. America's best days lie ahead.

*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/30th of those shown for A.

Take a look again at the 44-year table on page 2. In 75% of those years, the S&P stocks recorded a gain. I would guess that a roughly similar percentage of years will be positive in the next 44. But neither Charlie Munger, my partner in running Berkshire, nor I can predict the winning and losing years in advance. (In our usual opinionated view, we don't think anyone else can either.) We're certain, for example, that the economy will be in shambles throughout 2009 – and, for that matter, probably well beyond – but that conclusion does not tell us whether the stock market will rise or fall.

In good years and bad, Charlie and I simply focus on four goals:

- (1) maintaining Berkshire's Gibraltar-like financial position, which features huge amounts of excess liquidity, near-term obligations that are modest, and dozens of sources of earnings and cash;
- (2) widening the "moats" around our operating businesses that give them durable competitive advantages;
- (3) acquiring and developing new and varied streams of earnings;
- (4) expanding and nurturing the cadre of outstanding operating managers who, over the years, have delivered Berkshire exceptional results.

Berkshire in 2008

Most of the Berkshire businesses whose results are significantly affected by the economy earned below their potential last year, and that will be true in 2009 as well. Our retailers were hit particularly hard, as were our operations tied to residential construction. In aggregate, however, our manufacturing, service and retail businesses earned substantial sums and most of them – particularly the larger ones – continue to strengthen their competitive positions. Moreover, we are fortunate that Berkshire's two most important businesses – our insurance and utility groups – produce earnings that are not correlated to those of the general economy. Both businesses delivered outstanding results in 2008 and have excellent prospects.

As predicted in last year's report, the exceptional underwriting profits that our insurance businesses realized in 2007 were not repeated in 2008. Nevertheless, the insurance group delivered an underwriting gain for the sixth consecutive year. This means that our \$58.5 billion of insurance "float" – money that doesn't belong to us but that we hold and invest for our own benefit – cost us less than zero. In fact, we were *paid* \$2.8 billion to hold our float during 2008. Charlie and I find this enjoyable.

Over time, most insurers experience a substantial underwriting loss, which makes their economics far different from ours. Of course, we too will experience underwriting losses in some years. But we have the best group of managers in the insurance business, and in most cases they oversee entrenched and valuable franchises. Considering these strengths, I believe that we will earn an underwriting profit over the years and that our float will therefore cost us nothing. Our insurance operation, the core business of Berkshire, is an economic powerhouse.

Charlie and I are equally enthusiastic about our utility business, which had record earnings last year and is poised for future gains. Dave Sokol and Greg Abel, the managers of this operation, have achieved results unmatched elsewhere in the utility industry. I love it when they come up with new projects because in this capital-intensive business these ventures are often large. Such projects offer Berkshire the opportunity to put out substantial sums at decent returns.

Things also went well on the capital-allocation front last year. Berkshire is always a buyer of both businesses and securities, and the disarray in markets gave us a tailwind in our purchases. When investing, pessimism is your friend, euphoria the enemy.

In our insurance portfolios, we made three large investments on terms that would be unavailable in normal markets. These should add about \$1½ billion pre-tax to Berkshire’s annual earnings and offer possibilities for capital gains as well. We also closed on our Marmon acquisition (we own 64% of the company now and will purchase its remaining stock over the next six years). Additionally, certain of our subsidiaries made “tuck-in” acquisitions that will strengthen their competitive positions and earnings.

That’s the good news. But there’s another less pleasant reality: During 2008 I did some dumb things in investments. I made at least one major mistake of commission and several lesser ones that also hurt. I will tell you more about these later. Furthermore, I made some errors of omission, sucking my thumb when new facts came in that should have caused me to re-examine my thinking and promptly take action.

Additionally, the market value of the bonds and stocks that we continue to hold suffered a significant decline along with the general market. This does not bother Charlie and me. Indeed, we enjoy such price declines if we have funds available to increase our positions. Long ago, Ben Graham taught me that “Price is what you pay; value is what you get.” Whether we’re talking about socks or stocks, I like buying quality merchandise when it is marked down.

Yardsticks

Berkshire has two major areas of value. The first is our investments: stocks, bonds and cash equivalents. At yearend those totaled \$122 billion (not counting the investments held by our finance and utility operations, which we assign to our second bucket of value). About \$58.5 billion of that total is funded by our insurance float.

Berkshire’s second component of value is earnings that come from sources other than investments and insurance. These earnings are delivered by our 67 non-insurance companies, itemized on page 96. We exclude our insurance earnings from this calculation because the value of our insurance operation comes from the investable funds it generates, and we have already included this factor in our first bucket.

In 2008, our investments fell from \$90,343 per share of Berkshire (after minority interest) to \$77,793, a decrease that was caused by a decline in market prices, not by net sales of stocks or bonds. Our second segment of value fell from pre-tax earnings of \$4,093 per Berkshire share to \$3,921 (again after minority interest).

Both of these performances are unsatisfactory. Over time, we need to make decent gains in each area if we are to increase Berkshire’s intrinsic value at an acceptable rate. Going forward, however, our focus will be on the earnings segment, just as it has been for several decades. We like buying underpriced securities, but we like buying fairly-priced operating businesses even more.

Now, let’s take a look at the four major operating sectors of Berkshire. Each of these has vastly different balance sheet and income account characteristics. Therefore, lumping them together, as is done in standard financial statements, impedes analysis. So we’ll present them as four separate businesses, which is how Charlie and I view them.

Regulated Utility Business

Berkshire has an 87.4% (diluted) interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.8 million end users make it the U.K.'s third largest distributor of electricity; (2) MidAmerican Energy, which serves 723,000 electric customers, primarily in Iowa; (3) Pacific Power and Rocky Mountain Power, serving about 1.7 million electric customers in six western states; and (4) Kern River and Northern Natural pipelines, which carry about 9% of the natural gas consumed in the U.S.

Our partners in ownership of MidAmerican are its two terrific managers, Dave Sokol and Greg Abel, and my long-time friend, Walter Scott. It's unimportant how many votes each party has; we make major moves only when we are unanimous in thinking them wise. Nine years of working with Dave, Greg and Walter have reinforced my original belief: Berkshire couldn't have better partners.

Somewhat incongruously, MidAmerican also owns the second largest real estate brokerage firm in the U.S., HomeServices of America. This company operates through 21 locally-branded firms that have 16,000 agents. Last year was a terrible year for home sales, and 2009 looks no better. We will continue, however, to acquire quality brokerage operations when they are available at sensible prices.

Here are some key figures on MidAmerican's operations:

	<i>Earnings (in millions)</i>	
	<i>2008</i>	<i>2007</i>
U.K. utilities	\$ 339	\$ 337
Iowa utility	425	412
Western utilities	703	692
Pipelines	595	473
HomeServices	(45)	42
Other (net)	186	130
Operating earnings before corporate interest and taxes	2,203	2,086
Constellation Energy*	1,092	—
Interest, other than to Berkshire	(332)	(312)
Interest on Berkshire junior debt	(111)	(108)
Income tax	(1,002)	(477)
Net earnings	<u>\$ 1,850</u>	<u>\$ 1,189</u>
Earnings applicable to Berkshire**	\$ 1,704	\$ 1,114
Debt owed to others	19,145	19,002
Debt owed to Berkshire	1,087	821

*Consists of a breakup fee of \$175 million and a profit on our investment of \$917 million.

**Includes interest earned by Berkshire (net of related income taxes) of \$72 in 2008 and \$70 in 2007.

MidAmerican's record in operating its regulated electric utilities and natural gas pipelines is truly outstanding. Here's some backup for that claim.

Our two pipelines, Kern River and Northern Natural, were both acquired in 2002. A firm called Mastio regularly ranks pipelines for customer satisfaction. Among the 44 rated, Kern River came in 9th when we purchased it and Northern Natural ranked 39th. There was work to do.

In Mastio's 2009 report, Kern River ranked 1st and Northern Natural 3rd. Charlie and I couldn't be more proud of this performance. It came about because hundreds of people at each operation committed themselves to a new culture and then delivered on their commitment.

Achievements at our electric utilities have been equally impressive. In 1995, MidAmerican became the major provider of electricity in Iowa. By judicious planning and a zeal for efficiency, the company has kept electric prices unchanged since our purchase and has promised to hold them steady through 2013.

MidAmerican has maintained this extraordinary price stability while making Iowa number one among all states in the percentage of its generation capacity that comes from wind. Since our purchase, MidAmerican's wind-based facilities have grown from zero to almost 20% of total capacity.

Similarly, when we purchased PacifiCorp in 2006, we moved aggressively to expand wind generation. Wind capacity was then 33 megawatts. It's now 794, with more coming. (Arriving at PacifiCorp, we found "wind" of a different sort: The company had 98 committees that met frequently. Now there are 28. Meanwhile, we generate and deliver considerably more electricity, doing so with 2% fewer employees.)

In 2008 alone, MidAmerican spent \$1.8 billion on wind generation at our two operations, and today the company is number one in the nation among regulated utilities in ownership of wind capacity. By the way, compare that \$1.8 billion to the \$1.1 billion of pre-tax earnings of PacifiCorp (shown in the table as "Western") and Iowa. In our utility business, we spend all we earn, and then some, in order to fulfill the needs of our service areas. Indeed, MidAmerican has not paid a dividend since Berkshire bought into the company in early 2000. Its earnings have instead been reinvested to develop the utility systems our customers require and deserve. In exchange, we have been allowed to earn a fair return on the huge sums we have invested. It's a great partnership for all concerned.

* * * * *

Our long-avowed goal is to be the "buyer of choice" for businesses – particularly those built and owned by families. The way to achieve this goal is to deserve it. That means we must keep our promises; avoid leveraging up acquired businesses; grant unusual autonomy to our managers; and hold the purchased companies through thick and thin (though we prefer thick and thicker).

Our record matches our rhetoric. Most buyers competing against us, however, follow a different path. For them, acquisitions are "merchandise." Before the ink dries on their purchase contracts, these operators are contemplating "exit strategies." We have a decided advantage, therefore, when we encounter sellers who truly care about the future of their businesses.

Some years back our competitors were known as "leveraged-buyout operators." But LBO became a bad name. So in Orwellian fashion, the buyout firms decided to change their moniker. What they did not change, though, were the essential ingredients of their previous operations, including their cherished fee structures and love of leverage.

Their new label became "private equity," a name that turns the facts upside-down: A purchase of a business by these firms almost invariably results in dramatic *reductions* in the equity portion of the acquiree's capital structure compared to that previously existing. A number of these acquirees, purchased only two to three years ago, are now in mortal danger because of the debt piled on them by their private-equity buyers. Much of the bank debt is selling below 70¢ on the dollar, and the public debt has taken a far greater beating. The private-equity firms, it should be noted, are not rushing in to inject the equity their wards now desperately need. Instead, they're keeping their remaining funds *very* private.

In the regulated utility field there are no large family-owned businesses. Here, Berkshire hopes to be the "buyer of choice" of *regulators*. It is they, rather than selling shareholders, who judge the fitness of purchasers when transactions are proposed.

There is no hiding your history when you stand before these regulators. They can – and do – call their counterparts in other states where you operate and ask how you have behaved in respect to all aspects of the business, including a willingness to commit adequate equity capital.

When MidAmerican proposed its purchase of PacifiCorp in 2005, regulators in the six new states we would be serving immediately checked our record in Iowa. They also carefully evaluated our financing plans and capabilities. We passed this examination, just as we expect to pass future ones.

There are two reasons for our confidence. First, Dave Sokol and Greg Abel are going to run any businesses with which they are associated in a first-class manner. They don't know of any other way to operate. Beyond that is the fact that we hope to buy more regulated utilities in the future – and we know that our business behavior in jurisdictions where we are operating today will determine how we are welcomed by new jurisdictions tomorrow.

Insurance

Our insurance group has propelled Berkshire's growth since we first entered the business in 1967. This happy result has not been due to general prosperity in the industry. During the 25 years ending in 2007, return on net worth for insurers averaged 8.5% versus 14.0% for the Fortune 500. Clearly our insurance CEOs have not had the wind at their back. Yet these managers have excelled to a degree Charlie and I never dreamed possible in the early days. Why do I love them? Let me count the ways.

At GEICO, Tony Nicely – now in his 48th year at the company after joining it when he was 18 – continues to gobble up market share while maintaining disciplined underwriting. When Tony became CEO in 1993, GEICO had 2.0% of the auto insurance market, a level at which the company had long been stuck. Now we have a 7.7% share, up from 7.2% in 2007.

The combination of new business gains and an improvement in the renewal rate on existing business has moved GEICO into the number three position among auto insurers. In 1995, when Berkshire purchased control, GEICO was number seven. Now we trail only State Farm and Allstate.

GEICO grows because it saves money for motorists. No one *likes* to buy auto insurance. But virtually everyone likes to drive. So, sensibly, drivers look for the lowest-cost insurance consistent with first-class service. Efficiency is the key to low cost, and efficiency is Tony's specialty. Five years ago the number of policies per employee was 299. In 2008, the number was 439, a huge increase in productivity.

As we view GEICO's current opportunities, Tony and I feel like two hungry mosquitoes in a nudist camp. Juicy targets are everywhere. First, and most important, our new business in auto insurance is now exploding. Americans are focused on saving money as never before, and they are flocking to GEICO. In January 2009, we set a monthly record – by a wide margin – for growth in policyholders. That record will last exactly 28 days: As we go to press, it's clear February's gain will be even better.

Beyond this, we are gaining ground in allied lines. Last year, our motorcycle policies increased by 23.4%, which raised our market share from about 6% to more than 7%. Our RV and ATV businesses are also growing rapidly, albeit from a small base. And, finally, we recently began insuring commercial autos, a big market that offers real promise.

GEICO is now saving money for millions of Americans. Go to GEICO.com or call 1-800-847-7536 and see if we can save you money as well.

General Re, our large international reinsurer, also had an outstanding year in 2008. Some time back, the company had serious problems (which I totally failed to detect when we purchased it in late 1998). By 2001, when Joe Brandon took over as CEO, assisted by his partner, Tad Montross, General Re's culture had further deteriorated, exhibiting a loss of discipline in underwriting, reserving and expenses. After Joe and Tad took charge, these problems were decisively and successfully addressed. Today General Re has regained its luster. Last spring Joe stepped down, and Tad became CEO. Charlie and I are grateful to Joe for righting the ship and are certain that, with Tad, General Re's future is in the best of hands.

Reinsurance is a business of long-term promises, sometimes extending for fifty years or more. This past year has retaught clients a crucial principle: A promise is no better than the person or institution making it. That's where General Re excels: It is the *only* reinsurer that is backed by an AAA corporation. Ben Franklin once said, "It's difficult for an empty sack to stand upright." That's no worry for General Re clients.

Our third major insurance operation is Ajit Jain's reinsurance division, headquartered in Stamford and staffed by only 31 employees. This may be one of the most remarkable businesses in the world, hard to characterize but easy to admire.

From year to year, Ajit's business is never the same. It features very large transactions, incredible speed of execution and a willingness to quote on policies that leave others scratching their heads. When there is a huge and unusual risk to be insured, Ajit is almost certain to be called.

Ajit came to Berkshire in 1986. Very quickly, I realized that we had acquired an extraordinary talent. So I did the logical thing: I wrote his parents in New Delhi and asked if they had another one like him at home. Of course, I knew the answer before writing. There *isn't* anyone like Ajit.

Our smaller insurers are just as outstanding in their own way as the "big three," regularly delivering valuable float to us at a negative cost. We aggregate their results below under "Other Primary." For space reasons, we don't discuss these insurers individually. But be assured that Charlie and I appreciate the contribution of each.

Here is the record for the four legs to our insurance stool. The underwriting profits signify that all four provided funds to Berkshire last year without cost, just as they did in 2007. And in both years our underwriting profitability was considerably better than that achieved by the industry. Of course, we ourselves will periodically have a terrible year in insurance. But, overall, I expect us to *average* an underwriting profit. If so, we will be using free funds of large size for the indefinite future.

Insurance Operations	Underwriting Profit (in millions)		Yearend Float	
	2008	2007	2008	2007
General Re	\$ 342	\$ 555	\$21,074	\$23,009
BH Reinsurance	1,324	1,427	24,221	23,692
GEICO	916	1,113	8,454	7,768
Other Primary	210	279	4,739	4,229
	<u>\$2,792</u>	<u>\$3,374</u>	<u>\$58,488</u>	<u>\$58,698</u>

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/08 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 2,497	Notes payable	\$ 2,212
Accounts and notes receivable	5,047	Other current liabilities	8,087
Inventory	7,500	Total current liabilities	10,299
Other current assets	<u>752</u>		
Total current assets	15,796		
Goodwill and other intangibles	16,515	Deferred taxes	2,786
Fixed assets	16,338	Term debt and other liabilities	6,033
Other assets	<u>1,248</u>	Equity	<u>30,779</u>
	<u>\$49,897</u>		<u>\$49,897</u>

Earnings Statement (in millions)

	2008	2007	2006
Revenues	\$66,099	\$59,100	\$52,660
Operating expenses (including depreciation of \$1,280 in 2008, \$955 in 2007 and \$823 in 2006)	61,937	55,026	49,002
Interest expense	139	127	132
Pre-tax earnings	4,023*	3,947*	3,526*
Income taxes and minority interests	1,740	1,594	1,395
Net income	<u>\$ 2,283</u>	<u>\$ 2,353</u>	<u>\$ 2,131</u>

*Does not include purchase-accounting adjustments.

This motley group, which sells products ranging from lollipops to motor homes, earned an impressive 17.9% on average tangible net worth last year. It's also noteworthy that these operations used only minor financial leverage in achieving that return. Clearly we own some terrific businesses. We purchased many of them, however, at large premiums to net worth – a point reflected in the goodwill item shown on our balance sheet – and that fact reduces the earnings on our average *carrying* value to 8.1%.

Though the full-year result was satisfactory, earnings of many of the businesses in this group hit the skids in last year's fourth quarter. Prospects for 2009 look worse. Nevertheless, the group retains strong earning power even under today's conditions and will continue to deliver significant cash to the parent company. Overall, these companies improved their competitive positions last year, partly because our financial strength let us make advantageous tuck-in acquisitions. In contrast, many competitors were treading water (or sinking).

The most noteworthy of these acquisitions was Iscar's late-November purchase of Tungaloy, a leading Japanese producer of small tools. Charlie and I continue to look with astonishment – and appreciation! – at the accomplishments of Iscar's management. To secure one manager like Eitan Wertheimer, Jacob Harpaz or Danny Goldman when we acquire a company is a blessing. Getting three is like winning the Triple Crown. Iscar's growth since our purchase has exceeded our expectations – which were high – and the addition of Tungaloy will move performance to the next level.

MiTek, Benjamin Moore, Acme Brick, Forest River, Marmon and CTB also made one or more acquisitions during the year. CTB, which operates worldwide in the agriculture equipment field, has now picked up six small firms since we purchased it in 2002. At that time, we paid \$140 million for the company. Last year its pre-tax earnings were \$89 million. Vic Mancinelli, its CEO, followed Berkshire-like operating principles long before our arrival. He focuses on blocking and tackling, day by day doing the little things right and never getting off course. Ten years from now, Vic will be running a much larger operation and, more important, will be earning excellent returns on invested capital.

Finance and Financial Products

I will write here at some length about the mortgage operation of Clayton Homes and skip any financial commentary, which is summarized in the table at the end of this section. I do this because Clayton's recent experience may be useful in the public-policy debate about housing and mortgages. But first a little background.

Clayton is the largest company in the manufactured home industry, delivering 27,499 units last year. This came to about 34% of the industry's 81,889 total. Our share will likely grow in 2009, partly because much of the rest of the industry is in acute distress. Industrywide, units sold have steadily declined since they hit a peak of 372,843 in 1998.

At that time, much of the industry employed sales practices that were atrocious. Writing about the period somewhat later, I described it as involving “borrowers who shouldn’t have borrowed being financed by lenders who shouldn’t have lent.”

To begin with, the need for meaningful down payments was frequently ignored. Sometimes fakery was involved. (“That certainly looks like a \$2,000 cat to me” says the salesman who will receive a \$3,000 commission if the loan goes through.) Moreover, impossible-to-meet monthly payments were being agreed to by borrowers who signed up because they had nothing to lose. The resulting mortgages were usually packaged (“securitized”) and sold by Wall Street firms to unsuspecting investors. This chain of folly had to end badly, and it did.

Clayton, it should be emphasized, followed far more sensible practices in its own lending throughout that time. Indeed, no purchaser of the mortgages it originated and then securitized has ever lost a dime of principal or interest. But Clayton was the exception; industry losses were staggering. And the hangover continues to this day.

This 1997-2000 fiasco should have served as a canary-in-the-coal-mine warning for the far-larger conventional housing market. But investors, government and rating agencies learned exactly nothing from the manufactured-home debacle. Instead, in an eerie rerun of that disaster, the same mistakes were repeated with conventional homes in the 2004-07 period: Lenders happily made loans that borrowers couldn’t repay out of their incomes, and borrowers just as happily signed up to meet those payments. Both parties counted on “house-price appreciation” to make this otherwise impossible arrangement work. It was Scarlett O’Hara all over again: “I’ll think about it tomorrow.” The consequences of this behavior are now reverberating through every corner of our economy.

Clayton’s 198,888 borrowers, however, have continued to pay normally throughout the housing crash, handing us no unexpected losses. This is *not* because these borrowers are unusually creditworthy, a point proved by FICO scores (a standard measure of credit risk). Their median FICO score is 644, compared to a national median of 723, and about 35% are below 620, the segment usually designated “sub-prime.” Many disastrous pools of mortgages on conventional homes are populated by borrowers with far better credit, as measured by FICO scores.

Yet at yearend, our delinquency rate on loans we have originated was 3.6%, up only modestly from 2.9% in 2006 and 2.9% in 2004. (In addition to our originated loans, we’ve also bought bulk portfolios of various types from other financial institutions.) Clayton’s foreclosures during 2008 were 3.0% of originated loans compared to 3.8% in 2006 and 5.3% in 2004.

Why are our borrowers – characteristically people with modest incomes and far-from-great credit scores – performing so well? The answer is elementary, going right back to Lending 101. Our borrowers simply looked at how full-bore mortgage payments would compare with their actual – not hoped-for – income and then decided whether they could live with that commitment. Simply put, they took out a mortgage with the intention of paying it off, whatever the course of home prices.

Just as important is what our borrowers did *not* do. They did not count on making their loan payments by means of refinancing. They did not sign up for “teaser” rates that upon reset were outsized relative to their income. And they did not assume that they could always sell their home at a profit if their mortgage payments became onerous. Jimmy Stewart would have loved these folks.

Of course, a number of our borrowers will run into trouble. They generally have no more than minor savings to tide them over if adversity hits. The major cause of delinquency or foreclosure is the loss of a job, but death, divorce and medical expenses all cause problems. If unemployment rates rise – as they surely will in 2009 – more of Clayton’s borrowers will have troubles, and we will have larger, though still manageable, losses. But our problems will not be driven to any extent by the trend of home prices.

Commentary about the current housing crisis often ignores the crucial fact that most foreclosures do *not* occur because a house is worth less than its mortgage (so-called “upside-down” loans). Rather, foreclosures take place because borrowers can’t pay the monthly payment that they agreed to pay. Homeowners who have made a meaningful down-payment – derived from savings and not from other borrowing – seldom walk away from a primary residence simply because its value today is less than the mortgage. Instead, they walk when they can’t make the monthly payments.

Home ownership is a wonderful thing. My family and I have enjoyed my present home for 50 years, with more to come. But enjoyment and utility should be the primary motives for purchase, not profit or refi possibilities. And the home purchased ought to fit the income of the purchaser.

The present housing debacle should teach home buyers, lenders, brokers and government some simple lessons that will ensure stability in the future. Home purchases should involve an honest-to-God down payment of at least 10% and monthly payments that can be comfortably handled by the borrower’s income. That income should be carefully verified.

Putting people into homes, though a desirable goal, shouldn’t be our country’s primary objective. Keeping them in their homes should be the ambition.

* * * * *

Clayton’s lending operation, though not damaged by the performance of its borrowers, is nevertheless threatened by an element of the credit crisis. Funders that have access to any sort of government guarantee – banks with FDIC-insured deposits, large entities with commercial paper now backed by the Federal Reserve, and others who are using imaginative methods (or lobbying skills) to come under the government’s umbrella – have money costs that are minimal. Conversely, highly-rated companies, such as Berkshire, are experiencing borrowing costs that, in relation to Treasury rates, are at record levels. Moreover, funds are abundant for the government-guaranteed borrower but often scarce for others, no matter how creditworthy they may be.

This unprecedented “spread” in the cost of money makes it unprofitable for any lender who doesn’t enjoy government-guaranteed funds to go up against those with a favored status. Government is determining the “haves” and “have-nots.” That is why companies are rushing to convert to bank holding companies, not a course feasible for Berkshire.

Though Berkshire’s credit is pristine – we are one of only seven AAA corporations in the country – our cost of borrowing is now *far* higher than competitors with shaky balance sheets but government backing. At the moment, it is much better to be a financial cripple with a government guarantee than a Gibraltar without one.

Today’s extreme conditions may soon end. At worst, we believe we will find at least a partial solution that will allow us to continue much of Clayton’s lending. Clayton’s earnings, however, will surely suffer if we are forced to compete for long against government-favored lenders.

	<i>Pre-Tax Earnings</i> <i>(in millions)</i>	
	<i>2008</i>	<i>2007</i>
Net investment income	\$330	\$ 272
Life and annuity operation	23	(60)
Leasing operations	87	111
Manufactured-housing finance (Clayton)	206	526
Other*	141	157
Income before investment and derivatives gains or losses	<u>\$787</u>	<u>\$1,006</u>

*Includes \$92 million in 2008 and \$85 million in 2007 of fees that Berkshire charges Clayton for the use of Berkshire’s credit.

Tax-Exempt Bond Insurance

Early in 2008, we activated Berkshire Hathaway Assurance Company (“BHAC”) as an insurer of the tax-exempt bonds issued by states, cities and other local entities. BHAC insures these securities for issuers both at the time their bonds are sold to the public (primary transactions) and later, when the bonds are already owned by investors (secondary transactions).

By yearend 2007, the half dozen or so companies that had been the major players in this business had all fallen into big trouble. The cause of their problems was captured long ago by Mae West: “I was Snow White, but I drifted.”

The monolines (as the bond insurers are called) initially insured only tax-exempt bonds that were low-risk. But over the years competition for this business intensified, and rates fell. Faced with the prospect of stagnating or declining earnings, the monoline managers turned to ever-riskier propositions. Some of these involved the insuring of residential mortgage obligations. When housing prices plummeted, the monoline industry quickly became a basket case.

Early in the year, Berkshire offered to assume all of the insurance issued on tax-exempts that was on the books of the three largest monolines. These companies were all in life-threatening trouble (though they said otherwise.) We would have charged a 1½% rate to take over the guarantees on about \$822 billion of bonds. If our offer had been accepted, we would have been required to pay any losses suffered by investors who owned these bonds – a guarantee stretching for 40 years in some cases. Ours was not a frivolous proposal: For reasons we will come to later, it involved substantial risk for Berkshire.

The monolines summarily rejected our offer, in some cases appending an insult or two. In the end, though, the turndowns proved to be *very* good news for us, because it became apparent that I had severely underpriced our offer.

Thereafter, we wrote about \$15.6 billion of insurance in the secondary market. And here’s the punch line: About 77% of this business was on bonds that were already insured, largely by the three aforementioned monolines. In these agreements, we have to pay for defaults *only* if the original insurer is financially unable to do so.

We wrote this “second-to-pay” insurance for rates averaging 3.3%. That’s right; we have been paid far more for becoming the second to pay than the 1.5% we would have earlier charged to be the first to pay. In one extreme case, we actually agreed to be *fourth* to pay, nonetheless receiving about three times the 1% premium charged by the monoline that remains *first* to pay. In other words, three other monolines have to first go broke before we need to write a check.

Two of the three monolines to which we made our initial bulk offer later raised substantial capital. This, of course, directly helps *us*, since it makes it less likely that we will have to pay, at least in the near term, any claims on our second-to-pay insurance because these two monolines fail. In addition to our book of secondary business, we have also written \$3.7 billion of primary business for a premium of \$96 million. In primary business, of course, we are first to pay if the issuer gets in trouble.

We have a great many more multiples of capital behind the insurance we write than does any other monoline. Consequently, our guarantee is far more valuable than theirs. This explains why many sophisticated investors have bought second-to-pay insurance from us even though they were already insured by another monoline. BHAC has become not only the insurer of preference, but in many cases the *sole* insurer acceptable to bondholders.

Nevertheless, we remain very cautious about the business we write and regard it as far from a sure thing that this insurance will ultimately be profitable for us. The reason is simple, though I have never seen even a passing reference to it by any financial analyst, rating agency or monoline CEO.

The rationale behind very low premium rates for insuring tax-exempts has been that defaults have historically been few. But that record largely reflects the experience of entities that issued *uninsured* bonds. Insurance of tax-exempt bonds didn't exist before 1971, and even after that most bonds remained uninsured.

A universe of tax-exempts fully covered by insurance would be certain to have a somewhat different loss experience from a group of uninsured, but otherwise similar bonds, the only question being *how* different. To understand why, let's go back to 1975 when New York City was on the edge of bankruptcy. At the time its bonds – virtually all uninsured – were heavily held by the city's wealthier residents as well as by New York banks and other institutions. These local bondholders deeply desired to solve the city's fiscal problems. So before long, concessions and cooperation from a host of involved constituencies produced a solution. Without one, it was apparent to all that New York's citizens and businesses would have experienced widespread and severe financial losses from their bond holdings.

Now, imagine that all of the city's bonds had instead been insured by Berkshire. Would similar belt-tightening, tax increases, labor concessions, etc. have been forthcoming? Of course not. At a minimum, Berkshire would have been asked to "share" in the required sacrifices. And, considering our deep pockets, the required contribution would most certainly have been substantial.

Local governments are going to face *far* tougher fiscal problems in the future than they have to date. The pension liabilities I talked about in last year's report will be a huge contributor to these woes. Many cities and states were surely horrified when they inspected the status of their funding at yearend 2008. The gap between assets and a realistic actuarial valuation of present liabilities is simply staggering.

When faced with large revenue shortfalls, communities that have all of their bonds insured will be more prone to develop "solutions" less favorable to bondholders than those communities that have uninsured bonds held by local banks and residents. Losses in the tax-exempt arena, when they come, are also likely to be highly correlated among issuers. If a few communities stiff their creditors and get away with it, the chance that others will follow in their footsteps will grow. What mayor or city council is going to choose pain to local citizens in the form of major tax increases over pain to a far-away bond insurer?

Insuring tax-exempts, therefore, has the look today of a dangerous business – one with similarities, in fact, to the insuring of natural catastrophes. In both cases, a string of loss-free years can be followed by a devastating experience that more than wipes out all earlier profits. We will try, therefore, to proceed carefully in this business, eschewing many classes of bonds that other monolines regularly embrace.

* * * * *

The type of fallacy involved in projecting loss experience from a universe of non-insured bonds onto a deceptively-similar universe in which many bonds are insured pops up in other areas of finance. "Back-tested" models of many kinds are susceptible to this sort of error. Nevertheless, they are frequently touted in financial markets as guides to future action. (If merely looking up past financial data would tell you what the future holds, the Forbes 400 would consist of librarians.)

Indeed, the stupefying losses in mortgage-related securities came in large part because of flawed, history-based models used by salesmen, rating agencies and investors. These parties looked at loss experience over periods when home prices rose only moderately and speculation in houses was negligible. They then made this experience a yardstick for evaluating future losses. They blissfully ignored the fact that house prices had recently skyrocketed, loan practices had deteriorated and many buyers had opted for houses they couldn't afford. In short, universe "past" and universe "current" had very different characteristics. But lenders, government and media largely failed to recognize this all-important fact.

Investors should be skeptical of history-based models. Constructed by a nerdy-sounding priesthood using esoteric terms such as beta, gamma, sigma and the like, these models tend to look impressive. Too often, though, investors forget to examine the assumptions behind the symbols. Our advice: Beware of geeks bearing formulas.

* * * * *

A final post-script on BHAC: Who, you may wonder, runs this operation? While I help set policy, all of the heavy lifting is done by Ajit and his crew. Sure, they were already generating \$24 billion of float along with hundreds of millions of underwriting profit annually. But how busy can that keep a 31-person group? Charlie and I decided it was high time for them to start doing a full day's work.

Investments

Because of accounting rules, we divide our large holdings of common stocks this year into two categories. The table below, presenting the first category, itemizes investments that are carried on our balance sheet at market value and that had a yearend value of more than \$500 million.

<u>Shares</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<i>12/31/08</i>	
			<u>Cost*</u>	<u>Market (in millions)</u>
151,610,700	American Express Company	13.1	\$ 1,287	\$ 2,812
200,000,000	The Coca-Cola Company	8.6	1,299	9,054
84,896,273	ConocoPhillips	5.7	7,008	4,398
30,009,591	Johnson & Johnson	1.1	1,847	1,795
130,272,500	Kraft Foods Inc.	8.9	4,330	3,498
3,947,554	POSCO	5.2	768	1,191
91,941,010	The Procter & Gamble Company	3.1	643	5,684
22,111,966	Sanofi-Aventis	1.7	1,827	1,404
11,262,000	Swiss Re	3.2	773	530
227,307,000	Tesco plc	2.9	1,326	1,193
75,145,426	U.S. Bancorp	4.3	2,337	1,879
19,944,300	Wal-Mart Stores, Inc.	0.5	942	1,118
1,727,765	The Washington Post Company	18.4	11	674
304,392,068	Wells Fargo & Company	7.2	6,702	8,973
	Others		6,035	4,870
	Total Common Stocks Carried at Market		\$37,135	\$49,073

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

In addition, we have holdings in Moody's and Burlington Northern Santa Fe that we now carry at "equity value" – our cost plus retained earnings since our purchase, minus the tax that would be paid if those earnings were paid to us as dividends. This accounting treatment is usually required when ownership of an investee company reaches 20%.

We purchased 15% of Moody's some years ago and have not since bought a share. Moody's, though, has repurchased its own shares and, by late 2008, those repurchases reduced its outstanding shares to the point that our holdings rose above 20%. Burlington Northern has also repurchased shares, but our increase to 20% primarily occurred because we continued to buy this stock.

Unless facts or rules change, you will see these holdings reflected in our balance sheet at “equity accounting” values, whatever their market prices. You will also see our share of their earnings (less applicable taxes) regularly included in our quarterly and annual earnings.

I told you in an earlier part of this report that last year I made a major mistake of commission (and maybe more; this one sticks out). Without urging from Charlie or anyone else, I bought a large amount of ConocoPhillips stock when oil and gas prices were near their peak. I in no way anticipated the dramatic fall in energy prices that occurred in the last half of the year. I still believe the odds are good that oil sells far higher in the future than the current \$40-\$50 price. But so far I have been dead wrong. Even if prices should rise, moreover, the terrible timing of my purchase has cost Berkshire several billion dollars.

I made some other already-recognizable errors as well. They were smaller, but unfortunately not *that* small. During 2008, I spent \$244 million for shares of two Irish banks that appeared cheap to me. At yearend we wrote these holdings down to market: \$27 million, for an 89% loss. Since then, the two stocks have declined even further. The tennis crowd would call my mistakes “unforced errors.”

On the plus side last year, we made purchases totaling \$14.5 billion in fixed-income securities issued by Wrigley, Goldman Sachs and General Electric. We very much like these commitments, which carry high current yields that, in themselves, make the investments more than satisfactory. But in each of these three purchases, we also acquired a substantial equity participation as a bonus. To fund these large purchases, I had to sell portions of some holdings that I would have preferred to keep (primarily Johnson & Johnson, Procter & Gamble and ConocoPhillips). However, I have pledged – to you, the rating agencies and myself – to always run Berkshire with more than ample cash. We never want to count on the kindness of strangers in order to meet tomorrow’s obligations. When forced to choose, I will not trade even a night’s sleep for the chance of extra profits.

The investment world has gone from underpricing risk to overpricing it. This change has not been minor; the pendulum has covered an extraordinary arc. A few years ago, it would have seemed unthinkable that yields like today’s could have been obtained on good-grade municipal or corporate bonds even while risk-free governments offered near-zero returns on short-term bonds and no better than a pittance on long-terms. When the financial history of this decade is written, it will surely speak of the Internet bubble of the late 1990s and the housing bubble of the early 2000s. But the U.S. Treasury bond bubble of late 2008 may be regarded as almost equally extraordinary.

Clinging to cash equivalents or long-term government bonds at present yields is almost certainly a terrible policy if continued for long. Holders of these instruments, of course, have felt increasingly comfortable – in fact, almost smug – in following this policy as financial turmoil has mounted. They regard their judgment confirmed when they hear commentators proclaim “cash is king,” even though that wonderful cash is earning close to nothing and will surely find its purchasing power eroded over time.

Approval, though, is not the goal of investing. In fact, approval is often counter-productive because it sedates the brain and makes it less receptive to new facts or a re-examination of conclusions formed earlier. Beware the investment activity that produces applause; the great moves are usually greeted by yawns.

Derivatives

Derivatives are dangerous. They have dramatically increased the leverage and risks in our financial system. They have made it almost impossible for investors to understand and analyze our largest commercial banks and investment banks. They allowed Fannie Mae and Freddie Mac to engage in massive misstatements of earnings for years. So indecipherable were Freddie and Fannie that their federal regulator, OFHEO, whose more than 100 employees had no job except the oversight of these two institutions, totally missed their cooking of the books.

Indeed, recent events demonstrate that certain big-name CEOs (or former CEOs) at major financial institutions were simply incapable of managing a business with a huge, complex book of derivatives. Include Charlie and me in this hapless group: When Berkshire purchased General Re in 1998, we knew we could not get our minds around its book of 23,218 derivatives contracts, made with 884 counterparties (many of which we had never heard of). So we decided to close up shop. Though we were under no pressure and were operating in benign markets as we exited, it took us five years and more than \$400 million in losses to largely complete the task. Upon leaving, our feelings about the business mirrored a line in a country song: “I liked you better before I got to know you so well.”

Improved “transparency” – a favorite remedy of politicians, commentators and financial regulators for averting future train wrecks – won’t cure the problems that derivatives pose. I know of no reporting mechanism that would come close to describing and measuring the risks in a huge and complex portfolio of derivatives. Auditors can’t audit these contracts, and regulators can’t regulate them. When I read the pages of “disclosure” in 10-Ks of companies that are entangled with these instruments, all I end up knowing is that I *don’t* know what is going on in their portfolios (and then I reach for some aspirin).

For a case study on regulatory effectiveness, let’s look harder at the Freddie and Fannie example. These giant institutions were created by Congress, which retained control over them, dictating what they could and could not do. To aid its oversight, Congress created OFHEO in 1992, admonishing it to make sure the two behemoths were behaving themselves. With that move, Fannie and Freddie became the most intensely-regulated companies of which I am aware, as measured by manpower assigned to the task.

On June 15, 2003, OFHEO (whose annual reports are available on the Internet) sent its 2002 report to Congress – specifically to its four bosses in the Senate and House, among them none other than Messrs. Sarbanes and Oxley. The report’s 127 pages included a self-congratulatory cover-line: “Celebrating 10 Years of Excellence.” The transmittal letter and report were delivered nine days *after* the CEO and CFO of Freddie had resigned in disgrace and the COO had been fired. No mention of their departures was made in the letter, even while the report concluded, as it always did, that “Both Enterprises were financially sound and well managed.”

In truth, both enterprises had engaged in massive accounting shenanigans for some time. Finally, in 2006, OFHEO issued a 340-page scathing chronicle of the sins of Fannie that, more or less, blamed the fiasco on every party but – you guessed it – Congress and OFHEO.

The Bear Stearns collapse highlights the counterparty problem embedded in derivatives transactions, a time bomb I first discussed in Berkshire’s 2002 report. On April 3, 2008, Tim Geithner, then the able president of the New York Fed, explained the need for a rescue: “The sudden discovery by Bear’s derivative counterparties that important financial positions they had put in place to protect themselves from financial risk were no longer operative would have triggered substantial further dislocation in markets. This would have precipitated a rush by Bear’s counterparties to liquidate the collateral they held against those positions and to attempt to replicate those positions in already very fragile markets.” This is Fedspeak for “We stepped in to avoid a financial chain reaction of unpredictable magnitude.” In my opinion, the Fed was right to do so.

A normal stock or bond trade is completed in a few days with one party getting its cash, the other its securities. Counterparty risk therefore quickly disappears, which means credit problems can’t accumulate. This rapid settlement process is key to maintaining the integrity of markets. That, in fact, is a reason for NYSE and NASDAQ *shortening* the settlement period from five days to three days in 1995.

Derivatives contracts, in contrast, often go unsettled for years, or even decades, with counterparties building up huge claims against each other. “Paper” assets and liabilities – often hard to quantify – become important parts of financial statements though these items will not be validated for many years. Additionally, a frightening web of mutual dependence develops among huge financial institutions. Receivables and payables by the billions become concentrated in the hands of a few large dealers who are apt to be highly-leveraged in other ways as well. Participants seeking to dodge troubles face the same problem as someone seeking to avoid venereal disease: It’s not just whom *you* sleep with, but also whom *they* are sleeping with.

Sleeping around, to continue our metaphor, can actually be useful for large derivatives dealers because it assures them government aid if trouble hits. In other words, only companies having problems that can infect the entire neighborhood – I won’t mention names – are certain to become a concern of the state (an outcome, I’m sad to say, that is proper). From this irritating reality comes *The First Law of Corporate Survival* for ambitious CEOs who pile on leverage and run large and unfathomable derivatives books: Modest incompetence simply won’t do; it’s mindboggling screw-ups that are required.

Considering the ruin I’ve pictured, you may wonder why Berkshire is a party to 251 derivatives contracts (other than those used for operational purposes at MidAmerican and the few left over at Gen Re). The answer is simple: I believe each contract we own was mispriced at inception, sometimes dramatically so. I both initiated these positions and monitor them, a set of responsibilities consistent with my belief that the CEO of any large financial organization *must* be the Chief Risk Officer as well. If we lose money on our derivatives, it will be my fault.

Our derivatives dealings require our counterparties to make payments to us when contracts are initiated. Berkshire therefore always holds the money, which leaves us assuming no meaningful counterparty risk. As of yearend, the payments made to us less losses we have paid – our derivatives “float,” so to speak – totaled \$8.1 billion. This float is similar to insurance float: If we break even on an underlying transaction, we will have enjoyed the use of free money for a long time. Our expectation, though it is far from a sure thing, is that we will do better than break even and that the substantial investment income we earn on the funds will be frosting on the cake.

Only a small percentage of our contracts call for any posting of collateral when the market moves against us. Even under the chaotic conditions existing in last year’s fourth quarter, we had to post less than 1% of our securities portfolio. (When we post collateral, we deposit it with third parties, meanwhile retaining the investment earnings on the deposited securities.) In our 2002 annual report, we warned of the lethal threat that posting requirements create, real-life illustrations of which we witnessed last year at a variety of financial institutions (and, for that matter, at Constellation Energy, which was within hours of bankruptcy when MidAmerican arrived to effect a rescue).

Our contracts fall into four major categories. With apologies to those who are not fascinated by financial instruments, I will explain them in excruciating detail.

- We have added modestly to the “equity put” portfolio I described in last year’s report. Some of our contracts come due in 15 years, others in 20. We must make a payment to our counterparty at maturity if the reference index to which the put is tied is then below what it was at the inception of the contract. Neither party can elect to settle early; it’s only the price on the final day that counts.

To illustrate, we might sell a \$1 billion 15-year put contract on the S&P 500 when that index is at, say, 1300. If the index is at 1170 – down 10% – on the day of maturity, we would pay \$100 million. If it is above 1300, we owe nothing. For us to lose \$1 billion, the index would have to go to zero. In the meantime, the sale of the put would have delivered us a premium – perhaps \$100 million to \$150 million – that we would be free to invest as we wish.

Our put contracts total \$37.1 billion (at current exchange rates) and are spread among four major indices: the S&P 500 in the U.S., the FTSE 100 in the U.K., the Euro Stoxx 50 in Europe, and the Nikkei 225 in Japan. Our first contract comes due on September 9, 2019 and our last on January 24, 2028. We have received premiums of \$4.9 billion, money we have invested. We, meanwhile, have paid nothing, since all expiration dates are far in the future. Nonetheless, we have used Black-Scholes valuation methods to record a yearend liability of \$10 billion, an amount that will change on every reporting date. The two financial items – this estimated loss of \$10 billion minus the \$4.9 billion in premiums we have received – means that we have so far reported a mark-to-market loss of \$5.1 billion from these contracts.

We endorse mark-to-market accounting. I will explain later, however, why I believe the Black-Scholes formula, even though it is the standard for establishing the dollar liability for options, produces strange results when the long-term variety are being valued.

One point about our contracts that is sometimes not understood: For us to lose the full \$37.1 billion we have at risk, all stocks in all four indices would have to go to *zero* on their various termination dates. If, however – as an example – all indices fell 25% from their value at the inception of each contract, and foreign-exchange rates remained as they are today, we would owe about \$9 billion, payable between 2019 and 2028. Between the inception of the contract and those dates, we would have held the \$4.9 billion premium and earned investment income on it.

- The second category we described in last year's report concerns derivatives requiring us to pay when credit losses occur at companies that are included in various high-yield indices. Our standard contract covers a five-year period and involves 100 companies. We modestly expanded our position last year in this category. But, of course, the contracts on the books at the end of 2007 moved one year closer to their maturity. Overall, our contracts now have an average life of $2\frac{1}{3}$ years, with the first expiration due to occur on September 20, 2009 and the last on December 20, 2013.

By yearend we had received premiums of \$3.4 billion on these contracts and paid losses of \$542 million. Using mark-to-market principles, we also set up a liability for future losses that at yearend totaled \$3.0 billion. Thus we had to that point recorded a loss of about \$100 million, derived from our \$3.5 billion total in paid and estimated future losses minus the \$3.4 billion of premiums we received. In our quarterly reports, however, the amount of gain or loss has swung wildly from a profit of \$327 million in the second quarter of 2008 to a loss of \$693 million in the fourth quarter of 2008.

Surprisingly, we made payments on these contracts of only \$97 million last year, far below the estimate I used when I decided to enter into them. This year, however, losses have accelerated sharply with the mushrooming of large bankruptcies. In last year's letter, I told you I expected these contracts to show a profit at expiration. Now, with the recession deepening at a rapid rate, the possibility of an eventual loss has increased. Whatever the result, I will keep you posted.

- In 2008 we began to write “credit default swaps” on individual companies. This is simply credit insurance, similar to what we write in BHAC, except that here we bear the credit risk of corporations rather than of tax-exempt issuers.

If, say, the XYZ company goes bankrupt, and we have written a \$100 million contract, we are obligated to pay an amount that reflects the shrinkage in value of a comparable amount of XYZ's debt. (If, for example, the company's bonds are selling for 30 after default, we would owe \$70 million.) For the typical contract, we receive quarterly payments for five years, after which our insurance expires.

At yearend we had written \$4 billion of contracts covering 42 corporations, for which we receive annual premiums of \$93 million. This is the only derivatives business we write that has any counterparty risk; the party that buys the contract from us must be good for the quarterly premiums it will owe us over the five years. We are unlikely to expand this business to any extent because most buyers of this protection now insist that the seller post collateral, and we will not enter into such an arrangement.

- At the request of our customers, we write a few tax-exempt bond insurance contracts that are similar to those written at BHAC, but that are structured as derivatives. The only meaningful difference between the two contracts is that mark-to-market accounting is required for derivatives whereas standard accrual accounting is required at BHAC.

But this difference can produce some strange results. The bonds covered – in effect, insured – by these derivatives are largely general obligations of states, and we feel good about them. At yearend, however, mark-to-market accounting required us to record a loss of \$631 million on these derivatives contracts. Had we instead insured the same bonds at the same price in BHAC, and used the accrual accounting required at insurance companies, we would have recorded a small *profit* for the year. The two methods by which we insure the bonds will eventually produce the same accounting result. In the short term, however, the variance in reported profits can be substantial.

We have told you before that our derivative contracts, subject as they are to mark-to-market accounting, will produce wild swings in the earnings we report. The ups and downs neither cheer nor bother Charlie and me. Indeed, the “downs” can be helpful in that they give us an opportunity to expand a position on favorable terms. I hope this explanation of our dealings will lead you to think similarly.

* * * * *

The Black-Scholes formula has approached the status of holy writ in finance, and we use it when valuing our equity put options for financial statement purposes. Key inputs to the calculation include a contract’s maturity and strike price, as well as the analyst’s expectations for volatility, interest rates and dividends.

If the formula is applied to extended time periods, however, it can produce absurd results. In fairness, Black and Scholes almost certainly understood this point well. But their devoted followers may be ignoring whatever caveats the two men attached when they first unveiled the formula.

It’s often useful in testing a theory to push it to extremes. So let’s postulate that we sell a 100- year \$1 billion put option on the S&P 500 at a strike price of 903 (the index’s level on 12/31/08). Using the implied volatility assumption for long-dated contracts that we do, and combining that with appropriate interest and dividend assumptions, we would find the “proper” Black-Scholes premium for this contract to be \$2.5 million.

To judge the rationality of that premium, we need to assess whether the S&P will be valued a century from now at less than today. Certainly the dollar will then be worth a small fraction of its present value (at only 2% inflation it will be worth roughly 14¢). So that will be a factor pushing the stated value of the index higher. Far more important, however, is that one hundred years of retained earnings will hugely increase the value of most of the companies in the index. In the 20th Century, the Dow-Jones Industrial Average increased by about 175-fold, mainly because of this retained-earnings factor.

Considering everything, I believe the probability of a decline in the index over a one-hundred-year period to be *far* less than 1%. But let’s use that figure and also assume that the most likely decline – should one occur – is 50%. Under these assumptions, the mathematical expectation of loss on our contract would be \$5 million (\$1 billion X 1% X 50%).

But if we had received our theoretical premium of \$2.5 million up front, we would have only had to invest it at 0.7% compounded annually to cover this loss expectancy. Everything earned above that would have been profit. Would you like to borrow money for 100 years at a 0.7% rate?

Let’s look at my example from a worst-case standpoint. Remember that 99% of the time we would pay nothing if my assumptions are correct. But even in the worst case among the remaining 1% of possibilities – that is, one assuming a *total* loss of \$1 billion – our borrowing cost would come to only 6.2%. Clearly, either my assumptions are crazy or the formula is inappropriate.

The ridiculous premium that Black-Scholes dictates in my extreme example is caused by the inclusion of volatility in the formula and by the fact that volatility is determined by how much stocks have moved around in some past period of days, months or years. This metric is simply irrelevant in estimating the probability-weighted range of values of American business 100 years from now. (Imagine, if you will, getting a quote every day on a farm from a manic-depressive neighbor and then using the volatility calculated from these changing quotes as an important ingredient in an equation that predicts a probability-weighted range of values for the farm a century from now.)

Though historical volatility is a useful – but far from foolproof – concept in valuing short-term options, its utility diminishes rapidly as the duration of the option lengthens. In my opinion, the valuations that the Black-Scholes formula now place on our long-term put options overstate our liability, though the overstatement will diminish as the contracts approach maturity.

Even so, we will continue to use Black-Scholes when we are estimating our financial-statement liability for long-term equity puts. The formula represents conventional wisdom and any substitute that I might offer would engender extreme skepticism. That would be perfectly understandable: CEOs who have concocted their own valuations for esoteric financial instruments have seldom erred on the side of conservatism. That club of optimists is one that Charlie and I have no desire to join.

The Annual Meeting

Our meeting this year will be held on Saturday, May 2nd. As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:00. Then, after a short recess, Charlie and I will convene the annual meeting at 3:15. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course, is to *shop*. We will help you do that by filling the 194,300-square-foot hall that adjoins the meeting area with the products of Berkshire subsidiaries. Last year, the 31,000 people who came to the meeting did their part, and almost every location racked up record sales. But you can do better. (A friendly warning: If I find sales are lagging, I lock the exits.)

This year Clayton will showcase its new *i-house* that includes Shaw flooring, Johns Manville insulation and MiTek fasteners. This innovative “green” home, featuring solar panels and numerous other energy-saving products, is truly a home of the future. Estimated costs for electricity and heating total only about \$1 per day when the home is sited in an area like Omaha. After purchasing the *i-house*, you should next consider the Forest River RV and pontoon boat on display nearby. Make your neighbors jealous.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 50 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can.

On Saturday, at the Omaha airport, we will have the usual array of NetJets aircraft available for your inspection. Stop by the NetJets booth at the Qwest to learn about viewing these planes. Come to Omaha by bus; leave in your new plane. And take along – with no fear of a strip search – the Ginsu knives that you've purchased at the exhibit of our Quikut subsidiary.

Next, if you have any money left, visit the Bookworm, which will be selling about 30 books and DVDs. A shipping service will be available for those whose thirst for knowledge exceeds their carrying capacity.

Finally, we will have three fascinating cars on the exhibition floor, including one from the past and one of the future. Paul Andrews, CEO of our subsidiary, TTI, will bring his 1935 Duesenberg, a car that once belonged to Mrs. Forrest Mars, Sr., parent and grandparent of our new partners in the Wrigley purchase. The future will be represented by a new plug-in electric car developed by BYD, an amazing Chinese company in which we have a 10% interest.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. We initiated this special event at NFM twelve years ago, and sales during the "Weekend" grew from \$5.3 million in 1997 to a record \$33.3 million in 2008. On Saturday of that weekend, we also set a single day record of \$7.2 million. Ask any retailer what he thinks of such volume.

To obtain the Berkshire discount, you must make your purchases between Thursday, April 30th and Monday, May 4th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a western cookout to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, May 1st. The second, the main gala, will be held on Sunday, May 3rd, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 27th through Saturday, May 9th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon.

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 3rd, and will be serving from 1 p.m. until 10 p.m. Last year Gorat's, which seats 240, served 975 dinners on Shareholder Sunday. The three-day total was 2,448 including 702 T-bone steaks, the entrée preferred by the *cognoscenti*. Please don't embarrass me by ordering foie gras. Remember: To come to Gorat's on that day, you must have a reservation. To make one, call 402-551-3733 on April 1st (*but not before*).

We will again have a reception at 4 p.m. on Saturday afternoon for shareholders who have come from outside North America. Every year our meeting draws many people from around the globe, and Charlie and I want to be sure we personally greet those who have come so far. Last year we enjoyed meeting more than 700 of you from many dozens of countries. Any shareholder who comes from outside the U.S. or Canada will be given a special credential and instructions for attending this function.

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This year we will be making important changes in how we handle the meeting's question periods. In recent years, we have received only a handful of questions directly related to Berkshire and its operations. Last year there were practically none. So we need to steer the discussion back to Berkshire's businesses.

In a related problem, there has been a mad rush when the doors open at 7 a.m., led by people who wish to be first in line at the 12 microphones available for questioners. This is not desirable from a safety standpoint, nor do we believe that sprinting ability should be the determinant of who gets to pose questions. (At age 78, I've concluded that speed afoot is a ridiculously overrated talent.) Again, a new procedure is desirable.

In our first change, several financial journalists from organizations representing newspapers, magazines and television will participate in the question-and-answer period, asking Charlie and me questions that shareholders have submitted by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be emailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com. From the questions submitted, each journalist will choose the dozen or so he or she decides are the most interesting and important. (In your e-mail, let the journalist know if you would like your name mentioned if your question is selected.)

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists will pick some tough ones and that's the way we like it.

In our second change, we will have a drawing at 8:15 at each microphone for those shareholders hoping to ask questions themselves. At the meeting, I will alternate the questions asked by the journalists with those from the winning shareholders. At least half the questions – those selected by the panel from your submissions – are therefore certain to be Berkshire-related. We will meanwhile continue to get some good – and perhaps entertaining – questions from the audience as well.

So join us at our Woodstock for Capitalists and let us know how you like the new format. Charlie and I look forward to seeing you.

February 27, 2009

Warren E. Buffett
Chairman of the Board

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
19995	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
Compounded Annual Gain – 1965-2009	20.3%	9.3%	11.0
Overall Gain – 1964-2009	434,057%	5,430%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2009 was \$21.8 billion, which increased the per-share book value of both our Class A and Class B stock by 19.8%. Over the last 45 years (that is, since present management took over) book value has grown from \$19 to \$84,487, a rate of 20.3% compounded annually.*

Berkshire's recent acquisition of Burlington Northern Santa Fe (BNSF) has added at least 65,000 shareholders to the 500,000 or so already on our books. It's important to Charlie Munger, my long-time partner, and me that *all* of our owners understand Berkshire's operations, goals, limitations and culture. In each annual report, consequently, we restate the economic principles that guide us. This year these principles appear on pages 89-94 and I urge all of you – but particularly our new shareholders – to read them. Berkshire has adhered to these principles for decades and will continue to do so long after I'm gone.

In this letter we will also review some of the basics of our business, hoping to provide both a freshman orientation session for our BNSF newcomers and a refresher course for Berkshire veterans.

How We Measure Ourselves

Our metrics for evaluating our managerial performance are displayed on the facing page. From the start, Charlie and I have believed in having a rational and unbending standard for measuring what we have – or have not – accomplished. That keeps us from the temptation of seeing where the arrow of performance lands and *then* painting the bull's eye around it.

Selecting the S&P 500 as our bogey was an easy choice because our shareholders, at virtually no cost, can match its performance by holding an index fund. Why should they pay us for merely duplicating that result?

A more difficult decision for us was how to measure the progress of Berkshire versus the S&P. There are good arguments for simply using the change in our stock price. Over an extended period of time, in fact, that is the best test. But year-to-year market prices can be extraordinarily erratic. Even evaluations covering as long as a decade can be greatly distorted by foolishly high or low prices at the beginning or end of the measurement period. Steve Ballmer, of Microsoft, and Jeff Immelt, of GE, can tell you about that problem, suffering as they do from the nosebleed prices at which their stocks traded when they were handed the managerial baton.

The ideal standard for measuring our yearly progress would be the change in Berkshire's per-share intrinsic value. Alas, that value cannot be calculated with anything close to precision, so we instead use a crude proxy for it: per-share book value. Relying on this yardstick has its shortcomings, which we discuss on pages 92 and 93. Additionally, book value at most companies understates intrinsic value, and that is certainly the case at Berkshire. In aggregate, our businesses are worth considerably more than the values at which they are carried on our books. In our all-important insurance business, moreover, the difference is huge. Even so, Charlie and I believe that our book value – understated though it is – supplies the most useful tracking device for changes in intrinsic value. By this measurement, as the opening paragraph of this letter states, our book value since the start of fiscal 1965 has grown at a rate of 20.3% compounded annually.

*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

We should note that had we instead chosen *market prices* as our yardstick, Berkshire's results would look better, showing a gain since the start of fiscal 1965 of 22% compounded annually. Surprisingly, this modest difference in annual compounding rate leads to an 801,516% market-value gain for the entire 45-year period compared to the book-value gain of 434,057% (shown on page 2). Our market gain is better because in 1965 Berkshire shares sold at an appropriate discount to the book value of its underearning textile assets, whereas today Berkshire shares regularly sell at a premium to the accounting values of its first-class businesses.

Summed up, the table on page 2 conveys three messages, two positive and one hugely negative. First, we have never had *any* five-year period beginning with 1965-69 and ending with 2005-09 – and there have been 41 of these – during which our gain in book value did not exceed the S&P's gain. Second, though we have lagged the S&P in some years that were positive for the market, we have consistently done better than the S&P in the eleven years during which it delivered negative results. In other words, our defense has been better than our offense, and that's likely to continue.

The big minus is that our performance advantage has shrunk dramatically as our size has grown, an unpleasant trend that is *certain* to continue. To be sure, Berkshire has many outstanding businesses and a cadre of truly great managers, operating within an unusual corporate culture that lets them maximize their talents. Charlie and I believe these factors will continue to produce better-than-average results over time. But huge sums forge their own anchor and our future advantage, if any, will be a small fraction of our historical edge.

What We Don't Do

Long ago, Charlie laid out his strongest ambition: "All I want to know is where I'm going to die, so I'll never go there." That bit of wisdom was inspired by Jacobi, the great Prussian mathematician, who counseled "Invert, always invert" as an aid to solving difficult problems. (I can report as well that this inversion approach works on a less lofty level: Sing a country song in reverse, and you will quickly recover your car, house and wife.)

Here are a few examples of how we apply Charlie's thinking at Berkshire:

- Charlie and I avoid businesses whose futures we can't evaluate, no matter how exciting their products may be. In the past, it required no brilliance for people to foresee the fabulous growth that awaited such industries as autos (in 1910), aircraft (in 1930) and television sets (in 1950). But the future then also included competitive dynamics that would decimate almost all of the companies entering those industries. Even the survivors tended to come away bleeding.

Just because Charlie and I can clearly see dramatic growth ahead for an industry does not mean we can judge what its profit margins and returns on capital will be as a host of competitors battle for supremacy. At Berkshire we will stick with businesses whose profit picture for decades to come seems reasonably predictable. Even then, we will make plenty of mistakes.

- We will never become dependent on the kindness of strangers. Too-big-to-fail is not a fallback position at Berkshire. Instead, we will always arrange our affairs so that any requirements for cash we may conceivably have will be dwarfed by our own liquidity. Moreover, that liquidity will be constantly refreshed by a gusher of earnings from our many and diverse businesses.

When the financial system went into cardiac arrest in September 2008, Berkshire was a *supplier* of liquidity and capital to the system, not a supplicant. At the very peak of the crisis, we poured \$15.5 billion into a business world that could otherwise look only to the federal government for help. Of that, \$9 billion went to bolster capital at three highly-regarded and previously-secure American businesses that needed – *without delay* – our tangible vote of confidence. The remaining \$6.5 billion satisfied our commitment to help fund the purchase of Wrigley, a deal that was completed without pause while, elsewhere, panic reigned.

We pay a steep price to maintain our premier financial strength. The \$20 billion-plus of cash-equivalent assets that we customarily hold is earning a pittance at present. But we sleep well.

- We tend to let our many subsidiaries operate on their own, without our supervising and monitoring them to any degree. That means we are sometimes late in spotting management problems and that both operating and capital decisions are occasionally made with which Charlie and I would have disagreed had we been consulted. Most of our managers, however, use the independence we grant them magnificently, rewarding our confidence by maintaining an owner-oriented attitude that is invaluable and too seldom found in huge organizations. We would rather suffer the visible costs of a few bad decisions than incur the many invisible costs that come from decisions made too slowly – or not at all – because of a stifling bureaucracy.

With our acquisition of BNSF, we now have about 257,000 employees and literally hundreds of different operating units. We hope to have many more of each. But we will never allow Berkshire to become some monolith that is overrun with committees, budget presentations and multiple layers of management. Instead, we plan to operate as a collection of separately-managed medium-sized and large businesses, most of whose decision-making occurs at the operating level. Charlie and I will limit ourselves to allocating capital, controlling enterprise risk, choosing managers and setting their compensation.

- We make no attempt to woo Wall Street. Investors who buy and sell based upon media or analyst commentary are not for us. Instead we want *partners* who join us at Berkshire because they wish to make a long-term investment in a *business* they themselves understand and because it's one that follows policies with which they concur. If Charlie and I were to go into a small venture with a few partners, we would seek individuals in sync with us, knowing that common goals and a shared destiny make for a happy business “marriage” between owners and managers. Scaling up to giant size doesn't change that truth.

To build a compatible shareholder population, we try to communicate with our owners directly and informatively. Our goal is to tell you what we would like to know if our positions were reversed. Additionally, we try to post our quarterly and annual financial information on the Internet early on weekends, thereby giving you and other investors plenty of time during a non-trading period to digest just what has happened at our multi-faceted enterprise. (Occasionally, SEC deadlines force a non-Friday disclosure.) These matters simply can't be adequately summarized in a few paragraphs, nor do they lend themselves to the kind of catchy headline that journalists sometimes seek.

Last year we saw, in one instance, how sound-bite reporting can go wrong. Among the 12,830 words in the annual letter was this sentence: “We are certain, for example, that the economy will be in shambles throughout 2009 – and probably well beyond – but that conclusion does not tell us whether the market will rise or fall.” Many news organizations reported – indeed, blared – the first part of the sentence while making no mention whatsoever of its ending. I regard this as terrible journalism: Misinformed readers or viewers may well have thought that Charlie and I were forecasting bad things for the stock market, though we had not only in that sentence, but also elsewhere, made it clear we weren't predicting the market at all. Any investors who were misled by the sensationalists paid a big price: The Dow closed the day of the letter at 7,063 and finished the year at 10,428.

Given a few experiences we've had like that, you can understand why I prefer that our communications with you remain as direct and unabridged as possible.

* * * * *

Let's move to the specifics of Berkshire's operations. We have four major operating sectors, each differing from the others in balance sheet and income account characteristics. Therefore, lumping them together, as is standard in financial statements, impedes analysis. So we'll present them as four separate businesses, which is how Charlie and I view them.

Insurance

Our property-casualty (P/C) insurance business has been the engine behind Berkshire's growth and will continue to be. It has worked wonders for us. We carry our P/C companies on our books at \$15.5 billion more than their net tangible assets, an amount lodged in our "Goodwill" account. These companies, however, are worth *far* more than their carrying value – and the following look at the economic model of the P/C industry will tell you why.

Insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit. Though individual policies and claims come and go, the amount of float we hold remains remarkably stable in relation to premium volume. Consequently, as our business grows, so does our float.

If premiums exceed the total of expenses and eventual losses, we register an underwriting profit that adds to the investment income produced from the float. This combination allows us to enjoy the use of free money – and, better yet, get *paid* for holding it. Alas, the hope of this happy result attracts intense competition, so vigorous in most years as to cause the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Usually this cost is fairly low, but in some catastrophe-ridden years the cost from underwriting losses more than eats up the income derived from use of float.

In my perhaps biased view, Berkshire has the best large insurance operation in the world. And I will absolutely state that we have the best managers. Our float has grown from \$16 million in 1967, when we entered the business, to \$62 billion at the end of 2009. Moreover, we have now operated at an underwriting profit for seven consecutive years. I believe it likely that we will continue to underwrite profitably in most – though certainly not all – future years. If we do so, our float will be cost-free, much as if someone deposited \$62 billion with us that we could invest for our own benefit without the payment of interest.

Let me emphasize again that cost-free float is *not* a result to be expected for the P/C industry as a whole: In most years, premiums have been inadequate to cover claims plus expenses. Consequently, the industry's overall return on tangible equity has for many decades fallen far short of that achieved by the S&P 500. Outstanding economics exist at Berkshire only because we have some outstanding managers running some unusual businesses. Our insurance CEOs deserve your thanks, having added many billions of dollars to Berkshire's value. It's a pleasure for me to tell you about these all-stars.

* * * * *

Let's start at GEICO, which is known to all of you because of its \$800 million annual advertising budget (close to twice that of the runner-up advertiser in the auto insurance field). GEICO is managed by Tony Nicely, who joined the company at 18. Now 66, Tony still tap-dances to the office every day, just as I do at 79. We both feel lucky to work at a business we love.

GEICO's customers have warm feelings toward the company as well. Here's proof: Since Berkshire acquired control of GEICO in 1996, its market share has increased from 2.5% to 8.1%, a gain reflecting the net addition of seven million policyholders. Perhaps they contacted us because they thought our gecko was cute, but they bought from us to save important money. (Maybe you can as well; call 1-800-847-7536 or go to www.GEICO.com.) And they've stayed with us because they like our service as well as our price.

Berkshire acquired GEICO in two stages. In 1976-80 we bought about one-third of the company's stock for \$47 million. Over the years, large repurchases by the company of its own shares caused our position to grow to about 50% without our having bought any more shares. Then, on January 2, 1996, we acquired the remaining 50% of GEICO for \$2.3 billion in cash, about 50 times the cost of our original purchase.

An old Wall Street joke gets close to our experience:

Customer: Thanks for putting me in XYZ stock at 5. I hear it's up to 18.

Broker: Yes, and that's just the beginning. In fact, the company is doing so well now, that it's an even better buy at 18 than it was when you made your purchase.

Customer: Damn, I knew I should have waited.

GEICO's growth may slow in 2010. U.S. vehicle registrations are actually down because of slumping auto sales. Moreover, high unemployment is causing a growing number of drivers to go uninsured. (That's illegal almost everywhere, but if you've lost your job and still want to drive . . .) Our "low-cost producer" status, however, is sure to give us significant gains in the future. In 1995, GEICO was the country's sixth largest auto insurer; now we are number three. The company's float has grown from \$2.7 billion to \$9.6 billion. Equally important, GEICO has operated at an underwriting profit in 13 of the 14 years Berkshire has owned it.

I became excited about GEICO in January 1951, when I first visited the company as a 20-year-old student. Thanks to Tony, I'm even more excited today.

* * * * *

A hugely important event in Berkshire's history occurred on a Saturday in 1985. Ajit Jain came into our office in Omaha – and I immediately knew we had found a superstar. (He had been discovered by Mike Goldberg, now elevated to St. Mike.)

We immediately put Ajit in charge of National Indemnity's small and struggling reinsurance operation. Over the years, he has built this business into a one-of-a-kind giant in the insurance world.

Staffed today by only 30 people, Ajit's operation has set records for transaction size in several areas of insurance. Ajit writes billion-dollar limits – and then keeps every dime of the risk instead of laying it off with other insurers. Three years ago, he took over huge liabilities from Lloyds, allowing it to clean up its relationship with 27,972 participants ("names") who had written problem-ridden policies that at one point threatened the survival of this 322-year-old institution. The premium for that single contract was \$7.1 billion. During 2009, he negotiated a life reinsurance contract that could produce \$50 billion of premium for us over the next 50 or so years.

Ajit's business is just the opposite of GEICO's. At that company, we have millions of small policies that largely renew year after year. Ajit writes relatively few policies, and the mix changes significantly from year to year. Throughout the world, he is known as the man to call when something both very large and unusual needs to be insured.

If Charlie, I and Ajit are ever in a sinking boat – and you can only save one of us – swim to Ajit.

* * * * *

Our third insurance powerhouse is General Re. Some years back this operation was troubled; now it is a gleaming jewel in our insurance crown.

Under the leadership of Tad Montross, General Re had an outstanding underwriting year in 2009, while also delivering us unusually large amounts of float per dollar of premium volume. Alongside General Re's P/C business, Tad and his associates have developed a major life reinsurance operation that has grown increasingly valuable.

Last year General Re finally attained 100% ownership of Cologne Re, which since 1995 has been a key – though only partially-owned – part of our presence around the world. Tad and I will be visiting Cologne in September to thank its managers for their important contribution to Berkshire.

Finally, we own a group of smaller companies, most of them specializing in odd corners of the insurance world. In aggregate, their results have consistently been profitable and, as the table below shows, the float they provide us is substantial. Charlie and I treasure these companies and their managers.

Here is the record of all four segments of our property-casualty and life insurance businesses:

<i>Insurance Operations</i>	<i>Underwriting Profit</i>		<i>Yearend Float</i>	
	<i>2009</i>	<i>(in millions)</i>	<i>2009</i>	<i>2008</i>
General Re	\$ 477	\$ 342	\$21,014	\$21,074
BH Reinsurance	349	1,324	26,223	24,221
GEICO	649	916	9,613	8,454
Other Primary	84	210	5,061	4,739
	<u>\$1,559</u>	<u>\$2,792</u>	<u>\$61,911</u>	<u>\$58,488</u>

* * * * *

And now a painful confession: Last year your chairman closed the book on a very expensive business fiasco entirely of his own making.

For many years I had struggled to think of side products that we could offer our millions of loyal GEICO customers. Unfortunately, I finally succeeded, coming up with a brilliant insight that we should market our own credit card. I reasoned that GEICO policyholders were likely to be good credit risks and, assuming we offered an attractive card, would likely favor us with their business. We got business all right – but of the wrong type.

Our pre-tax losses from credit-card operations came to about \$6.3 million before I finally woke up. We then sold our \$98 million portfolio of troubled receivables for 55¢ on the dollar, losing an additional \$44 million.

GEICO's managers, it should be emphasized, were never enthusiastic about my idea. They warned me that instead of getting the cream of GEICO's customers we would get the ---- well, let's call it the non-cream. I subtly indicated that I was older and wiser.

I was just older.

Regulated Utility Business

Berkshire has an 89.5% interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.8 million end users make it the U.K.'s third largest distributor of electricity; (2) MidAmerican Energy, which serves 725,000 electric customers, primarily in Iowa; (3) Pacific Power and Rocky Mountain Power, serving about 1.7 million electric customers in six western states; and (4) Kern River and Northern Natural pipelines, which carry about 8% of the natural gas consumed in the U.S.

MidAmerican has two terrific managers, Dave Sokol and Greg Abel. In addition, my long-time friend, Walter Scott, along with his family, has a major ownership position in the company. Walter brings extraordinary business savvy to *any* operation. Ten years of working with Dave, Greg and Walter have reinforced my original belief: Berkshire couldn't have better partners. They are truly a dream team.

Somewhat incongruously, MidAmerican also owns the second largest real estate brokerage firm in the U.S., HomeServices of America. This company operates through 21 locally-branded firms that have 16,000 agents. Though last year was again a terrible year for home sales, HomeServices earned a modest sum. It also acquired a firm in Chicago and will add other quality brokerage operations when they are available at sensible prices. A decade from now, HomeServices is likely to be much larger.

Here are some key figures on MidAmerican's operations:

	<i>Earnings (in millions)</i>	
	<i>2009</i>	<i>2008</i>
U.K. utilities	\$ 248	\$ 339
Iowa utility	285	425
Western utilities	788	703
Pipelines	457	595
HomeServices	43	(45)
Other (net)	25	186
Operating earnings before corporate interest and taxes	1,846	2,203
Constellation Energy *	—	1,092
Interest, other than to Berkshire	(318)	(332)
Interest on Berkshire junior debt	(58)	(111)
Income tax	(313)	(1,002)
Net earnings	<u>\$ 1,157</u>	<u>\$ 1,850</u>
Earnings applicable to Berkshire **	\$ 1,071	\$ 1,704
Debt owed to others	19,579	19,145
Debt owed to Berkshire	353	1,087

*Consists of a breakup fee of \$175 million and a profit on our investment of \$917 million.

**Includes interest earned by Berkshire (net of related income taxes) of \$38 in 2009 and \$72 in 2008.

Our regulated electric utilities, offering monopoly service in most cases, operate in a symbiotic manner with the customers in their service areas, with those users depending on us to provide first-class service and invest for their future needs. Permitting and construction periods for generation and major transmission facilities stretch way out, so it is incumbent on us to be far-sighted. We, in turn, look to our utilities' regulators (acting on behalf of our customers) to allow us an appropriate return on the huge amounts of capital we must deploy to meet future needs. We shouldn't expect our regulators to live up to their end of the bargain unless we live up to ours.

Dave and Greg make sure we do just that. National research companies consistently rank our Iowa and Western utilities at or near the top of their industry. Similarly, among the 43 U.S. pipelines ranked by a firm named Mastio, our Kern River and Northern Natural properties tied for second place.

Moreover, we continue to pour huge sums of money into our operations so as to not only prepare for the future but also make these operations more environmentally friendly. Since we purchased MidAmerican ten years ago, it has *never* paid a dividend. We have instead used earnings to improve and expand our properties in each of the territories we serve. As one dramatic example, in the last three years our Iowa and Western utilities have earned \$2.5 billion, while in this same period spending \$3 billion on wind generation facilities.

MidAmerican has consistently kept its end of the bargain with society and, to society's credit, it has reciprocated: With few exceptions, our regulators have promptly allowed us to earn a fair return on the ever-increasing sums of capital we must invest. Going forward, we will do whatever it takes to serve our territories in the manner they expect. We believe that, in turn, we will be allowed the return we deserve on the funds we invest.

In earlier days, Charlie and I shunned capital-intensive businesses such as public utilities. Indeed, the best businesses by far for owners continue to be those that have high returns on capital and that require little incremental investment to grow. We are fortunate to own a number of such businesses, and we would love to buy more. Anticipating, however, that Berkshire will generate ever-increasing amounts of cash, we are today quite willing to enter businesses that regularly require large capital expenditures. We expect only that these businesses have reasonable expectations of earning decent returns on the incremental sums they invest. If our expectations are met – and we believe that they will be – Berkshire's ever-growing collection of good to great businesses should produce above-average, though certainly not spectacular, returns in the decades ahead.

Our BNSF operation, it should be noted, has certain important economic characteristics that resemble those of our electric utilities. In both cases we provide fundamental services that are, and will remain, essential to the economic well-being of our customers, the communities we serve, and indeed the nation. Both will require heavy investment that greatly exceeds depreciation allowances for decades to come. Both must also plan far ahead to satisfy demand that is expected to outstrip the needs of the past. Finally, both require wise regulators who will provide certainty about allowable returns so that we can confidently make the huge investments required to maintain, replace and expand the plant.

We see a “social compact” existing between the public and our railroad business, just as is the case with our utilities. If either side shirks its obligations, both sides will inevitably suffer. Therefore, both parties to the compact should – and we believe will – understand the benefit of behaving in a way that encourages good behavior by the other. It is inconceivable that our country will realize anything close to its full economic potential without its possessing first-class electricity and railroad systems. We will do our part to see that they exist.

In the future, BNSF results will be included in this “regulated utility” section. Aside from the two businesses having similar underlying economic characteristics, both are logical users of substantial amounts of debt that is *not* guaranteed by Berkshire. Both will retain most of their earnings. Both will earn and invest large sums in good times or bad, though the railroad will display the greater cyclicity. Overall, we expect this regulated sector to deliver significantly increased earnings over time, albeit at the cost of our investing many tens – yes, tens – of billions of dollars of incremental equity capital.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/09 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 3,018	Notes payable	\$ 1,842
Accounts and notes receivable	5,066	Other current liabilities	<u>7,414</u>
Inventory	6,147	Total current liabilities	9,256
Other current assets	<u>625</u>		
Total current assets	14,856		
Goodwill and other intangibles	16,499	Deferred taxes	2,834
Fixed assets	15,374	Term debt and other liabilities	6,240
Other assets	<u>2,070</u>	Equity	<u>30,469</u>
	<u>\$48,799</u>		<u>\$48,799</u>

Earnings Statement (in millions)

	2009	2008	2007
Revenues	\$61,665	\$66,099	\$59,100
Operating expenses (including depreciation of \$1,422 in 2009, \$1,280 in 2008 and \$955 in 2007)	59,509	61,937	55,026
Interest expense	<u>98</u>	<u>139</u>	<u>127</u>
Pre-tax earnings	2,058*	4,023*	3,947*
Income taxes and minority interests	<u>945</u>	<u>1,740</u>	<u>1,594</u>
Net income	<u>\$ 1,113</u>	<u>\$ 2,283</u>	<u>\$ 2,353</u>

*Does not include purchase-accounting adjustments.

Almost all of the many and widely-diverse operations in this sector suffered to one degree or another from 2009's severe recession. The major exception was McLane, our distributor of groceries, confections and non-food items to thousands of retail outlets, the largest by far Wal-Mart.

Grady Rosier led McLane to record pre-tax earnings of \$344 million, which even so amounted to only slightly more than one cent per dollar on its huge sales of \$31.2 billion. McLane employs a vast array of physical assets – practically all of which it owns – including 3,242 trailers, 2,309 tractors and 55 distribution centers with 15.2 million square feet of space. McLane's prime asset, however, is Grady.

We had a number of companies at which profits improved even as sales contracted, always an exceptional managerial achievement. Here are the CEOs who made it happen:

<u>COMPANY</u>	<u>CEO</u>
Benjamin Moore (paint)	Denis Abrams
Borsheims (jewelry retailing)	Susan Jacques
H. H. Brown (manufacturing and retailing of shoes)	Jim Issler
CTB (agricultural equipment)	Vic Mancinelli
Dairy Queen	John Gainor
Nebraska Furniture Mart (furniture retailing)	Ron and Irv Blumkin
Pampered Chef (direct sales of kitchen tools)	Marla Gottschalk
See's (manufacturing and retailing of candy)	Brad Kinstler
Star Furniture (furniture retailing)	Bill Kimbrell

Among the businesses we own that have major exposure to the depressed industrial sector, both Marmon and Iscar turned in relatively strong performances. Frank Ptak's Marmon delivered a 13.5% pre-tax profit margin, a record high. Though the company's sales were down 27%, Frank's cost-conscious management mitigated the decline in earnings.

Nothing stops Israel-based Iscar – not wars, recessions or competitors. The world's two other leading suppliers of small cutting tools both had very difficult years, each operating at a loss throughout much of the year. Though Iscar's results were down significantly from 2008, the company regularly reported profits, even while it was integrating and rationalizing Tungaloy, the large Japanese acquisition that we told you about last year. When manufacturing rebounds, Iscar will set new records. Its incredible managerial team of Eitan Wertheimer, Jacob Harpaz and Danny Goldman will see to that.

Every business we own that is connected to residential and commercial construction suffered severely in 2009. Combined pre-tax earnings of Shaw, Johns Manville, Acme Brick, and MiTek were \$227 million, an 82.5% decline from \$1.295 billion in 2006, when construction activity was booming. These businesses continue to bump along the bottom, though their competitive positions remain undented.

The major problem for Berkshire last year was NetJets, an aviation operation that offers fractional ownership of jets. Over the years, it has been enormously successful in establishing itself as the premier company in its industry, with the value of its fleet far exceeding that of its three major competitors *combined*. Overall, our dominance in the field remains unchallenged.

NetJets' business operation, however, has been another story. In the eleven years that we have owned the company, it has recorded an aggregate pre-tax loss of \$157 million. Moreover, the company's debt has soared from \$102 million at the time of purchase to \$1.9 billion in April of last year. Without Berkshire's guarantee of this debt, NetJets would have been out of business. It's clear that I failed you in letting NetJets descend into this condition. But, luckily, I have been bailed out.

Dave Sokol, the enormously talented builder and operator of MidAmerican Energy, became CEO of NetJets in August. His leadership has been transforming: Debt has already been reduced to \$1.4 billion, and, after suffering a staggering loss of \$711 million in 2009, the company is now solidly profitable.

Most important, none of the changes wrought by Dave have in any way undercut the top-of-the-line standards for safety and service that Rich Santulli, NetJets' previous CEO and the father of the fractional-ownership industry, insisted upon. Dave and I have the strongest possible personal interest in maintaining these standards because we and our families use NetJets for almost all of our flying, as do many of our directors and managers. None of us are assigned special planes nor crews. We receive exactly the same treatment as any other owner, meaning we pay the same prices as everyone else does when we are using our personal contracts. In short, we eat our own cooking. In the aviation business, no other testimonial means more.

Finance and Financial Products

Our largest operation in this sector is Clayton Homes, the country's leading producer of modular and manufactured homes. Clayton was not always number one: A decade ago the three leading manufacturers were Fleetwood, Champion and Oakwood, which together accounted for 44% of the output of the industry. All have since gone bankrupt. Total industry output, meanwhile, has fallen from 382,000 units in 1999 to 60,000 units in 2009.

The industry is in shambles for two reasons, the first of which must be lived with if the U.S. economy is to recover. This reason concerns U.S. housing starts (including apartment units). In 2009, starts were 554,000, by far the lowest number in the 50 years for which we have data. Paradoxically, this is *good* news.

People *thought* it was good news a few years back when housing starts – the supply side of the picture – were running about two million annually. But household formations – the demand side – only amounted to about 1.2 million. After a few years of such imbalances, the country unsurprisingly ended up with far too many houses.

There were three ways to cure this overhang: (1) blow up a lot of houses, a tactic similar to the destruction of autos that occurred with the “cash-for-clunkers” program; (2) speed up household formations by, say, encouraging teenagers to cohabit, a program not likely to suffer from a lack of volunteers or; (3) reduce new housing starts to a number far below the rate of household formations.

Our country has wisely selected the third option, which means that within a year or so residential housing problems should largely be behind us, the exceptions being only high-value houses and those in certain localities where overbuilding was particularly egregious. Prices will remain far below “bubble” levels, of course, but for every seller (or lender) hurt by this there will be a buyer who benefits. Indeed, many families that couldn’t afford to buy an appropriate home a few years ago now find it well within their means because the bubble burst.

The second reason that manufactured housing is troubled is specific to the industry: the punitive differential in mortgage rates between factory-built homes and site-built homes. Before you read further, let me underscore the obvious: Berkshire has a dog in this fight, and you should therefore assess the commentary that follows with special care. That warning made, however, let me explain why the rate differential causes problems for both large numbers of lower-income Americans and Clayton.

The residential mortgage market is shaped by government rules that are expressed by FHA, Freddie Mac and Fannie Mae. Their lending standards are all-powerful because the mortgages they insure can typically be securitized and turned into what, in effect, is an obligation of the U.S. government. Currently buyers of conventional site-built homes who qualify for these guarantees can obtain a 30-year loan at about 5 ¼%. In addition, these are mortgages that have recently been purchased in massive amounts by the Federal Reserve, an action that also helped to keep rates at bargain-basement levels.

In contrast, very few factory-built homes qualify for agency-insured mortgages. Therefore, a meritorious buyer of a factory-built home must pay about 9% on his loan. For the all-cash buyer, Clayton’s homes offer terrific value. If the buyer needs mortgage financing, however – and, of course, most buyers do – the difference in financing costs too often negates the attractive price of a factory-built home.

Last year I told you why our buyers – generally people with low incomes – performed so well as credit risks. Their attitude was all-important: They signed up to live in the home, not resell or refinance it. Consequently, our buyers usually took out loans with payments geared to their verified incomes (we weren't making "liar's loans") and looked forward to the day they could burn their mortgage. If they lost their jobs, had health problems or got divorced, we could of course expect defaults. But they seldom walked away simply because house values had fallen. Even today, though job-loss troubles have grown, Clayton's delinquencies and defaults remain reasonable and will not cause us significant problems.

We have tried to qualify more of our customers' loans for treatment similar to those available on the site-built product. So far we have had only token success. Many families with modest incomes but responsible habits have therefore had to forego home ownership simply because the financing differential attached to the factory-built product makes monthly payments too expensive. If qualifications aren't broadened, so as to open low-cost financing to *all* who meet down-payment and income standards, the manufactured-home industry seems destined to struggle and dwindle.

Even under these conditions, I believe Clayton will operate profitably in coming years, though well below its potential. We couldn't have a better manager than CEO Kevin Clayton, who treats Berkshire's interests as if they were his own. Our product is first-class, inexpensive and constantly being improved. Moreover, we will continue to use Berkshire's credit to support Clayton's mortgage program, convinced as we are of its soundness. Even so, Berkshire can't borrow at a rate approaching that available to government agencies. This handicap will limit sales, hurting both Clayton and a multitude of worthy families who long for a low-cost home.

In the following table, Clayton's earnings are net of the company's payment to Berkshire for the use of its credit. Offsetting this cost to Clayton is an identical amount of income credited to Berkshire's finance operation and included in "Other Income." The cost and income amount was \$116 million in 2009 and \$92 million in 2008.

The table also illustrates how severely our furniture (CORT) and trailer (XTRA) leasing operations have been hit by the recession. Though their competitive positions remain as strong as ever, we have yet to see any bounce in these businesses.

	<i>Pre-Tax Earnings</i> <i>(in millions)</i>	
	<i>2009</i>	<i>2008</i>
Net investment income	\$278	\$330
Life and annuity operation	116	23
Leasing operations	14	87
Manufactured-housing finance (Clayton)	187	206
Other income *	186	141
Income before investment and derivatives gains or losses	<u>\$781</u>	<u>\$787</u>

*Includes \$116 million in 2009 and \$92 million in 2008 of fees that Berkshire charges Clayton for the use of Berkshire's credit.

* * * * *

At the end of 2009, we became a 50% owner of Berkadia Commercial Mortgage (formerly known as Capmark), the country's third-largest servicer of commercial mortgages. In addition to servicing a \$235 billion portfolio, the company is an important originator of mortgages, having 25 offices spread around the country. Though commercial real estate will face major problems in the next few years, long-term opportunities for Berkadia are significant.

Our partner in this operation is Leucadia, run by Joe Steinberg and Ian Cumming, with whom we had a terrific experience some years back when Berkshire joined with them to purchase Finova, a troubled finance business. In resolving that situation, Joe and Ian did far more than their share of the work, an arrangement I always encourage. Naturally, I was delighted when they called me to partner again in the Capmark purchase.

Our first venture was also christened Berkadia. So let's call this one Son of Berkadia. Someday I'll be writing you about Grandson of Berkadia.

Investments

Below we show our common stock investments that at yearend had a market value of more than \$1 billion.

<u>Shares</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost *</i>	<i>Market (in millions)</i>
151,610,700	American Express Company	12.7	\$ 1,287	\$ 6,143
225,000,000	BYD Company, Ltd.	9.9	232	1,986
200,000,000	The Coca-Cola Company	8.6	1,299	11,400
37,711,330	ConocoPhillips	2.5	2,741	1,926
28,530,467	Johnson & Johnson	1.0	1,724	1,838
130,272,500	Kraft Foods Inc.	8.8	4,330	3,541
3,947,554	POSCO	5.2	768	2,092
83,128,411	The Procter & Gamble Company	2.9	533	5,040
25,108,967	Sanofi-Aventis	1.9	2,027	1,979
234,247,373	Tesco plc	3.0	1,367	1,620
76,633,426	U.S. Bancorp	4.0	2,371	1,725
39,037,142	Wal-Mart Stores, Inc.	1.0	1,893	2,087
334,235,585	Wells Fargo & Company	6.5	7,394	9,021
	Others		6,680	8,636
	Total Common Stocks Carried at Market		<u>\$34,646</u>	<u>\$59,034</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

In addition, we own positions in non-traded securities of Dow Chemical, General Electric, Goldman Sachs, Swiss Re and Wrigley with an aggregate cost of \$21.1 billion and a carrying value of \$26.0 billion. We purchased these five positions in the last 18 months. Setting aside the significant equity potential they provide us, these holdings deliver us an aggregate of \$2.1 billion annually in dividends and interest. Finally, we owned 76,777,029 shares (22.5%) of BNSF at yearend, which we then carried at \$85.78 per share, but which have subsequently been melded into our purchase of the entire company.

In 2009, our largest sales were in ConocoPhillips, Moody's, Procter & Gamble and Johnson & Johnson (sales of the latter occurring after we had built our position earlier in the year). Charlie and I believe that all of these stocks will likely trade higher in the future. We made some sales early in 2009 to raise cash for our Dow and Swiss Re purchases and late in the year made other sales in anticipation of our BNSF purchase.

We told you last year that very unusual conditions then existed in the corporate and municipal bond markets and that these securities were ridiculously cheap relative to U.S. Treasuries. We backed this view with some purchases, but I should have done far more. Big opportunities come infrequently. When it's raining gold, reach for a bucket, not a thimble.

We entered 2008 with \$44.3 billion of cash-equivalents, and we have since retained operating earnings of \$17 billion. Nevertheless, at yearend 2009, our cash was down to \$30.6 billion (with \$8 billion earmarked for the BNSF acquisition). We've put a lot of money to work during the chaos of the last two years. It's been an ideal period for investors: A climate of fear is their best friend. Those who invest only when commentators are upbeat end up paying a heavy price for meaningless reassurance. In the end, what counts in investing is what you pay for a business – through the purchase of a small piece of it in the stock market – and what that business earns in the succeeding decade or two.

* * * * *

Last year I wrote extensively about our derivatives contracts, which were then the subject of both controversy and misunderstanding. For that discussion, please go to www.berkshirehathaway.com.

We have since changed only a few of our positions. Some credit contracts have run off. The terms of about 10% of our equity put contracts have also changed: Maturities have been shortened and strike prices materially reduced. In these modifications, no money changed hands.

A few points from last year's discussion are worth repeating:

- (1) Though it's no sure thing, I expect our contracts in aggregate to deliver us a profit over their lifetime, even when investment income on the huge amount of float they provide us is excluded in the calculation. Our derivatives float – which is not included in the \$62 billion of insurance float I described earlier – was about \$6.3 billion at yearend.
- (2) Only a handful of our contracts require us to post collateral under any circumstances. At last year's low point in the stock and credit markets, our posting requirement was \$1.7 billion, a small fraction of the derivatives-related float we held. When we do post collateral, let me add, the securities we put up continue to earn money for our account.
- (3) Finally, you should expect large swings in the carrying value of these contracts, items that can affect our reported quarterly earnings in a huge way but that do not affect our cash or investment holdings. That thought certainly fit 2009's circumstances. Here are the pre-tax quarterly gains and losses from derivatives valuations that were part of our reported earnings last year:

<u>Quarter</u>	<u>\$ Gain (Loss) in Billions</u>
1	(1.517)
2	2.357
3	1.732
4	1.052

As we've explained, these wild swings neither cheer nor bother Charlie and me. When we report to you, we will continue to separate out these figures (as we do realized investment gains and losses) so that you can more clearly view the earnings of our operating businesses. We are delighted that we hold the derivatives contracts that we do. To date we have significantly profited from the float they provide. We expect also to earn further investment income over the life of our contracts.

We have long invested in derivatives contracts that Charlie and I think are mispriced, just as we try to invest in mispriced stocks and bonds. Indeed, we first reported to you that we held such contracts in early 1998. The dangers that derivatives pose for both participants and society – dangers of which we've long warned, and that can be dynamite – arise when these contracts lead to leverage and/or counterparty risk that is extreme. At Berkshire nothing like that has occurred – nor will it.

It's my job to keep Berkshire far away from such problems. Charlie and I believe that a CEO must not delegate risk control. It's simply too important. At Berkshire, I both initiate and monitor *every* derivatives contract on our books, with the exception of operations-related contracts at a few of our subsidiaries, such as MidAmerican, and the minor runoff contracts at General Re. If Berkshire ever gets in trouble, it will be *my* fault. It will not be because of misjudgments made by a Risk Committee or Chief Risk Officer.

* * * * *

In my view a board of directors of a huge financial institution is *derelict* if it does not insist that its CEO bear full responsibility for risk control. If he's incapable of handling that job, he should look for other employment. And if he fails at it – with the government thereupon required to step in with funds or guarantees – the financial consequences for him and his board should be severe.

It has not been shareholders who have botched the operations of some of our country's largest financial institutions. Yet they have borne the burden, with 90% or more of the value of their holdings wiped out in most cases of failure. Collectively, they have lost more than \$500 billion in just the four largest financial fiascos of the last two years. To say these *owners* have been "bailed-out" is to make a mockery of the term.

The CEOs and directors of the failed companies, however, have largely gone unscathed. Their fortunes may have been diminished by the disasters they oversaw, but they still live in grand style. It is the behavior of these CEOs and directors that needs to be changed: If their institutions and the country are harmed by their recklessness, they should pay a heavy price – one not reimbursable by the companies they've damaged nor by insurance. CEOs and, in many cases, directors have long benefitted from oversized financial carrots; some *meaningful* sticks now need to be part of their employment picture as well.

An Inconvenient Truth (Boardroom Overheating)

Our subsidiaries made a few small "bolt-on" acquisitions last year for cash, but our blockbuster deal with BNSF required us to issue about 95,000 Berkshire shares that amounted to 6.1% of those previously outstanding. Charlie and I enjoy issuing Berkshire stock about as much as we relish prepping for a colonoscopy.

The reason for our distaste is simple. If we wouldn't dream of selling Berkshire in its entirety at the current market price, why in the world should we "sell" a significant part of the company at that same inadequate price by issuing our stock in a merger?

In evaluating a stock-for-stock offer, shareholders of the target company quite understandably focus on the market price of the acquirer's shares that are to be given them. But they also expect the transaction to deliver them the *intrinsic* value of their own shares – the ones they are giving up. If shares of a prospective acquirer are selling below their intrinsic value, it's impossible for that buyer to make a sensible deal in an all-stock deal. You simply can't exchange an undervalued stock for a fully-valued one without hurting your shareholders.

Imagine, if you will, Company A and Company B, of equal size and both with businesses intrinsically worth \$100 per share. Both of their stocks, however, sell for \$80 per share. The CEO of A, long on confidence and short on smarts, offers 1 1/4 shares of A for each share of B, correctly telling his directors that B is worth \$100 per share. He will neglect to explain, though, that what he is giving will cost his shareholders \$125 in intrinsic value. If the directors are mathematically challenged as well, and a deal is therefore completed, the shareholders of B will end up owning 55.6% of A & B's combined assets and A's shareholders will own 44.4%. Not everyone at A, it should be noted, is a loser from this nonsensical transaction. Its CEO now runs a company twice as large as his original domain, in a world where size tends to correlate with both prestige and compensation.

If an acquirer's stock is overvalued, it's a different story: Using it as a currency works to the acquirer's advantage. That's why bubbles in various areas of the stock market have invariably led to serial issuances of stock by sly promoters. Going by the market value of their stock, they can afford to overpay because they are, in effect, using counterfeit money. Periodically, many air-for-assets acquisitions have taken place, the late 1960s having been a particularly obscene period for such chicanery. Indeed, certain large companies were built in this way. (No one involved, of course, ever publicly acknowledges the reality of what is going on, though there is plenty of private snickering.)

In our BNSF acquisition, the selling shareholders quite properly evaluated our offer at \$100 per share. The cost to us, however, was somewhat higher since 40% of the \$100 was delivered in our shares, which Charlie and I believed to be worth more than their market value. Fortunately, we had long owned a substantial amount of BNSF stock that we purchased in the market for cash. All told, therefore, only about 30% of our cost overall was paid with Berkshire shares.

In the end, Charlie and I decided that the disadvantage of paying 30% of the price through stock was offset by the opportunity the acquisition gave us to deploy \$22 billion of cash in a business we understood and liked for the long term. It has the additional virtue of being run by Matt Rose, whom we trust and admire. We also like the prospect of investing additional billions over the years at reasonable rates of return. But the final decision was a close one. If we had needed to use more stock to make the acquisition, it would in fact have made no sense. We would have then been giving up more than we were getting.

* * * * *

I have been in dozens of board meetings in which acquisitions have been deliberated, often with the directors being instructed by high-priced investment bankers (are there any other kind?). Invariably, the bankers give the board a detailed assessment of the value of the company being purchased, with emphasis on why it is worth far more than its market price. In more than fifty years of board memberships, however, never have I heard the investment bankers (or management!) discuss the true value of what is being *given*. When a deal involved the issuance of the acquirer's stock, they simply used market value to measure the cost. *They did this even though they would have argued that the acquirer's stock price was woefully inadequate – absolutely no indicator of its real value – had a takeover bid for the acquirer instead been the subject up for discussion.*

When stock is the currency being contemplated in an acquisition and when directors are hearing from an advisor, it appears to me that there is only one way to get a rational and balanced discussion. Directors should hire a second advisor to make the case *against* the proposed acquisition, with its fee contingent on the deal *not* going through. Absent this drastic remedy, our recommendation in respect to the use of advisors remains: "Don't ask the barber whether you need a haircut."

* * * * *

I can't resist telling you a true story from long ago. We owned stock in a large well-run bank that for decades had been statutorily prevented from acquisitions. Eventually, the law was changed and our bank immediately began looking for possible purchases. Its managers – fine people and able bankers – not unexpectedly began to behave like teenage boys who had just discovered girls.

They soon focused on a much smaller bank, also well-run and having similar financial characteristics in such areas as return on equity, interest margin, loan quality, etc. Our bank sold at a modest price (that's why we had bought into it), hovering near book value and possessing a very low price/earnings ratio. Alongside, though, the small-bank owner was being wooed by other large banks in the state and was holding out for a price close to three times book value. Moreover, he wanted stock, not cash.

Naturally, our fellows caved in and agreed to this value-destroying deal. "We need to show that we are in the hunt. Besides, it's only a small deal," they said, as if only *major* harm to shareholders would have been a legitimate reason for holding back. Charlie's reaction at the time: "Are we supposed to applaud because the dog that fouls our lawn is a Chihuahua rather than a Saint Bernard?"

The seller of the smaller bank – no fool – then delivered one final demand in his negotiations. “After the merger,” he in effect said, perhaps using words that were phrased more diplomatically than these, “I’m going to be a large shareholder of your bank, and it will represent a huge portion of my net worth. You have to promise me, therefore, that you’ll never again do a deal this dumb.”

Yes, the merger went through. The owner of the small bank became richer, we became poorer, and the managers of the big bank – newly bigger – lived happily ever after.

The Annual Meeting

Our best guess is that 35,000 people attended the annual meeting last year (up from 12 – *no* zeros omitted – in 1981). With our shareholder population much expanded, we expect even more this year. Therefore, we will have to make a few changes in the usual routine. There will be no change, however, in our enthusiasm for having you attend. Charlie and I like to meet you, answer your questions and – best of all – have you *buy* lots of goods from our businesses.

The meeting this year will be held on Saturday, May 1st. As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest’s stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day’s question periods, please do so while *Charlie* is talking. (Act fast; he can be terse.)

The best reason to exit, of course, is to *shop*. We will help you do that by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. But you can do better. (A friendly warning: If I find sales are lagging, I get testy and lock the exits.)

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can.

Be sure to visit the Bookworm. Among the more than 30 books and DVDs it will offer are two new books by my sons: Howard’s *Fragile*, a volume filled with photos and commentary about lives of struggle around the globe and Peter’s *Life Is What You Make It*. Completing the family trilogy will be the debut of my sister Doris’s biography, a story focusing on her remarkable philanthropic activities. Also available will be *Poor Charlie’s Almanack*, the story of my partner. This book is something of a publishing miracle – never advertised, yet year after year selling many thousands of copies from its Internet site. (Should you need to ship your book purchases, a nearby shipping service will be available.)

If you are a big spender – or, for that matter, merely a gawker – visit Elliott Aviation on the east side of the Omaha airport between noon and 5:00 p.m. on Saturday. There we will have a fleet of NetJets aircraft that will get your pulse racing.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” discount pricing. To obtain the Berkshire discount, you must make your purchases between Thursday, April 29th and Monday, May 3rd inclusive, and also present your meeting credential. The period’s special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a Berkylle BBQ to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, April 30th. The second, the main gala, will be held on Sunday, May 2nd, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 26th through Saturday, May 8th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder. Enter with rhinestones; leave with diamonds. My daughter tells me that the more you buy, the more you save (kids say the darnedest things).

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers.

Our special treat for shareholders this year will be the return of my friend, Ariel Hsing, the country’s top-ranked junior table tennis player (and a good bet to win at the Olympics some day). Now 14, Ariel came to the annual meeting four years ago and demolished all comers, including me. (You can witness my humiliating defeat on YouTube; just type in Ariel Hsing Berkshire.)

Naturally, I’ve been plotting a comeback and will take her on outside of Borsheims at 1:00 p.m. on Sunday. It will be a three-point match, and after I soften her up, all shareholders are invited to try their luck at similar three-point contests. Winners will be given a box of See’s candy. We will have equipment available, but bring your own paddle if you think it will help. (It won’t.)

Gorat’s will again be open exclusively for Berkshire shareholders on Sunday, May 2nd, and will be serving from 1 p.m. until 10 p.m. Last year, though, it was overwhelmed by demand. With many more diners expected this year, I’ve asked my friend, Donna Sheehan, at Piccolo’s – another favorite restaurant of mine – to serve shareholders on Sunday as well. (Piccolo’s giant root beer float is mandatory for any fan of fine dining.) I plan to eat at both restaurants: All of the weekend action makes me *really* hungry, and I have favorite dishes at each spot. Remember: To make a reservation at Gorat’s, call 402-551-3733 on April 1st (*but not before*) and at Piccolo’s call 402-342-9038.

Regrettably, we will not be able to have a reception for international visitors this year. Our count grew to about 800 last year, and my simply signing one item per person took about 2½ hours. Since we expect even more international visitors this year, Charlie and I decided we must drop this function. But be assured, we welcome every international visitor who comes.

Last year we changed our method of determining what questions would be asked at the meeting and received many dozens of letters applauding the new arrangement. We will therefore again have the same three financial journalists lead the question-and-answer period, asking Charlie and me questions that shareholders have submitted to them by e-mail.

The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be e-mailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com. From the questions submitted, each journalist will choose the dozen or so he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is selected.)

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists will pick some tough ones and that's the way we like it.

We will again have a drawing at 8:15 on Saturday at each of 13 microphones for those shareholders wishing to ask questions themselves. At the meeting, I will alternate the questions asked by the journalists with those from the winning shareholders. We've added 30 minutes to the question time and will probably have time for about 30 questions from each group.

* * * * *

At 86 and 79, Charlie and I remain lucky beyond our dreams. We were born in America; had terrific parents who saw that we got good educations; have enjoyed wonderful families and great health; and came equipped with a "business" gene that allows us to prosper in a manner hugely disproportionate to that experienced by many people who contribute as much or more to our society's well-being. Moreover, we have long had jobs that we love, in which we are helped in countless ways by talented and cheerful associates. Indeed, over the years, our work has become ever more fascinating; no wonder we tap-dance to work. If pushed, we would gladly pay substantial sums to have our jobs (but don't tell the Comp Committee).

Nothing, however, is more fun for us than getting together with our shareholder-partners at Berkshire's annual meeting. So join us on May 1st at the Qwest for our annual Woodstock for Capitalists. We'll see you there.

February 26, 2010

Warren E. Buffett
Chairman of the Board

P.S. Come by rail.

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
19995	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
2010	13.0	15.1	(2.1)
Compounded Annual Gain – 1965-2010	20.2%	9.4%	10.8
Overall Gain – 1964-2010	490,409%	6,262%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

The per-share book value of both our Class A and Class B stock increased by 13% in 2010. Over the last 46 years (that is, since present management took over), book value has grown from \$19 to \$95,453, a rate of 20.2% compounded annually.*

The highlight of 2010 was our acquisition of Burlington Northern Santa Fe, a purchase that's working out even better than I expected. It now appears that owning this railroad will increase Berkshire's "normal" earning power by nearly 40% pre-tax and by well over 30% after-tax. Making this purchase increased our share count by 6% and used \$22 billion of cash. Since we've quickly replenished the cash, the economics of this transaction have turned out very well.

A "normal year," of course, is not something that either Charlie Munger, Vice Chairman of Berkshire and my partner, or I can define with anything like precision. But for the purpose of estimating our current earning power, we are envisioning a year free of a mega-catastrophe in insurance and possessing a general business climate somewhat better than that of 2010 but weaker than that of 2005 or 2006. Using these assumptions, and several others that I will explain in the "Investment" section, I can estimate that the normal earning power of the assets we currently own is about \$17 billion pre-tax and \$12 billion after-tax, excluding any capital gains or losses. Every day Charlie and I think about how we can build on this base.

Both of us are enthusiastic about BNSF's future because railroads have major cost and environmental advantages over trucking, their main competitor. Last year BNSF moved each ton of freight it carried a record 500 miles on a single gallon of diesel fuel. That's *three* times more fuel-efficient than trucking is, which means our railroad owns an important advantage in operating costs. Concurrently, our country gains because of reduced greenhouse emissions and a much smaller need for imported oil. When traffic travels by rail, society benefits.

Over time, the movement of goods in the United States will increase, and BNSF should get its full share of the gain. The railroad will need to invest massively to bring about this growth, but no one is better situated than Berkshire to supply the funds required. However slow the economy, or chaotic the markets, our checks will clear.

Last year – in the face of widespread pessimism about our economy – we demonstrated our enthusiasm for capital investment at Berkshire by spending \$6 billion on property and equipment. Of this amount, \$5.4 billion – or 90% of the total – was spent in the United States. Certainly our businesses will expand abroad in the future, but an overwhelming part of their future investments will be at home. In 2011, we will set a new record for capital spending – \$8 billion – and spend *all* of the \$2 billion increase in the United States.

Money will always flow toward opportunity, and there is an abundance of that in America. Commentators today often talk of "great uncertainty." But think back, for example, to December 6, 1941, October 18, 1987 and September 10, 2001. No matter how serene today may be, tomorrow is *always* uncertain.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

Don't let that reality spook you. Throughout my lifetime, politicians and pundits have constantly moaned about terrifying problems facing America. Yet our citizens now live an astonishing six times better than when I was born. The prophets of doom have overlooked the all-important factor that *is* certain: Human potential is far from exhausted, and the American system for unleashing that potential – a system that has worked wonders for over two centuries despite frequent interruptions for recessions and even a Civil War – remains alive and effective.

We are not natively smarter than we were when our country was founded nor do we work harder. But look around you and see a world beyond the dreams of any colonial citizen. Now, as in 1776, 1861, 1932 and 1941, America's best days lie ahead.

Performance

Charlie and I believe that those entrusted with handling the funds of others should establish performance goals at the onset of their stewardship. Lacking such standards, managements are tempted to shoot the arrow of performance and then paint the bull's-eye around wherever it lands.

In Berkshire's case, we long ago told you that our job is to increase per-share intrinsic value at a rate greater than the increase (including dividends) of the S&P 500. In some years we succeed; in others we fail. But, if we are unable over time to reach that goal, we have done nothing for our investors, who by themselves could have realized an equal or better result by owning an index fund.

The challenge, of course, is the calculation of intrinsic value. Present that task to Charlie and me separately, and you will get two different answers. Precision just isn't possible.

To eliminate subjectivity, we therefore use an *understated* proxy for intrinsic-value – book value – when measuring our performance. To be sure, some of our businesses are worth far more than their carrying value on our books. (Later in this report, we'll present a case study.) But since that premium seldom swings wildly from year to year, book value can serve as a reasonable device for tracking how we are doing.

The table on [page 2](#) shows our 46-year record against the S&P, a performance quite good in the earlier years and now only satisfactory. The bountiful years, we want to emphasize, will never return. The huge sums of capital we currently manage eliminate *any* chance of exceptional performance. We will strive, however, for better-than-average results and feel it fair for you to hold us to that standard.

Yearly figures, it should be noted, are neither to be ignored nor viewed as all-important. The pace of the earth's movement around the sun is not synchronized with the time required for either investment ideas or operating decisions to bear fruit. At GEICO, for example, we enthusiastically spent \$900 million last year on advertising to obtain policyholders who deliver us no immediate profits. If we could spend twice that amount productively, we would happily do so though short-term results would be further penalized. Many large investments at our railroad and utility operations are also made with an eye to payoffs well down the road.

To provide you a longer-term perspective on performance, we present on the [facing page](#) the yearly figures from page 2 recast into a series of five-year periods. Overall, there are 42 of these periods, and they tell an interesting story. On a comparative basis, our best years ended in the early 1980s. The *market's* golden period, however, came in the 17 following years, with Berkshire achieving stellar absolute returns even as our relative advantage narrowed.

After 1999, the market stalled (or have you already noticed that?). Consequently, the satisfactory performance relative to the S&P that Berkshire has achieved since then has delivered only moderate absolute results.

Looking forward, we hope to average several points better than the S&P – though that result is, of course, far from a sure thing. If we succeed in that aim, we will almost certainly produce better relative results in bad years for the stock market and suffer poorer results in strong markets.

Berkshire's Corporate Performance vs. the S&P 500 by Five-Year Periods

Five-Year Period	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965-1969	17.2	5.0	12.2
1966-1970	14.7	3.9	10.8
1967-1971	13.9	9.2	4.7
1968-1972	16.8	7.5	9.3
1969-1973	17.7	2.0	15.7
1970-1974	15.0	(2.4)	17.4
1971-1975	13.9	3.2	10.7
1972-1976	20.8	4.9	15.9
1973-1977	23.4	(0.2)	23.6
1974-1978	24.4	4.3	20.1
1975-1979	30.1	14.7	15.4
1976-1980	33.4	13.9	19.5
1977-1981	29.0	8.1	20.9
1978-1982	29.9	14.1	15.8
1979-1983	31.6	17.3	14.3
1980-1984	27.0	14.8	12.2
1981-1985	32.6	14.6	18.0
1982-1986	31.5	19.8	11.7
1983-1987	27.4	16.4	11.0
1984-1988	25.0	15.2	9.8
1985-1989	31.1	20.3	10.8
1986-1990	22.9	13.1	9.8
1987-1991	25.4	15.3	10.1
1988-1992	25.6	15.8	9.8
1989-1993	24.4	14.5	9.9
1990-1994	18.6	8.7	9.9
1991-1995	25.6	16.5	9.1
1992-1996	24.2	15.2	9.0
1993-1997	26.9	20.2	6.7
1994-1998	33.7	24.0	9.7
1995-1999	30.4	28.5	1.9
1996-2000	22.9	18.3	4.6
1997-2001	14.8	10.7	4.1
1998-2002	10.4	(0.6)	11.0
1999-2003	6.0	(0.6)	6.6
2000-2004	8.0	(2.3)	10.3
2001-2005	8.0	0.6	7.4
2002-2006	13.1	6.2	6.9
2003-2007	13.3	12.8	0.5
2004-2008	6.9	(2.2)	9.1
2005-2009	8.6	0.4	8.2
2006-2010	10.0	2.3	7.7

Notes: The first two periods cover the five years beginning September 30 of the previous year. The third period covers 63 months beginning September 30, 1966 to December 31, 1971. All other periods involve calendar years.

The other notes on page 2 also apply to this table.

Intrinsic Value – Today and Tomorrow

Though Berkshire's intrinsic value cannot be precisely calculated, two of its three key pillars can be measured. Charlie and I rely heavily on these measurements when we make our own estimates of Berkshire's value.

The first component of value is our investments: stocks, bonds and cash equivalents. At yearend these totaled \$158 billion at market value.

Insurance float – money we temporarily hold in our insurance operations that does not belong to us – funds \$66 billion of our investments. This float is “free” as long as insurance underwriting breaks even, meaning that the premiums we receive equal the losses and expenses we incur. Of course, underwriting results are volatile, swinging erratically between profits and losses. Over our entire history, though, we've been significantly profitable, and I also expect us to average breakeven results or better in the future. If we do that, all of our investments – those funded both by float and by retained earnings – can be viewed as an element of value for Berkshire shareholders.

Berkshire's second component of value is earnings that come from sources other than investments and insurance underwriting. These earnings are delivered by our 68 non-insurance companies, itemized on page 106. In Berkshire's early years, we focused on the investment side. During the past two decades, however, we've increasingly emphasized the development of earnings from non-insurance businesses, a practice that will continue.

The following tables illustrate this shift. In the first table, we present per-share investments at decade intervals beginning in 1970, three years after we entered the insurance business. We exclude those investments applicable to minority interests.

<i>Yearend</i>	<i>Per-Share Investments</i>	<i>Period</i>	<i>Compounded Annual Increase in Per-Share Investments</i>
1970	\$ 66		
1980	754	1970-1980	27.5%
1990	7,798	1980-1990	26.3%
2000	50,229	1990-2000	20.5%
2010	94,730	2000-2010	6.6%

Though our compounded annual increase in per-share investments was a healthy 19.9% over the 40-year period, our rate of increase has slowed sharply as we have focused on using funds to buy operating businesses.

The payoff from this shift is shown in the following table, which illustrates how earnings of our non-insurance businesses have increased, again on a per-share basis and after applicable minority interests.

<i>Year</i>	<i>Per-Share Pre-Tax Earnings</i>	<i>Period</i>	<i>Compounded Annual Increase in Per-Share Pre-Tax Earnings</i>
1970	\$ 2.87		
1980	19.01	1970-1980	20.8%
1990	102.58	1980-1990	18.4%
2000	918.66	1990-2000	24.5%
2010	5,926.04	2000-2010	20.5%

For the forty years, our compounded annual gain in pre-tax, non-insurance earnings per share is 21.0%. During the same period, Berkshire's stock price increased at a rate of 22.1% annually. Over time, you can expect our stock price to move in rough tandem with Berkshire's investments and earnings. Market price and intrinsic value often follow very different paths – sometimes for extended periods – but eventually they meet.

There is a third, more subjective, element to an intrinsic value calculation that can be either positive or negative: the efficacy with which retained earnings will be deployed in the future. We, as well as many other businesses, are likely to retain earnings over the next decade that will equal, or even exceed, the capital we presently employ. Some companies will turn these retained dollars into fifty-cent pieces, others into two-dollar bills.

This “what-will-they-do-with-the-money” factor must always be evaluated along with the “what-do-we-have-now” calculation in order for us, or anybody, to arrive at a sensible estimate of a company’s intrinsic value. That’s because an outside investor stands by helplessly as management reinvests his share of the company’s earnings. If a CEO can be expected to do this job well, the reinvestment prospects add to the company’s current value; if the CEO’s talents or motives are suspect, today’s value must be discounted. The difference in outcome can be huge. A dollar of then-value in the hands of Sears Roebuck’s or Montgomery Ward’s CEOs in the late 1960s had a far different destiny than did a dollar entrusted to Sam Walton.

* * * * *

Charlie and I hope that the per-share earnings of our non-insurance businesses continue to increase at a decent rate. But the job gets tougher as the numbers get larger. We will need both good performance from our current businesses and more *major* acquisitions. We’re prepared. Our elephant gun has been reloaded, and my trigger finger is itchy.

Partially offsetting our anchor of size are several important advantages we have. First, we possess a cadre of truly skilled managers who have an unusual commitment to their own operations and to Berkshire. Many of our CEOs are independently wealthy and work only because they love what they do. They are volunteers, not mercenaries. Because no one can offer them a job they would enjoy more, they can’t be lured away.

At Berkshire, managers can focus on running their businesses: They are not subjected to meetings at headquarters nor financing worries nor Wall Street harassment. They simply get a letter from me every two years (it’s reproduced on [pages 104-105](#)) and call me when they wish. And their wishes do differ: There are managers to whom I have not talked in the last year, while there is one with whom I talk almost daily. Our trust is in people rather than process. A “hire well, manage little” code suits both them and me.

Berkshire’s CEOs come in many forms. Some have MBAs; others never finished college. Some use budgets and are by-the-book types; others operate by the seat of their pants. Our team resembles a baseball squad composed of all-stars having vastly different batting styles. Changes in our line-up are seldom required.

Our second advantage relates to the allocation of the money our businesses earn. After meeting the needs of those businesses, we have very substantial sums left over. Most companies limit themselves to reinvesting funds within the industry in which they have been operating. That often restricts them, however, to a “universe” for capital allocation that is both tiny and quite inferior to what is available in the wider world. Competition for the few opportunities that *are* available tends to become fierce. The seller has the upper hand, as a girl might if she were the only female at a party attended by many boys. That lopsided situation would be great for the girl, but terrible for the boys.

At Berkshire we face no institutional restraints when we deploy capital. Charlie and I are limited only by our ability to understand the likely future of a possible acquisition. If we clear that hurdle – and frequently we can’t – we are then able to compare any one opportunity against a host of others.

When I took control of Berkshire in 1965, I didn't exploit this advantage. Berkshire was then only in textiles, where it had in the previous decade lost significant money. The dumbest thing I could have done was to pursue "opportunities" to improve and expand the existing textile operation – so for years that's exactly what I did. And then, in a final burst of brilliance, I went out and bought *another* textile company. Aaaaaaargh! Eventually I came to my senses, heading first into insurance and then into other industries.

There is even a supplement to this world-is-our-oyster advantage: In addition to evaluating the attractions of one business against a host of others, we also measure businesses against opportunities available in marketable securities, a comparison most managements don't make. Often, businesses are priced ridiculously high against what can likely be earned from investments in stocks or bonds. At such moments, we buy securities and bide our time.

Our flexibility in respect to capital allocation has accounted for much of our progress to date. We have been able to take money we earn from, say, See's Candies or Business Wire (two of our best-run businesses, but also two offering limited reinvestment opportunities) and use it as part of the stake we needed to buy BNSF.

Our final advantage is the hard-to-duplicate culture that permeates Berkshire. And in businesses, culture counts.

To start with, the directors who represent you think and act like owners. They receive token compensation: no options, no restricted stock and, for that matter, virtually no cash. We do not provide them directors and officers liability insurance, a given at almost every other large public company. If they mess up with your money, they will lose their money as well. Leaving my holdings aside, directors and their families own Berkshire shares worth more than \$3 billion. Our directors, therefore, monitor Berkshire's actions and results with keen interest and an owner's eye. You and I are lucky to have them as stewards.

This same owner-orientation prevails among our managers. In many cases, these are people who have sought out Berkshire as an acquirer for a business that they and their families have long owned. They came to us with an owner's mindset, and we provide an environment that encourages them to retain it. Having managers who love their businesses is no small advantage.

Cultures self-propagate. Winston Churchill once said, "You shape your houses and then they shape you." That wisdom applies to businesses as well. Bureaucratic procedures beget more bureaucracy, and imperial corporate palaces induce imperious behavior. (As one wag put it, "You know you're no longer CEO when you get in the back seat of your car and it doesn't move.") At Berkshire's "World Headquarters" our annual rent is \$270,212. Moreover, the home-office investment in furniture, art, Coke dispenser, lunch room, high-tech equipment – you name it – totals \$301,363. As long as Charlie and I treat your money as if it were our own, Berkshire's managers are likely to be careful with it as well.

Our compensation programs, our annual meeting and even our annual reports are all designed with an eye to reinforcing the Berkshire culture, and making it one that will repel and expel managers of a different bent. This culture grows stronger every year, and it will remain intact long after Charlie and I have left the scene.

We will need all of the strengths I've just described to do reasonably well. Our managers will deliver; you can count on that. But whether Charlie and I can hold up our end in capital allocation depends in part on the competitive environment for acquisitions. You will get our best efforts.

GEICO

Now let me tell you a story that will help you understand how the intrinsic value of a business can far exceed its book value. Relating this tale also gives me a chance to relive some great memories.

Sixty years ago last month, GEICO entered my life, destined to shape it in a huge way. I was then a 20-year-old graduate student at Columbia, having elected to go there because my hero, Ben Graham, taught a once-a-week class at the school.

One day at the library, I checked out Ben's entry in Who's Who in America and found he was chairman of Government Employees Insurance Co. (now called GEICO). I knew nothing of insurance and had never heard of the company. The librarian, however, steered me to a large compendium of insurers and, after reading the page on GEICO, I decided to visit the company. The following Saturday, I boarded an early train for Washington.

Alas, when I arrived at the company's headquarters, the building was closed. I then rather frantically started pounding on a door, until finally a janitor appeared. I asked him if there was anyone in the office I could talk to, and he steered me to the only person around, Lorimer Davidson.

That was my lucky moment. During the next four hours, "Davy" gave me an education about both insurance and GEICO. It was the beginning of a wonderful friendship. Soon thereafter, I graduated from Columbia and became a stock salesman in Omaha. GEICO, of course, was my prime recommendation, which got me off to a great start with dozens of customers. GEICO also jump-started my net worth because, soon after meeting Davy, I made the stock 75% of my \$9,800 investment portfolio. (Even so, I felt *over*-diversified.)

Subsequently, Davy became CEO of GEICO, taking the company to undreamed-of heights before it got into trouble in the mid-1970s, a few years after his retirement. When that happened – with the stock falling by more than 95% – Berkshire bought about one-third of the company in the market, a position that over the years increased to 50% because of GEICO's repurchases of its own shares. Berkshire's cost for this half of the business was \$46 million. (Despite the size of our position, we exercised no control over operations.)

We then purchased the remaining 50% of GEICO at the beginning of 1996, which spurred Davy, at 95, to make a video tape saying how happy he was that his beloved GEICO would permanently reside with Berkshire. (He also playfully concluded with, "Next time, Warren, please make an appointment.")

A lot has happened at GEICO during the last 60 years, but its core goal – saving Americans substantial money on their purchase of auto insurance – remains unchanged. (Try us at 1-800-847-7536 or www.GEICO.com.) In other words, get the policyholder's business by *deserving* his business. Focusing on this objective, the company has grown to be America's third-largest auto insurer, with a market share of 8.8%.

When Tony Nicely, GEICO's CEO, took over in 1993, that share was 2.0%, a level at which it had been stuck for more than a decade. GEICO became a different company under Tony, finding a path to consistent growth while simultaneously maintaining underwriting discipline and keeping its costs low.

Let me quantify Tony's achievement. When, in 1996, we bought the 50% of GEICO we didn't already own, it cost us about \$2.3 billion. That price implied a value of \$4.6 billion for 100%. GEICO then had tangible net worth of \$1.9 billion.

The excess over tangible net worth of the implied value – \$2.7 billion – was what we estimated GEICO's "goodwill" to be worth at that time. That goodwill represented the economic value of the policyholders who were then doing business with GEICO. In 1995, those customers had paid the company \$2.8 billion in premiums. Consequently, we were valuing GEICO's customers at about 97% (2.7/2.8) of what they were annually paying the company. By industry standards, that was a very high price. But GEICO was no ordinary insurer: Because of the company's low costs, its policyholders were consistently profitable and unusually loyal.

Today, premium volume is \$14.3 billion and growing. Yet we carry the goodwill of GEICO on our books at only \$1.4 billion, an amount that will remain unchanged no matter how much the value of GEICO increases. (Under accounting rules, you write down the carrying value of goodwill if its economic value decreases, but leave it unchanged if economic value increases.) Using the 97%-of-premium-volume yardstick we applied to our 1996 purchase, the real value today of GEICO's economic goodwill is about \$14 billion. And this value is likely to be much higher ten and twenty years from now. GEICO – off to a strong start in 2011 – is the gift that keeps giving.

One not-so-small footnote: Under Tony, GEICO has developed one of the country's largest personal-lines insurance *agencies*, which primarily sells homeowners policies to our GEICO auto insurance customers. In this business, we represent a number of insurers that are not affiliated with us. They take the risk; we simply sign up the customers. Last year we sold 769,898 new policies at this agency operation, up 34% from the year before. The obvious way this activity aids us is that it produces commission revenue; equally important is the fact that it further strengthens our relationship with our policyholders, helping us retain them.

I owe an enormous debt to Tony and Davy (and, come to think of it, to that janitor as well).

* * * * *

Now, let's examine the four major sectors of Berkshire. Each has vastly different balance sheet and income characteristics from the others. Lumping them together therefore impedes analysis. So we'll present them as four separate businesses, which is how Charlie and I view them.

We will look first at insurance, Berkshire's core operation and the engine that has propelled our expansion over the years.

Insurance

Property-casualty ("P/C") insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit. Though individual policies and claims come and go, the amount of float we hold remains remarkably stable in relation to premium volume. Consequently, as our business grows, so does our float. And how we have grown: Just take a look at the following table:

<i>Yearend</i>	<i>Float (in \$ millions)</i>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income that our float produces. When such a profit occurs, we enjoy the use of free money – and, better yet, get *paid* for holding it. Alas, the wish of all insurers to achieve this happy result creates intense competition, so vigorous in most years that it causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. For example, State Farm, by far the country's largest insurer and a well-managed company, has incurred an underwriting loss in seven of the last ten years. During that period, its aggregate underwriting loss was more than \$20 billion.

At Berkshire, we have now operated at an underwriting profit for eight consecutive years, our total underwriting gain for the period having been \$17 billion. I believe it likely that we will continue to underwrite profitably in most – though certainly not all – future years. If we accomplish that, our float will be better than cost-free. We will benefit just as we would if some party deposited \$66 billion with us, paid us a fee for holding its money and then let us invest its funds for our own benefit.

Let me emphasize again that cost-free float is *not* an outcome to be expected for the P/C industry as a whole: In most years, industry premiums have been inadequate to cover claims plus expenses. Consequently, the industry's overall return on tangible equity has for many decades fallen far short of the average return realized by American industry, a sorry performance almost certain to continue. Berkshire's outstanding economics exist only because we have some terrific managers running some unusual businesses. We've already told you about GEICO, but we have two other very large operations, and a bevy of smaller ones as well, each a star in its own way.

* * * * *

First off is the Berkshire Hathaway Reinsurance Group, run by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most importantly, brains in a manner that is unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources. Indeed, we are *far* more conservative than most large insurers in that respect. In the past year, Ajit has significantly increased his life reinsurance operation, developing annual premium volume of about \$2 billion that will repeat for decades.

From a standing start in 1985, Ajit has created an insurance business with float of \$30 billion and significant underwriting profits, a feat that no CEO of any other insurer has come close to matching. By his accomplishments, he has added a great many billions of dollars to the value of Berkshire. Even kryptonite bounces off Ajit.

* * * * *

We have another insurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation requires four disciplines: (1) An understanding of *all* exposures that might cause a policy to incur losses; (2) A conservative evaluation of the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) The setting of a premium that will deliver a profit, on average, after both prospective loss costs and operating expenses are covered; and (4) The willingness to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. The urgings of Wall Street, pressures from the agency force and brokers, or simply a refusal by a testosterone-driven CEO to accept shrinking volumes has led too many insurers to write business at inadequate prices. "The other guy is doing it so we must as well" spells trouble in any business, but none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been better than cost-free under his leadership, and we expect that, on average, it will continue to be.

* * * * *

Finally, we own a group of smaller companies, most of them specializing in odd corners of the insurance world. In aggregate, their results have consistently been profitable and, as the table below shows, the float they provide us is substantial. Charlie and I treasure these companies and their managers.

Here is the record of all four segments of our property-casualty and life insurance businesses:

Insurance Operations	Underwriting Profit		Yearend Float	
	2010	(in millions)	2010	2009
General Re	\$ 452	\$ 477	\$20,049	\$21,014
BH Reinsurance	176	250	30,370	27,753
GEICO	1,117	649	10,272	9,613
Other Primary	268	84	5,141	5,061
	<u>\$2,013</u>	<u>\$1,460</u>	<u>\$65,832</u>	<u>\$63,441</u>

Among large insurance operations, Berkshire's impresses me as the best in the world.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/10 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 2,673	Notes payable	\$ 1,805
Accounts and notes receivable	5,396	Other current liabilities	8,169
Inventory	7,101	Total current liabilities	9,974
Other current assets	550		
Total current assets	15,720		
Goodwill and other intangibles	16,976	Deferred taxes	3,001
Fixed assets	15,421	Term debt and other liabilities	6,621
Other assets	3,029	Equity	31,550
	<u>\$51,146</u>		<u>\$51,146</u>

Earnings Statement (in millions)

	2010	2009	2008
Revenues	\$66,610	\$61,665	\$66,099
Operating expenses (including depreciation of \$1,362 in 2010, \$1,422 in 2009 and \$1,280 in 2008)	62,225	59,509	61,937
Interest expense	111	98	139
Pre-tax earnings	4,274*	2,058*	4,023*
Income taxes and non-controlling interests	1,812	945	1,740
Net earnings	<u>\$ 2,462</u>	<u>\$ 1,113</u>	<u>\$ 2,283</u>

*Does not include purchase-accounting adjustments.

This group of companies sells products ranging from lollipops to jet airplanes. Some of the businesses enjoy terrific economics, measured by earnings on unleveraged net *tangible* assets that run from 25% after-tax to more than 100%. Others produce good returns in the area of 12-20%. Unfortunately, a few have very poor returns, a result of some serious mistakes I have made in my job of capital allocation. These errors came about because I misjudged either the competitive strength of the business I was purchasing or the future economics of the industry in which it operated. I try to look out ten or twenty years when making an acquisition, but sometimes my eyesight has been poor.

Most of the companies in this section improved their earnings last year and four set records. Let's look first at the record-breakers.

- TTI, our electronic components distributor, had sales 21% above its previous high (recorded in 2008) and pre-tax earnings that topped its earlier record by 58%. Its sales gains spanned three continents, with North America at 16%, Europe at 26%, and Asia at 50%. The thousands of items TTI distributes are pedestrian, many selling for less than a dollar. The magic of TTI's exceptional performance is created by Paul Andrews, its CEO, and his associates.

- Forest River, our RV and boat manufacturer, had record sales of nearly \$2 billion and record earnings as well. Forest River has 82 plants, and I have yet to visit one (or the home office, for that matter). There's no need; Pete Liegl, the company's CEO, runs a terrific operation. Come view his products at the annual meeting. Better yet, buy one.
- CTB, our farm-equipment company, again set an earnings record. I told you in the 2008 Annual Report about Vic Mancinelli, the company's CEO. He just keeps getting better. Berkshire paid \$140 million for CTB in 2002. It has since paid us dividends of \$160 million and eliminated \$40 million of debt. Last year it earned \$106 million pre-tax. Productivity gains have produced much of this increase. When we bought CTB, sales per employee were \$189,365; now they are \$405,878.
- Would you believe shoes? H. H. Brown, run by Jim Issler and best known for its Born brand, set a new record for sales and earnings (helped by its selling 1,110 pairs of shoes at our annual meeting). Jim has brilliantly adapted to major industry changes. His work, I should mention, is overseen by Frank Rooney, 89, a superb businessman and still a dangerous fellow with whom to have a bet on the golf course.

A huge story in this sector's year-to-year improvement occurred at NetJets. I can't overstate the breadth and importance of Dave Sokol's achievements at this company, the leading provider of fractional ownership of jet airplanes. NetJets has long been an operational success, owning a 2010 market share five times that of its nearest competitor. Our overwhelming leadership stems from a wonderful team of pilots, mechanics and service personnel. This crew again did its job in 2010, with customer satisfaction, as delineated in our regular surveys, hitting new highs.

Even though NetJets was consistently a runaway winner with customers, our financial results, since its acquisition in 1998, were a failure. In the 11 years through 2009, the company reported an aggregate pre-tax loss of \$157 million, a figure that was far understated since borrowing costs at NetJets were heavily subsidized by its free use of Berkshire's credit. Had NetJets been operating on a stand-alone basis, its loss over the years would have been several hundreds of millions greater.

We are now charging NetJets an appropriate fee for Berkshire's guarantee. Despite this fee (which came to \$38 million in 2010), NetJets earned \$207 million pre-tax in 2010, a swing of \$918 million from 2009. Dave's quick restructuring of management and the company's rationalization of its purchasing and spending policies has ended the hemorrhaging of cash and turned what was Berkshire's only major business problem into a solidly profitable operation.

Dave has meanwhile maintained NetJets' industry-leading reputation for safety and service. In many important ways, our training and operational standards are considerably stronger than those required by the FAA. Maintaining top-of-the-line standards is the right thing to do, but I also have a selfish reason for championing this policy. My family and I have flown more than 5,000 hours on NetJets (that's equal to being airborne 24 hours a day for seven months) and will fly thousands of hours more in the future. We receive no special treatment and have used a random mix of at least 100 planes and 300 crews. Whichever the plane or crew, we always know we are flying with the best-trained pilots in private aviation.

The largest earner in our manufacturing, service and retailing sector is Marmon, a collection of 130 businesses. We will soon increase our ownership in this company to 80% by carrying out our scheduled purchase of 17% of its stock from the Pritzker family. The cost will be about \$1.5 billion. We will then purchase the remaining Pritzker holdings in 2013 or 2014, whichever date is selected by the family. Frank Ptak runs Marmon wonderfully, and we look forward to 100% ownership.

Next to Marmon, the two largest earners in this sector are Iscar and McLane. Both had excellent years. In 2010, Grady Rosier's McLane entered the wine and spirits distribution business to supplement its \$32 billion operation as a distributor of food products, cigarettes, candy and sundries. In purchasing Empire Distributors, an operator in Georgia and North Carolina, we teamed up with David Kahn, the company's dynamic CEO. David is leading our efforts to expand geographically. By yearend he had already made his first acquisition, Horizon Wine and Spirits in Tennessee.

At Iscar, profits were up 159% in 2010, and we may well surpass pre-recession levels in 2011. Sales are improving throughout the world, particularly in Asia. Credit Eitan Wertheimer, Jacob Harpaz and Danny Goldman for an exceptional performance, one far superior to that of Iscar's main competitors.

All that is good news. Our businesses related to home construction, however, continue to struggle. Johns Manville, MiTek, Shaw and Acme Brick have maintained their competitive positions, but their profits are far below the levels of a few years ago. Combined, these operations earned \$362 million pre-tax in 2010 compared to \$1.3 billion in 2006, and their employment has fallen by about 9,400.

A housing recovery will probably begin within a year or so. In any event, it is certain to occur at some point. Consequently: (1) At MiTek, we have made, or committed to, five bolt-on acquisitions during the past eleven months; (2) At Acme, we just recently acquired the leading manufacturer of brick in Alabama for \$50 million; (3) Johns Manville is building a \$55 million roofing membrane plant in Ohio, to be completed next year; and (4) Shaw will spend \$200 million in 2011 on plant and equipment, all of it situated in America. These businesses entered the recession strong and will exit it stronger. At Berkshire, our time horizon is forever.

Regulated, Capital-Intensive Businesses

We have two very large businesses, BNSF and MidAmerican Energy, with important common characteristics that distinguish them from our many others. Consequently, we give them their own sector in this letter and split out their financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is the huge investment they have in very long-lived, regulated assets, with these funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is not needed: Both businesses have earning power that, even under very adverse business conditions, amply covers their interest requirements. For example, in recessionary 2010 with BNSF's car loadings far off peak levels, the company's interest coverage was 6:1.

Both companies are heavily regulated, and both will have a never-ending need to make major investments in plant and equipment. Both also need to provide efficient, customer-satisfying service to earn the respect of their communities and regulators. In return, both need to be assured that they will be allowed to earn reasonable earnings on future capital investments.

Earlier I explained just how important railroads are to our country's future. Rail moves 42% of America's inter-city freight, measured by ton-miles, and BNSF moves more than any other railroad – about 28% of the industry total. A little math will tell you that more than 11% of *all* inter-city ton-miles of freight in the U.S. is transported by BNSF. Given the shift of population to the West, our share may well inch higher.

All of this adds up to a huge responsibility. We are a major and essential part of the American economy's circulatory system, obliged to constantly maintain and improve our 23,000 miles of track along with its ancillary bridges, tunnels, engines and cars. In carrying out this job, we must anticipate society's needs, not merely react to them. Fulfilling our societal obligation, we will regularly spend far more than our depreciation, with this excess amounting to \$2 billion in 2011. I'm confident we will earn appropriate returns on our huge incremental investments. Wise regulation and wise investment are two sides of the same coin.

At MidAmerican, we participate in a similar "social compact." We are expected to put up ever-increasing sums to satisfy the future needs of our customers. If we meanwhile operate reliably and efficiently, we know that we will obtain a fair return on these investments.

MidAmerican supplies 2.4 million customers in the U.S. with electricity, operating as the largest supplier in Iowa, Wyoming and Utah and as an important provider in other states as well. Our pipelines transport 8% of the country's natural gas. Obviously, many millions of Americans depend on us every day.

MidAmerican has delivered outstanding results for both its owners (Berkshire's interest is 89.8%) and its customers. Shortly after MidAmerican purchased Northern Natural Gas pipeline in 2002, that company's performance as a pipeline was rated dead last, 43 out of 43, by the leading authority in the field. In the most recent report published, Northern Natural was ranked second. The top spot was held by our other pipeline, Kern River.

In its electric business, MidAmerican has a comparable record. Iowa rates have not increased since we purchased our operation there in 1999. During the same period, the other major electric utility in the state has raised prices more than 70% and now has rates far above ours. In certain metropolitan areas in which the two utilities operate side by side, electric bills of our customers run far below those of their neighbors. I am told that comparable houses sell at higher prices in these cities if they are located in our service area.

MidAmerican will have 2,909 megawatts of wind generation in operation by the end of 2011, more than any other regulated electric utility in the country. The total amount that MidAmerican has invested or committed to wind is a staggering \$5.4 billion. We can make this sort of investment because MidAmerican retains *all* of its earnings, unlike other utilities that generally pay out most of what they earn.

As you can tell by now, I am proud of what has been accomplished for our society by Matt Rose at BNSF and by David Sokol and Greg Abel at MidAmerican. I am also both proud and grateful for what they have accomplished for Berkshire shareholders. Below are the relevant figures:

<u>MidAmerican</u>	<i>Earnings (in millions)</i>	
	<u>2010</u>	<u>2009</u>
U.K. utilities	\$ 333	\$ 248
Iowa utility	279	285
Western utilities	783	788
Pipelines	378	457
HomeServices	42	43
Other (net)	47	25
Operating earnings before corporate interest and taxes	1,862	1,846
Interest, other than to Berkshire	(323)	(318)
Interest on Berkshire junior debt	(30)	(58)
Income tax	(271)	(313)
Net earnings	<u>\$1,238</u>	<u>\$1,157</u>
Earnings applicable to Berkshire*	\$1,131	\$1,071

*Includes interest earned by Berkshire (net of related income taxes) of \$19 in 2010 and \$38 in 2009.

BNSF

(Historical accounting through 2/12/10; purchase accounting subsequently)

	<i>(in millions)</i>	
	<u>2010</u>	<u>2009</u>
Revenues	\$16,850	\$14,016
Operating earnings	4,495	3,254
Interest (Net)	507	613
Pre-Tax earnings	3,988	2,641
Net earnings	2,459	1,721

Finance and Financial Products

This, our smallest sector, includes two rental companies, XTRA (trailers) and CORT (furniture), and Clayton Homes, the country's leading producer and financer of manufactured homes.

Both of our leasing businesses improved their performances last year, albeit from a very low base. XTRA increased the utilization of its equipment from 63% in 2009 to 75% in 2010, thereby raising pre-tax earnings to \$35 million from \$17 million in 2009. CORT experienced a pickup in business as the year progressed and also significantly tightened its operations. The combination increased its pre-tax results from a loss of \$3 million in 2009 to \$18 million of profit in 2010.

At Clayton, we produced 23,343 homes, 47% of the industry's total of 50,046. Contrast this to the peak year of 1998, when 372,843 homes were manufactured. (We then had an industry share of 8%.) Sales would have been terrible last year under any circumstances, but the financing problems I commented upon in the 2009 report continue to exacerbate the distress. To explain: Home-financing policies of our government, expressed through the loans found acceptable by FHA, Freddie Mac and Fannie Mae, favor site-built homes and work to negate the price advantage that manufactured homes offer.

We finance more manufactured-home buyers than any other company. Our experience, therefore, should be instructive to those parties preparing to overhaul our country's home-loan practices. Let's take a look.

Clayton owns 200,804 mortgages that it originated. (It also has some mortgage portfolios that it purchased.) At the origination of these contracts, the average FICO score of our borrowers was 648, and 47% were 640 or below. Your banker will tell you that people with such scores are generally regarded as questionable credits.

Nevertheless, our portfolio has performed well during conditions of stress. Here's our loss experience during the last five years for originated loans:

<i>Year</i>	<i>Net Losses as a Percentage of Average Loans</i>
2006	1.53%
2007	1.27%
2008	1.17%
2009	1.86%
2010	1.72%

Our borrowers get in trouble when they lose their jobs, have health problems, get divorced, etc. The recession has hit them hard. But they want to stay in their homes, and generally they borrowed sensible amounts in relation to their income. In addition, we were keeping the originated mortgages for our own account, which means we were not securitizing or otherwise reselling them. If we were stupid in our lending, *we* were going to pay the price. That concentrates the mind.

If home buyers throughout the country had behaved like our buyers, America would not have had the crisis that it did. Our approach was simply to get a meaningful down-payment and gear *fixed* monthly payments to a sensible percentage of income. This policy kept Clayton solvent and also kept buyers in their homes.

Home ownership makes sense for most Americans, particularly at today's lower prices and bargain interest rates. All things considered, the third best investment I ever made was the purchase of my home, though I would have made far more money had I instead rented and used the purchase money to buy stocks. (The two best investments were wedding rings.) For the \$31,500 I paid for our house, my family and I gained 52 years of terrific memories with more to come.

But a house can be a nightmare if the buyer's eyes are bigger than his wallet and if a lender – often protected by a government guarantee – facilitates his fantasy. Our country's social goal should not be to put families into the house of their dreams, but rather to put them into a house they can afford.

Investments

Below we show our common stock investments that at yearend had a market value of more than \$1 billion.

<u>Shares</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost *</i> <i>(in millions)</i>	<i>Market</i> <i>(in millions)</i>
151,610,700	American Express Company	12.6	\$ 1,287	\$ 6,507
225,000,000	BYD Company, Ltd.	9.9	232	1,182
200,000,000	The Coca-Cola Company	8.6	1,299	13,154
29,109,637	ConocoPhillips	2.0	2,028	1,982
45,022,563	Johnson & Johnson	1.6	2,749	2,785
97,214,584	Kraft Foods Inc.	5.6	3,207	3,063
19,259,600	Munich Re	10.5	2,896	2,924
3,947,555	POSCO	4.6	768	1,706
72,391,036	The Procter & Gamble Company	2.6	464	4,657
25,848,838	Sanofi-Aventis	2.0	2,060	1,656
242,163,773	Tesco plc	3.0	1,414	1,608
78,060,769	U.S. Bancorp	4.1	2,401	2,105
39,037,142	Wal-Mart Stores, Inc.	1.1	1,893	2,105
358,936,125	Wells Fargo & Company	6.8	8,015	11,123
	Others		3,020	4,956
	Total Common Stocks Carried at Market		<u>\$33,733</u>	<u>\$61,513</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

In our reported earnings we reflect only the dividends our portfolio companies pay us. Our share of the undistributed earnings of these investees, however, was more than \$2 billion last year. These retained earnings are important. In our experience – and, for that matter, in the experience of investors over the past century – undistributed earnings have been either matched or exceeded by market gains, albeit in a highly irregular manner. (Indeed, sometimes the correlation goes in reverse. As one investor said in 2009: "This is worse than divorce. I've lost half my net worth – and I still have my wife.") In the future, we expect our market gains to eventually at least equal the earnings our investees retain.

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In our earlier estimate of Berkshire's normal earning power, we made three adjustments that relate to future investment income (but did *not* include anything for the undistributed earnings factor I have just described).

The first adjustment was decidedly negative. Last year, we discussed five large fixed-income investments that have been contributing substantial sums to our reported earnings. One of these – our Swiss Re note – was redeemed in the early days of 2011, and two others – our Goldman Sachs and General Electric preferred stocks – are likely to be gone by yearend. General Electric is entitled to call our preferred in October and has stated its intention to do so. Goldman Sachs has the right to call our preferred on 30 days notice, but has been held back by the Federal Reserve (bless it!), which unfortunately will likely give Goldman the green light before long.

All three of the companies redeeming must pay us a premium to do so – in aggregate about \$1.4 billion – but all of the redemptions are nevertheless unwelcome. After they occur, our earning power will be significantly reduced. That's the bad news.

There are two probable offsets. At yearend we held \$38 billion of cash equivalents that have been earning a pittance throughout 2010. At some point, however, better rates will return. They will add at least \$500 million – and perhaps much more – to our investment income. That sort of increase in money-market yields is unlikely to come soon. It is appropriate, nevertheless, for us to include improved rates in an estimate of “normal” earning power. Even before higher rates come about, furthermore, we could get lucky and find an opportunity to use some of our cash hoard at decent returns. That day can't come too soon for me: To update Aesop, a girl in a convertible is worth five in the phone book.

In addition, dividends on our current common stock holdings will almost certainly increase. The largest gain is likely to come at Wells Fargo. The Federal Reserve, our friend in respect to Goldman Sachs, has frozen dividend levels at major banks, whether strong or weak, during the last two years. Wells Fargo, though consistently prospering throughout the worst of the recession and currently enjoying enormous financial strength and earning power, has therefore been forced to maintain an artificially low payout. (We don't fault the Fed: For various reasons, an across-the-board freeze made sense during the crisis and its immediate aftermath.)

At some point, probably soon, the Fed's restrictions will cease. Wells Fargo can then reinstate the rational dividend policy that its owners deserve. At that time, we would expect our annual dividends from just this one security to increase by several hundreds of millions of dollars annually.

Other companies we hold are likely to increase their dividends as well. Coca-Cola paid us \$88 million in 1995, the year after we finished purchasing the stock. Every year since, Coke has increased its dividend. In 2011, we will almost certainly receive \$376 million from Coke, up \$24 million from last year. Within ten years, I would expect that \$376 million to double. By the end of that period, I wouldn't be surprised to see our share of Coke's *annual* earnings exceed 100% of what we paid for the investment. Time is the friend of the wonderful business.

Overall, I believe our “normal” investment income will at least equal what we realized in 2010, though the redemptions I described will cut our take in 2011 and perhaps 2012 as well.

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Last summer, Lou Simpson told me he wished to retire. Since Lou was a mere 74 – an age Charlie and I regard as appropriate only for trainees at Berkshire – his call was a surprise.

Lou joined GEICO as its investment manager in 1979, and his service to that company has been invaluable. In the 2004 Annual Report, I detailed his record with equities, and I have omitted updates only because his performance made mine look bad. Who needs that?

Lou has never been one to advertise his talents. But I will: Simply put, Lou is one of the investment greats. We will miss him.

* * * * *

Four years ago, I told you that we needed to add one or more younger investment managers to carry on when Charlie, Lou and I weren't around. At that time we had multiple outstanding candidates immediately available for my CEO job (as we do now), but we did not have backup in the investment area.

It's easy to identify many investment managers with great recent records. But past results, though important, do not suffice when prospective performance is being judged. How the record has been achieved is crucial, as is the manager's understanding of – and sensitivity to – risk (which in no way should be measured by beta, the choice of too many academics). In respect to the risk criterion, we were looking for someone with a hard-to-evaluate skill: the ability to anticipate the effects of economic scenarios not previously observed. Finally, we wanted someone who would regard working for Berkshire as far more than a job.

When Charlie and I met Todd Combs, we knew he fit our requirements. Todd, as was the case with Lou, will be paid a salary plus a contingent payment based on his performance relative to the S&P. We have arrangements in place for deferrals and carryforwards that will prevent see-saw performance being met by undeserved payments. The hedge-fund world has witnessed some terrible behavior by general partners who have received huge payouts on the upside and who then, when bad results occurred, have walked away rich, with their limited partners losing back their earlier gains. Sometimes these same general partners thereafter quickly started another fund so that they could immediately participate in future profits without having to overcome their past losses. Investors who put money with such managers should be labeled patsies, not partners.

As long as I am CEO, I will continue to manage the great majority of Berkshire's holdings, both bonds and equities. Todd initially will manage funds in the range of one to three billion dollars, an amount he can reset annually. His focus will be equities but he is not restricted to that form of investment. (Fund consultants like to require style boxes such as "long-short," "macro," "international equities." At Berkshire our only style box is "smart.")

Over time, we may add one or two investment managers if we find the right individuals. Should we do that, we will probably have 80% of each manager's performance compensation be dependent on his or her own portfolio and 20% on that of the other manager(s). We want a compensation system that pays off big for individual success but that also fosters cooperation, not competition.

When Charlie and I are no longer around, our investment manager(s) will have responsibility for the entire portfolio in a manner then set by the CEO and Board of Directors. Because good investors bring a useful perspective to the purchase of businesses, we would expect them to be consulted – but not to have a vote – on the wisdom of possible acquisitions. In the end, of course, the Board will make the call on any major acquisition.

One footnote: When we issued a press release about Todd's joining us, a number of commentators pointed out that he was "little-known" and expressed puzzlement that we didn't seek a "big-name." I wonder how many of them would have known of Lou in 1979, Ajit in 1985, or, for that matter, Charlie in 1959. Our goal was to find a 2-year-old Secretariat, not a 10-year-old Seabiscuit. (Whoops – that may not be the smartest metaphor for an 80-year-old CEO to use.)

Derivatives

Two years ago, in the 2008 Annual Report, I told you that Berkshire was a party to 251 derivatives contracts (other than those used for operations at our subsidiaries, such as MidAmerican, and the few left over at Gen Re). Today, the comparable number is 203, a figure reflecting both a few additions to our portfolio and the unwinding or expiration of some contracts.

Our continuing positions, all of which I am personally responsible for, fall largely into two categories. We view both categories as engaging us in insurance-like activities in which we receive premiums for assuming risks that others wish to shed. Indeed, the thought processes we employ in these derivatives transactions are identical to those we use in our insurance business. You should also understand that we get paid up-front when we enter into the contracts and therefore run no counterparty risk. That's important.

Our first category of derivatives consists of a number of contracts, written in 2004-2008, that required payments by us if there were bond defaults by companies included in certain high-yield indices. With minor exceptions, we were exposed to these risks for five years, with each contract covering 100 companies.

In aggregate, we received premiums of \$3.4 billion for these contracts. When I originally told you in our 2007 Annual Report about them, I said that I expected the contracts would deliver us an "underwriting profit," meaning that our losses would be less than the premiums we received. In addition, I said we would benefit from the use of float.

Subsequently, as you know too well, we encountered both a financial panic and a severe recession. A number of the companies in the high-yield indices failed, which required us to pay losses of \$2.5 billion. Today, however, our exposure is largely behind us because most of our higher-risk contracts have expired. Consequently, it appears almost certain that we will earn an underwriting profit as we originally anticipated. In addition, we have had the use of interest-free float that averaged about \$2 billion over the life of the contracts. In short, we charged the right premium, and that protected us when business conditions turned terrible three years ago.

Our other large derivatives position – whose contracts go by the name of “equity puts” – involves insurance we wrote for parties wishing to protect themselves against a possible decline in equity prices in the U.S., U.K., Europe and Japan. These contracts are tied to various equity indices, such as the S&P 500 in the U.S. and the FTSE 100 in the U.K. In the 2004-2008 period, we received \$4.8 billion of premiums for 47 of these contracts, most of which ran for 15 years. On these contracts, only the price of the indices on the termination date counts: No payments can be required before then.

As a first step in updating you about these contracts, I can report that late in 2010, at the instigation of our counterparty, we unwound eight contracts, all of them due between 2021 and 2028. We had originally received \$647 million in premiums for these contracts, and the unwinding required us to pay \$425 million. Consequently, we realized a gain of \$222 million and also had the interest-free and unrestricted use of that \$647 million for about three years.

Those 2010 transactions left us with 39 equity put contracts remaining on our books at yearend. On these, at their initiation, we received premiums of \$4.2 billion.

The future of these contracts is, of course, uncertain. But here is one perspective on them. If the prices of the relevant indices are the same at the contract expiration dates as these prices were on December 31, 2010 – and foreign exchange rates are unchanged – we would owe \$3.8 billion on expirations occurring from 2018 to 2026. You can call this amount “settlement value.”

On our yearend balance sheet, however, we carry the liability for those remaining equity puts at \$6.7 billion. In other words, if the prices of the relevant indices remain unchanged from that date, we will record a \$2.9 billion gain in the years to come, that being the difference between the liability figure of \$6.7 billion and the settlement value of \$3.8 billion. I believe that equity prices will very likely increase and that our liability will fall significantly between now and settlement date. If so, our gain from this point will be even greater. But that, of course, is far from a sure thing.

What is sure is that we will have the use of our remaining “float” of \$4.2 billion for an average of about 10 more years. (Neither this float nor that arising from the high-yield contracts is included in the insurance float figure of \$66 billion.) Since money is fungible, think of a portion of these funds as contributing to the purchase of BNSF.

As I have told you before, almost all of our derivatives contracts are free of any obligation to post collateral – a fact that cut the premiums we could otherwise have charged. But that fact also left us feeling comfortable during the financial crisis, allowing us in those days to commit to some advantageous purchases. Foregoing some additional derivatives premiums proved to be well worth it.

On Reporting and Misreporting: The Numbers That Count and Those That Don’t

Earlier in this letter, I pointed out some numbers that Charlie and I find useful in valuing Berkshire and measuring its progress.

Let’s focus here on a number we omitted, but which many in the media feature above all others: net income. Important though that number may be at most companies, it is almost always *meaningless* at Berkshire. Regardless of how our businesses might be doing, Charlie and I could – quite legally – cause net income in any given period to be almost any number we would like.

We have that flexibility because *realized* gains or losses on investments go into the net income figure, whereas *unrealized* gains (and, in most cases, losses) are excluded. For example, imagine that Berkshire had a \$10 billion increase in unrealized gains in a given year and concurrently had \$1 billion of realized losses. Our net income – which would count only the loss – would be reported as *less* than our operating income. If we had meanwhile realized gains in the *previous* year, headlines might proclaim that our earnings were down X% when in reality our business might be much improved.

If we really thought net income important, we could regularly feed realized gains into it simply because we have a huge amount of unrealized gains upon which to draw. Rest assured, though, that Charlie and I have *never* sold a security because of the effect a sale would have on the net income we were soon to report. We both have a deep disgust for “game playing” with numbers, a practice that was rampant throughout corporate America in the 1990s and still persists, though it occurs less frequently and less blatantly than it used to.

Operating earnings, despite having some shortcomings, are in general a reasonable guide as to how our businesses are doing. Ignore our net income figure, however. Regulations require that we report it to you. But if you find reporters focusing on it, that will speak more to their performance than ours.

Both realized and unrealized gains and losses are fully reflected in the calculation of our book value. Pay attention to the changes in that metric and to the course of our operating earnings, and you will be on the right track.

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As a p.s., I can’t resist pointing out just how capricious reported net income can be. Had our equity puts had a termination date of June 30, 2010, we would have been required to pay \$6.4 billion to our counterparties at that date. Security prices then generally rose in the next quarter, a move that brought the corresponding figure down to \$5.8 billion on September 30th. Yet the Black-Scholes formula that we use in valuing these contracts required us to *increase* our balance-sheet liability during this period from \$8.9 billion to \$9.6 billion, a change that, after the effect of tax accruals, reduced our net income for the quarter by \$455 million.

Both Charlie and I believe that Black-Scholes produces wildly inappropriate values when applied to long-dated options. We set out one absurd example in these pages two years ago. More tangibly, we put our money where our mouth was by entering into our equity put contracts. By doing so, we implicitly asserted that the Black-Scholes calculations used by our counterparties or their customers were faulty.

We continue, nevertheless, to use that formula in presenting our financial statements. Black-Scholes is the accepted standard for option valuation – almost all leading business schools teach it – and we would be accused of shoddy accounting if we deviated from it. Moreover, we would present our auditors with an insurmountable problem were we to do that: They have clients who are our counterparties and who use Black-Scholes values for the same contracts we hold. It would be impossible for our auditors to attest to the accuracy of both their values and ours were the two far apart.

Part of the appeal of Black-Scholes to auditors and regulators is that it produces a precise number. Charlie and I can’t supply one of those. We believe the true liability of our contracts to be far lower than that calculated by Black-Scholes, but we can’t come up with an exact figure – anymore than we can come up with a *precise* value for GEICO, BNSF, or for Berkshire Hathaway itself. Our inability to pinpoint a number doesn’t bother us: We would rather be approximately right than precisely wrong.

John Kenneth Galbraith once slyly observed that economists were most economical with ideas: They made the ones learned in graduate school last a lifetime. University finance departments often behave similarly. Witness the tenacity with which almost all clung to the theory of efficient markets throughout the 1970s and 1980s, dismissively calling powerful facts that refuted it “anomalies.” (I always love explanations of that kind: The Flat Earth Society probably views a ship’s circling of the globe as an annoying, but inconsequential, anomaly.)

Academics' current practice of teaching Black-Scholes as revealed truth needs re-examination. For that matter, so does the academic's inclination to dwell on the valuation of options. You can be highly successful as an investor without having the slightest ability to value an option. What students *should* be learning is how to value a business. That's what investing is all about.

Life and Debt

The fundamental principle of auto racing is that to finish first, you must first finish. That dictum is equally applicable to business and guides our every action at Berkshire.

Unquestionably, some people have become very rich through the use of borrowed money. However, that's also been a way to get very poor. When leverage works, it magnifies your gains. Your spouse thinks you're clever, and your neighbors get envious. But leverage is addictive. Once having profited from its wonders, very few people retreat to more conservative practices. And as we all learned in third grade – and some relearned in 2008 – any series of positive numbers, however impressive the numbers may be, evaporates when multiplied by a single zero. History tells us that leverage all too often produces zeroes, even when it is employed by very smart people.

Leverage, of course, can be lethal to businesses as well. Companies with large debts often assume that these obligations can be refinanced as they mature. That assumption is usually valid. Occasionally, though, either because of company-specific problems or a worldwide shortage of credit, maturities must actually be met by payment. For that, only cash will do the job.

Borrowers then learn that credit is like oxygen. When either is abundant, its presence goes unnoticed. When either is missing, that's *all* that is noticed. Even a short absence of credit can bring a company to its knees. In September 2008, in fact, its overnight disappearance in many sectors of the economy came dangerously close to bringing our entire country to its knees.

Charlie and I have *no* interest in any activity that could pose the slightest threat to Berkshire's well-being. (With our having a combined age of 167, starting over is not on our bucket list.) We are forever conscious of the fact that you, our partners, have entrusted us with what in many cases is a major portion of your savings. In addition, important philanthropy is dependent on our prudence. Finally, many disabled victims of accidents caused by our insureds are counting on us to deliver sums payable decades from now. It would be irresponsible for us to risk what all these constituencies need just to pursue a few points of extra return.

A little personal history may partially explain our extreme aversion to financial adventurism. I didn't meet Charlie until he was 35, though he grew up within 100 yards of where I have lived for 52 years and also attended the same inner-city public high school in Omaha from which my father, wife, children and two grandchildren graduated. Charlie and I did, however, both work as young boys at my grandfather's grocery store, though our periods of employment were separated by about five years. My grandfather's name was Ernest, and perhaps no man was more aptly named. No one worked for Ernest, even as a stock boy, without being shaped by the experience.

On the [facing page](#) you can read a letter sent in 1939 by Ernest to his youngest son, my Uncle Fred. Similar letters went to his other four children. I still have the letter sent to my Aunt Alice, which I found – along with \$1,000 of cash – when, as executor of her estate, I opened her safe deposit box in 1970.

Ernest never went to business school – he never in fact finished high school – but he understood the importance of liquidity as a condition for *assured* survival. At Berkshire, we have taken his \$1,000 solution a bit further and have pledged that we will hold at least \$10 billion of cash, excluding that held at our regulated utility and railroad businesses. Because of that commitment, we customarily keep at least \$20 billion on hand so that we can both withstand unprecedented insurance losses (our largest to date having been about \$3 billion from Katrina, the insurance industry's most expensive catastrophe) and quickly seize acquisition or investment opportunities, even during times of financial turmoil.

Dear Fred & Catherine:

Over a period of a good many years I have known a great many people who at some time or another have suffered in various ways simply because they did not have ready cash. I have known people who have had to sacrifice some of their holdings in order to have money that was necessary at that time.

For a good many years your grandfather kept a certain amount of money where he could put his hands on it in very short notice.

For a number of years I have made it a point to keep a reserve, should some occasion come up where I would need money quickly, without disturbing the money that I have in my business. There have been a couple occasions when I found it very convenient to go to this fund.

Thus, I feel that everyone should have a reserve. I hope it never happens to you, but the chances are that some day you will need money, and need it badly, and with this thought in view, I started a fund by placing \$200.00 in an envelope, with your name on it, when you were married. Each year I added something to it, until there is now \$1000.00 in the fund.

Ten years have elapsed since you were married, and this fund is now completed.

It is my wish that you place this envelope in your safety deposit box, and keep it for the purpose that it was created for. Should the time come when you need part, I wohld suggest that you use as little as possible, and replace it as soon as possible.

You might feel that this should be invested and bring you an income. Forget it -- the mental satisfaction of having \$1000.00 laid away where you can put your hands on it, is worth more than what interest it might bring, especially if you have the investment in something that you could not realize on quickly.

If in after years you feel this has been a good idea, you might repeat it with your own children.

For your information, I might mention that there has never been a Buffett who ever left a very large estate, but there has never been one that did not leave something. They never spent all they made, but always saved part of what they made, and it has all worked out pretty well.

This letter is being written at the expiration of ten years after you were married.

*Howard Buffett
"Dad"*

We keep our cash largely in U.S. Treasury bills and avoid other short-term securities yielding a few more basis points, a policy we adhered to long before the frailties of commercial paper and money market funds became apparent in September 2008. We agree with investment writer Ray DeVoe's observation, "More money has been lost reaching for yield than at the point of a gun." At Berkshire, we don't rely on bank lines, and we don't enter into contracts that could require postings of collateral except for amounts that are tiny in relation to our liquid assets.

Furthermore, not a dime of cash has left Berkshire for dividends or share repurchases during the past 40 years. Instead, we have retained *all* of our earnings to strengthen our business, a reinforcement now running about \$1 billion per month. Our net worth has thus increased from \$48 million to \$157 billion during those four decades and our intrinsic value has grown far more. No other American corporation has come close to building up its financial strength in this unrelenting way.

By being so cautious in respect to leverage, we penalize our returns by a minor amount. Having loads of liquidity, though, lets us sleep well. Moreover, during the episodes of financial chaos that occasionally erupt in our economy, we will be equipped both financially and emotionally to play offense while others scramble for survival. That's what allowed us to invest \$15.6 billion in 25 days of panic following the Lehman bankruptcy in 2008.

The Annual Meeting

The annual meeting will be held on Saturday, April 30th. Carrie Kizer from our home office will be the ringmaster, and her theme this year is Planes, Trains and Automobiles. This gives NetJets, BNSF and BYD a chance to show off.

As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day's question periods, please do so while *Charlie* is talking. (Act fast; he can be terse.)

The best reason to exit, of course, is to *shop*. We will help you do that by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. In a nine-hour period, we sold 1,053 pairs of Justin boots, 12,416 pounds of See's candy, 8,000 Dairy Queen Blizzards® and 8,800 Quikut knives (that's 16 knives per minute). But you can do better. Remember: Anyone who says money can't buy happiness simply hasn't learned where to shop.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least half of you, I believe we can.

Be sure to visit the Bookworm. It will carry more than 60 books and DVDs, including the Chinese language edition of Poor Charlie's Almanack, the ever-popular book about my partner. So what if you can't read Chinese? Just buy a copy and carry it around; it will make you look urbane and erudite. Should you need to ship your book purchases, a shipping service will be available nearby.

If you are a big spender – or merely a gawker – visit Elliott Aviation on the east side of the Omaha airport between noon and 5:00 p.m. on Saturday. There we will have a fleet of NetJets aircraft that will get your pulse racing. Come by bus; leave by private jet.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

Airlines have often jacked up prices – sometimes dramatically so – for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City versus Omaha. The drive is about 2½ hours and it may be that you can save significant money, particularly if you had planned to rent a car in Omaha.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” discount pricing. Last year the store did \$33.3 million of business during its annual meeting sale, a volume that – as far as I know – exceeds the one-week total of *any* retail store anywhere. To obtain the Berkshire discount, you must make your purchases between Tuesday, April 26th and Monday, May 2nd inclusive, and also present your meeting credential. The period’s special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, April 29th. The second, the main gala, will be held on Sunday, May 1st, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m. On Sunday, around 1 p.m., I will be at Borsheims with a smile and a shoeshine, selling jewelry just as I sold men’s shirts at J.C. Penney’s 63 years ago. I’ve told Susan Jacques, Borsheims’ CEO, that I’m still a hotshot salesman. But I see doubt in her eyes. So cut loose and buy something from me for your wife or sweetheart (presumably the same person). Make me look good.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 25th through Saturday, May 7th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire shareholder.

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world’s top bridge experts, available to play bridge with our shareholders on Sunday afternoon.

Gorat’s and Piccolo’s will again be open exclusively for Berkshire shareholders on Sunday, May 1st. Both will be serving until 10 p.m., with Gorat’s opening at 1 p.m. and Piccolo’s opening at 4 p.m. These restaurants are my favorites and – still being a growing boy – I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat’s, call 402-551-3733 on April 1st (*but not before*) and at Piccolo’s call 402-342-9038.

We will again have the same three financial journalists lead the question-and-answer period, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be emailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the dozen or so he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any email you send them. (In your email, let the journalist know if you would like your name mentioned if your question is selected.)

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists will pick some tough ones, and that’s the way we like it.

We will again have a drawing at 8:15 a.m. on Saturday at each of 13 microphones for those shareholders wishing to ask questions themselves. At the meeting, I will alternate the questions asked by the journalists with those from the winning shareholders. We hope to answer at least 60 questions. From our standpoint, the more the better. Our goal, which we pursue both through these annual letters and by our meeting discussions, is to give you a better understanding of the business that *you* own.

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For good reason, I regularly extol the accomplishments of our operating managers. Equally important, however, are the 20 men and women who work with me at our corporate office (all on one floor, which is the way we intend to keep it!).

This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 14,097-page Federal income tax return along with state and foreign returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and joyful. Their efforts go beyond activities strictly related to Berkshire: They deal with 48 universities (selected from 200 applicants) who will send students to Omaha this school year for a day with me and also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers for lunch. No CEO has it better.

This home office crew has my deepest thanks and deserves yours as well. Come to our Woodstock for Capitalism on April 30th and tell them so.

February 26, 2011

Warren E. Buffett
Chairman of the Board

Memo

To: Berkshire Hathaway Managers (“The All-Stars”)

cc: Berkshire Directors

From: Warren E. Buffett

Date: July 26, 2010

This is my biennial letter to reemphasize Berkshire’s top priority and to get your help on succession planning (yours, not mine!).

The priority is that all of us continue to zealously guard Berkshire’s reputation. We can’t be perfect but we can try to be. As I’ve said in these memos for more than 25 years: “We can afford to lose money – even a lot of money. But we can’t afford to lose reputation – even a shred of reputation.” We *must* continue to measure every act against not only what is legal but also what we would be happy to have written about on the front page of a national newspaper in an article written by an unfriendly but intelligent reporter.

Sometimes your associates will say “Everybody else is doing it.” This rationale is almost always a bad one if it is the main justification for a business action. It is totally unacceptable when evaluating a moral decision. Whenever somebody offers that phrase as a rationale, in effect they are saying that they can’t come up with a *good* reason. If anyone gives this explanation, tell them to try using it with a reporter or a judge and see how far it gets them.

If you see anything whose propriety or legality causes you to hesitate, be sure to give me a call. However, it’s very likely that if a given course of action evokes such hesitation, it’s too close to the line and should be abandoned. There’s plenty of money to be made in the center of the court. If it’s questionable whether some action is close to the line, just assume it is outside and forget it.

As a corollary, let me know promptly if there’s any significant bad news. I can handle bad news but I don’t like to deal with it after it has festered for awhile. A reluctance to face up immediately to bad news is what turned a problem at Salomon from one that could have easily been disposed of into one that almost caused the demise of a firm with 8,000 employees.

Somebody is doing something today at Berkshire that you and I would be unhappy about if we knew of it. That's inevitable: We now employ more than 250,000 people and the chances of that number getting through the day without any bad behavior occurring is nil. But we can have a huge effect in minimizing such activities by jumping on anything immediately when there is the slightest odor of impropriety. Your attitude on such matters, expressed by behavior as well as words, will be the most important factor in how the culture of your business develops. Culture, more than rule books, determines how an organization behaves.

In other respects, talk to me about what is going on as little or as much as you wish. Each of you does a first-class job of running your operation with your own individual style and you don't need me to help. The only items you need to clear with me are any changes in post-retirement benefits and any unusually large capital expenditures or acquisitions.

* * * * *

I need your help in respect to the question of succession. I'm not looking for any of you to retire and I hope you all live to 100. (In Charlie's case, 110.) But just in case you don't, please send me a letter (at home if you wish) giving your recommendation as who should take over tomorrow if you should become incapacitated overnight. These letters will be seen by no one but me unless I'm no longer CEO, in which case my successor will need the information. Please summarize the strengths and weaknesses of your primary candidate as well as any possible alternates you may wish to include. Most of you have participated in this exercise in the past and others have offered your ideas verbally. However, it's important to me to get a periodic update, and now that we have added so many businesses, I need to have your thoughts in writing rather than trying to carry them around in my memory. Of course, there are a few operations that are run by two or more of you – such as the Blumkins, the Merschmans, the pair at Applied Underwriters, etc. – and in these cases, just forget about this item. Your note can be short, informal, handwritten, etc. Just mark it "Personal for Warren."

Thanks for your help on all of this. And thanks for the way you run your businesses. You make my job easy.

WEB/db

P.S. Another minor request: Please turn down all proposals for me to speak, make contributions, intercede with the Gates Foundation, etc. Sometimes these requests for you to act as intermediary will be accompanied by "It can't hurt to ask." It will be easier for both of us if you just say "no." As an added favor, don't suggest that they instead write or call me. Multiply 76 businesses by the periodic "I think he'll be interested in this one" and you can understand why it is better to say no firmly and immediately.

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
19995	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
2010	13.0	15.1	(2.1)
2011	4.6	2.1	2.5
Compounded Annual Gain – 1965-2011	19.8%	9.2%	10.6
Overall Gain – 1964-2011	513,055%	6,397%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

The per-share book value of both our Class A and Class B stock increased by 4.6% in 2011. Over the last 47 years (that is, since present management took over), book value has grown from \$19 to \$99,860, a rate of 19.8% compounded annually.*

Charlie Munger, Berkshire's Vice Chairman and my partner, and I feel good about the company's progress during 2011. Here are the highlights:

- The primary job of a Board of Directors is to see that the right people are running the business and to be sure that the next generation of leaders is identified and ready to take over *tomorrow*. I have been on 19 corporate boards, and Berkshire's directors are at the top of the list in the time and diligence they have devoted to succession planning. What's more, their efforts have paid off.

As 2011 started, Todd Combs joined us as an investment manager, and shortly after yearend Ted Weschler came aboard. Both of these men have outstanding investment skills and a deep commitment to Berkshire. Each will be handling a few billion dollars in 2012, but they have the brains, judgment and character to manage our entire portfolio when Charlie and I are no longer running Berkshire.

Your Board is equally enthusiastic about my successor as CEO, an individual to whom they have had a great deal of exposure and whose managerial and human qualities they admire. (We have two superb back-up candidates as well.) When a transfer of responsibility is required, it will be seamless, and Berkshire's prospects will remain bright. More than 98% of my net worth is in Berkshire stock, all of which will go to various philanthropies. Being so heavily concentrated in one stock defies conventional wisdom. But I'm fine with this arrangement, knowing both the quality and diversity of the businesses we own and the caliber of the people who manage them. With these assets, my successor will enjoy a running start. Do not, however, infer from this discussion that Charlie and I are going anywhere; we continue to be in excellent health, and we love what we do.

- On September 16th we acquired Lubrizol, a worldwide producer of additives and other specialty chemicals. The company has had an outstanding record since James Hambrick became CEO in 2004, with pre-tax profits increasing from \$147 million to \$1,085 million. Lubrizol will have many opportunities for "bolt-on" acquisitions in the specialty chemical field. Indeed, we've already agreed to three, costing \$493 million. James is a disciplined buyer and a superb operator. Charlie and I are eager to expand his managerial domain.
- Our major businesses did well last year. In fact, *each* of our five largest non-insurance companies – BNSF, Iscar, Lubrizol, Marmon Group and MidAmerican Energy – delivered record operating earnings. In aggregate these businesses earned more than \$9 billion pre-tax in 2011. Contrast that to seven years ago, when we owned only one of the five, MidAmerican, whose pre-tax earnings were \$393 million. Unless the economy weakens in 2012, *each* of our fabulous five should again set a record, with aggregate earnings comfortably topping \$10 billion.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

- In total, our entire string of operating companies spent \$8.2 billion for property, plant and equipment in 2011, smashing our previous record by more than \$2 billion. About 95% of these outlays were made in the U.S., a fact that may surprise those who believe our country lacks investment opportunities. We welcome projects abroad, but expect the overwhelming majority of Berkshire's future capital commitments to be in America. In 2012, these expenditures will again set a record.
- Our insurance operations continued their delivery of costless capital that funds a myriad of other opportunities. This business produces "float" – money that doesn't belong to us, but that we get to invest for Berkshire's benefit. And if we pay out less in losses and expenses than we receive in premiums, we additionally earn an underwriting profit, meaning the float costs us less than nothing. Though we are sure to have underwriting losses from time to time, we've now had nine consecutive years of underwriting profits, totaling about \$17 billion. Over the same nine years our float increased from \$41 billion to its current record of \$70 billion. Insurance has been good to us.
- Finally, we made two major investments in marketable securities: (1) a \$5 billion 6% preferred stock of Bank of America that came with warrants allowing us to buy 700 million common shares at \$7.14 per share any time before September 2, 2021; and (2) 63.9 million shares of IBM that cost us \$10.9 billion. Counting IBM, we now have large ownership interests in four exceptional companies: 13.0% of American Express, 8.8% of Coca-Cola, 5.5% of IBM and 7.6% of Wells Fargo. (We also, of course, have many smaller, but important, positions.)

We view these holdings as partnership interests in wonderful businesses, not as marketable securities to be bought or sold based on their near-term prospects. Our share of *their* earnings, however, are far from fully reflected in *our* earnings; only the dividends we receive from these businesses show up in our financial reports. Over time, though, the undistributed earnings of these companies that are attributable to our ownership are of huge importance to us. That's because they will be used in a variety of ways to increase future earnings and dividends of the investee. They may also be devoted to stock repurchases, which will increase our share of the company's future earnings.

Had we owned our present positions throughout last year, our dividends from the "Big Four" would have been \$862 million. That's all that would have been reported in Berkshire's income statement. Our share of this quartet's earnings, however, would have been far greater: \$3.3 billion. Charlie and I believe that the \$2.4 billion that goes unreported on our books creates at least that amount of value for Berkshire as it fuels earnings gains in future years. We expect the combined earnings of the four – and their dividends as well – to increase in 2012 and, for that matter, almost every year for a long time to come. A decade from now, our current holdings of the four companies might well account for earnings of \$7 billion, of which \$2 billion in dividends would come to us.

I've run out of good news. Here are some developments that hurt us during 2011:

- A few years back, I spent about \$2 billion buying several bond issues of Energy Future Holdings, an electric utility operation serving portions of Texas. That was a mistake – a *big* mistake. In large measure, the company's prospects were tied to the price of natural gas, which tanked shortly after our purchase and remains depressed. Though we have annually received interest payments of about \$102 million since our purchase, the company's ability to pay will soon be exhausted unless gas prices rise substantially. We wrote down our investment by \$1 billion in 2010 and by an additional \$390 million last year.

At yearend, we carried the bonds at their market value of \$878 million. If gas prices remain at present levels, we will likely face a further loss, perhaps in an amount that will virtually wipe out our current carrying value. Conversely, a substantial increase in gas prices might allow us to recoup some, or even all, of our write-down. However things turn out, I totally miscalculated the gain/loss probabilities when I purchased the bonds. In tennis parlance, this was a major unforced error by your chairman.

- Three large and very attractive fixed-income investments were called away from us by their issuers in 2011. Swiss Re, Goldman Sachs and General Electric paid us an aggregate of \$12.8 billion to redeem securities that were producing about \$1.2 billion of pre-tax earnings for Berkshire. That's a lot of income to replace, though our Lubrizol purchase did offset most of it.
- Last year, I told you that “a housing recovery will probably begin within a year or so.” I was dead wrong. We have five businesses whose results are significantly influenced by housing activity. The connection is direct at Clayton Homes, which is the largest producer of homes in the country, accounting for about 7% of those constructed during 2011.

Additionally, Acme Brick, Shaw (carpet), Johns Manville (insulation) and MiTek (building products, primarily connector plates used in roofing) are all materially affected by construction activity. In aggregate, our five housing-related companies had pre-tax profits of \$513 million in 2011. That's similar to 2010 but down from \$1.8 billion in 2006.

Housing will come back – you can be sure of that. Over time, the number of housing units necessarily matches the number of households (after allowing for a normal level of vacancies). For a period of years prior to 2008, however, America added more housing units than households. Inevitably, we ended up with far too many units and the bubble popped with a violence that shook the entire economy. That created still another problem for housing: Early in a recession, household formations slow, and in 2009 the decrease was dramatic.

That devastating supply/demand equation is now reversed: Every day we are creating more households than housing units. People may postpone hitching up during uncertain times, but eventually hormones take over. And while “doubling-up” may be the initial reaction of some during a recession, living with in-laws can quickly lose its allure.

At our current annual pace of 600,000 housing starts – considerably less than the number of new households being formed – buyers and renters are sopping up what's left of the old oversupply. (This process will run its course at different rates around the country; the supply-demand situation varies widely by locale.) While this healing takes place, however, our housing-related companies sputter, employing only 43,315 people compared to 58,769 in 2006. This hugely important sector of the economy, which includes not only construction but everything that feeds off of it, remains in a *depression* of its own. I believe this is the major reason a recovery in employment has so severely lagged the steady and substantial comeback we have seen in almost all other sectors of our economy.

Wise monetary and fiscal policies play an important role in tempering recessions, but these tools don't create households nor eliminate excess housing units. Fortunately, demographics and our market system will restore the needed balance – probably before long. When that day comes, we will again build one million or more residential units annually. I believe pundits will be surprised at how far unemployment drops once that happens. They will then reawake to what has been true since 1776: America's best days lie ahead.

Intrinsic Business Value

Charlie and I measure our performance by the rate of gain in Berkshire's per-share intrinsic business value. If our gain over time outstrips the performance of the S&P 500, we have earned our paychecks. If it doesn't, we are overpaid at any price.

We have no way to pinpoint intrinsic value. But we do have a useful, *though considerably understated*, proxy for it: per-share book value. This yardstick is meaningless at most companies. At Berkshire, however, book value very roughly tracks business values. That's because the amount by which Berkshire's intrinsic value exceeds book value does not swing wildly from year to year, though it increases in most years. Over time, the divergence will likely become ever more substantial in absolute terms, remaining reasonably steady, however, on a percentage basis as both the numerator and denominator of the business-value/book-value equation increase.

We've regularly emphasized that our book-value performance is almost certain to outpace the S&P 500 in a bad year for the stock market and just as certainly will fall short in a strong up-year. The test is how we do over time. Last year's annual report included a table laying out results for the 42 five-year periods since we took over at Berkshire in 1965 (i.e., 1965-69, 1966-70, etc.). All showed our book value beating the S&P, and our string held for 2007-11. It will almost certainly snap, though, if the S&P 500 should put together a five-year winning streak (which it may well be on its way to doing as I write this).

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I also included two tables last year that set forth the key quantitative ingredients that will help you estimate our per-share intrinsic value. I won't repeat the full discussion here; you can find it reproduced on pages 99-100. To update the tables shown there, our per-share investments in 2011 increased 4% to \$98,366, and our pre-tax earnings from businesses other than insurance and investments increased 18% to \$6,990 per share.

Charlie and I like to see gains in both areas, but our primary focus is on building operating earnings. Over time, the businesses we currently own should increase their aggregate earnings, and we hope also to purchase some large operations that will give us a further boost. We now have eight subsidiaries that would each be included in the Fortune 500 were they stand-alone companies. That leaves only 492 to go. My task is clear, and I'm on the prowl.

Share Repurchases

Last September, we announced that Berkshire would repurchase its shares at a price of up to 110% of book value. We were in the market for only a few days – buying \$67 million of stock – before the price advanced beyond our limit. Nonetheless, the general importance of share repurchases suggests I should focus for a bit on the subject.

Charlie and I favor repurchases when two conditions are met: first, a company has ample funds to take care of the operational and liquidity needs of its business; second, its stock is selling at a material discount to the company's intrinsic business value, conservatively calculated.

We have witnessed many bouts of repurchasing that failed our second test. Sometimes, of course, infractions – even serious ones – are innocent; many CEOs never stop believing their stock is cheap. In other instances, a less benign conclusion seems warranted. It doesn't suffice to say that repurchases are being made to offset the dilution from stock issuances or simply because a company has excess cash. Continuing shareholders are *hurt* unless shares are purchased below intrinsic value. The first law of capital allocation – whether the money is slated for acquisitions or share repurchases – is that what is smart at one price is dumb at another. (One CEO who always stresses the price/value factor in repurchase decisions is Jamie Dimon at J.P. Morgan; I recommend that you read his annual letter.)

Charlie and I have mixed emotions when Berkshire shares sell well below intrinsic value. We like making money for continuing shareholders, and there is no surer way to do that than by buying an asset – our own stock – that we know to be worth *at least* x for less than that – for .9x, .8x or even lower. (As one of our directors says, it's like shooting fish in a barrel, *after* the barrel has been drained and the fish have quit flopping.) Nevertheless, we don't enjoy cashing out partners at a discount, even though our doing so may give the selling shareholders a slightly higher price than they would receive if our bid was absent. When we are buying, therefore, we want those exiting partners to be fully informed about the value of the assets they are selling.

At our limit price of 110% of book value, repurchases clearly increase Berkshire's per-share intrinsic value. And the more and the cheaper we buy, the greater the gain for continuing shareholders. Therefore, if given the opportunity, we will likely repurchase stock aggressively at our price limit or lower. You should know, however, that we have no interest in supporting the stock and that our bids will fade in particularly weak markets. Nor will we buy shares if our cash-equivalent holdings are below \$20 billion. At Berkshire, financial strength that is unquestionable takes precedence over all else.

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This discussion of repurchases offers me the chance to address the irrational reaction of many investors to changes in stock prices. When Berkshire buys stock in a company that is repurchasing shares, we hope for two events: First, we have the normal hope that earnings of the business will increase at a good clip for a long time to come; and second, we also hope that the stock *underperforms* in the market for a long time as well. A corollary to this second point: "Talking our book" about a stock we own – were that to be effective – would actually be harmful to Berkshire, not helpful as commentators customarily assume.

Let's use IBM as an example. As all business observers know, CEOs Lou Gerstner and Sam Palmisano did a superb job in moving IBM from near-bankruptcy twenty years ago to its prominence today. Their operational accomplishments were truly extraordinary.

But their financial management was equally brilliant, particularly in recent years as the company's financial flexibility improved. Indeed, I can think of no major company that has had better financial management, a skill that has materially increased the gains enjoyed by IBM shareholders. The company has used debt wisely, made value-adding acquisitions almost exclusively for cash and aggressively repurchased its own stock.

Today, IBM has 1.16 billion shares outstanding, of which we own about 63.9 million or 5.5%. Naturally, what happens to the company's earnings over the next five years is of enormous importance to us. Beyond that, the company will likely spend \$50 billion or so in those years to repurchase shares. Our quiz for the day: What should a long-term shareholder, such as Berkshire, cheer for during that period?

I won't keep you in suspense. We should wish for IBM's stock price to *languish* throughout the five years.

Let's do the math. If IBM's stock price averages, say, \$200 during the period, the company will acquire 250 million shares for its \$50 billion. There would consequently be 910 million shares outstanding, and we would own about 7% of the company. If the stock conversely sells for an average of \$300 during the five-year period, IBM will acquire only 167 million shares. That would leave about 990 million shares outstanding after five years, of which we would own 6.5%.

If IBM were to earn, say, \$20 billion in the fifth year, our share of those earnings would be a full \$100 million greater under the "disappointing" scenario of a lower stock price than they would have been at the higher price. At some later point our shares would be worth perhaps \$1½ billion more than if the "high-price" repurchase scenario had taken place.

The logic is simple: If you are going to be a net buyer of stocks in the future, either directly with your own money or indirectly (through your ownership of a company that is repurchasing shares), you are *hurt* when stocks rise. You benefit when stocks swoon. *Emotions*, however, too often complicate the matter: Most people, including those who will be net buyers in the future, take comfort in seeing stock prices advance. These shareholders resemble a commuter who rejoices after the price of gas increases, simply because his tank contains a day's supply.

Charlie and I don't expect to win many of you over to our way of thinking – we've observed enough human behavior to know the futility of that – but we do want you to be aware of our personal calculus. And here a confession is in order: In my early days I, too, rejoiced when the market rose. Then I read Chapter Eight of Ben Graham's *The Intelligent Investor*, the chapter dealing with how investors should view fluctuations in stock prices. Immediately the scales fell from my eyes, and low prices became my friend. Picking up that book was one of the luckiest moments in my life.

In the end, the success of our IBM investment will be determined primarily by its future earnings. But an important secondary factor will be how many shares the company purchases with the substantial sums it is likely to devote to this activity. And if repurchases ever reduce the IBM shares outstanding to 63.9 million, I will abandon my famed frugality and give Berkshire employees a paid holiday.

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Now, let's examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. Lumping them together therefore impedes analysis. So we'll present them as four separate businesses, which is how Charlie and I view them. Because we may be repurchasing Berkshire shares from some of you, we will offer our thoughts in each section as to how intrinsic value compares to carrying value.

Insurance

Let's look first at insurance, Berkshire's core operation and the engine that has propelled our expansion over the years.

Property-casualty ("P/C") insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit. Though individual policies and claims come and go, the amount of float we hold remains remarkably stable in relation to premium volume. Consequently, as our business grows, so does our float. And how we have grown, as the following table shows:

<u>Year</u>	<u>Float (in \$ millions)</u>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2011	70,571

It's unlikely that our float will grow much – if at all – from its current level. That's mainly because we already have an outsized amount relative to our premium volume. Were there to be a *decline* in float, I will add, it would almost certainly be *very* gradual and therefore impose no unusual demand for funds on us.

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit occurs, we enjoy the use of free money – and, better yet, get *paid* for holding it. Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous in most years that it causes the P/C industry as a whole to operate at a significant underwriting *loss*. For example, State Farm, by far the country's largest insurer and a well-managed company besides, has incurred an underwriting loss in eight of the last eleven years. There are a lot of ways to lose money in insurance, and the industry is resourceful in creating new ones.

As noted in the first section of this report, we have now operated at an underwriting profit for nine consecutive years, our gain for the period having totaled \$17 billion. I believe it likely that we will continue to underwrite profitably in most – though certainly not all – future years. If we accomplish that, our float will be better than cost-free. We will profit just as we would if some party deposited \$70.6 billion with us, paid us a fee for holding its money and then let us invest its funds for our own benefit.

So how does this attractive float affect intrinsic value calculations? Our float is deducted *in full* as a liability in calculating Berkshire's book value, just as if we had to pay it out tomorrow and were unable to replenish it. But that's an incorrect way to view float, which should instead be viewed as a revolving fund. If float is both costless and long-enduring, the true value of this liability is *far* lower than the accounting liability.

Partially offsetting this overstated liability is \$15.5 billion of "goodwill" attributable to our insurance companies that is included in book value as an asset. In effect, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. If an insurance business produces large and sustained underwriting losses, any goodwill asset attributable to it should be deemed valueless, whatever its original cost.

Fortunately, that's not the case at Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what *we* would pay to purchase float of *similar quality* – to be far in excess of its historic carrying value. The value of our float is one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds book value.

Let me emphasize once again that cost-free float is *not* an outcome to be expected for the P/C industry as a whole: We don't think there is much "Berkshire-quality" float existing in the insurance world. In most years, including 2011, the industry's premiums have been inadequate to cover claims plus expenses. Consequently, the

industry's overall return on tangible equity has for many decades fallen far short of the average return realized by American industry, a sorry performance almost certain to continue. Berkshire's outstanding economics exist only because we have some terrific managers running some extraordinary insurance operations. Let me tell you about the major units.

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First by float size is the Berkshire Hathaway Reinsurance Group, run by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most importantly, brains in a manner that is unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources. Indeed, we are *far* more conservative in that respect than most large insurers. For example, if the insurance industry should experience a \$250 billion loss from some mega-catastrophe – a loss about triple anything it has ever faced – Berkshire as a whole would likely record a moderate profit for the year because of its many streams of earnings. Concurrently, all other major insurers and reinsurers would be far in the red, and some would face insolvency.

From a standing start in 1985, Ajit has created an insurance business with float of \$34 billion and significant underwriting profits, a feat that no CEO of any other insurer has come close to matching. By these accomplishments, he has added a great many billions of dollars to the value of Berkshire. Charlie would gladly trade me for a second Ajit. Alas, there is none.

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We have another insurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively evaluate the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that will deliver a profit, on average, after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that their competitors are eagerly writing. That old line, "The other guy is doing it so we must as well," spells trouble in any business, but in none more so than insurance. Indeed, a good underwriter needs an independent mindset akin to that of the senior citizen who received a call from his wife while driving home. "Albert, be careful," she warned, "I just heard on the radio that there's a car going the wrong way down the Interstate." "Mabel, they don't know the half of it," replied Albert, "It's not just one car, there are hundreds of them."

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been better than cost-free under his leadership, and we expect that, on average, it will continue to be. In the first few years after we acquired it, General Re was a major headache. Now it's a treasure.

* * * * *

Finally, there is GEICO, the insurer on which I cut my teeth 61 years ago. GEICO is run by Tony Nicely, who joined the company at 18 and completed 50 years of service in 2011.

GEICO's much-envied record comes from Tony's brilliant execution of a superb and almost-impossible-to-replicate business model. During Tony's 18-year tenure as CEO, our market share has grown from 2.0% to 9.3%. If it had instead remained static – as it had for more than a decade before he took over – our premium volume would now be \$3.3 billion rather than the \$15.4 billion we attained in 2011. The extra value created by Tony and his associates is a major element in Berkshire's excess of intrinsic value over book value.

There is still more than 90% of the auto-insurance market left for GEICO to rake in. Don't bet against Tony acquiring chunks of it year after year in the future. Our low costs permit low prices, and every day more Americans discover that the Gecko is doing them a favor when he urges them to visit GEICO.com for a quote. (Our lizard has another endearing quality: Unlike human spokesmen or spokeswomen who expensively represent other insurance companies, our little fellow has no agent.)

* * * * *

In addition to our three major insurance operations, we own a group of smaller companies, most of them plying their trade in odd corners of the insurance world. In aggregate, their results have consistently been profitable and the float they provide us is substantial. Charlie and I treasure these companies and their managers.

At yearend, we acquired Princeton Insurance, a New Jersey writer of medical malpractice policies. This bolt-on transaction expands the managerial domain of Tim Kenesey, the star CEO of Medical Protective, our Indiana-based med-mal insurer. Princeton brings with it more than \$600 million of float, an amount that is included in the following table.

Here is the record of all four segments of our property-casualty and life insurance businesses:

<i>Insurance Operations</i>	<i>Underwriting Profit</i>		<i>Yearend Float</i>	
	<i>2011</i>	<i>2010</i>	<i>(in millions)</i>	<i>2011</i>
BH Reinsurance	\$ (714)	\$ 176	\$33,728	\$30,370
General Re	144	452	19,714	20,049
GEICO	576	1,117	11,169	10,272
Other Primary	242	268	5,960	5,141
	<u>\$ 248</u>	<u>\$2,013</u>	<u>\$70,571</u>	<u>\$65,832</u>

Among large insurance operations, Berkshire's impresses me as the best in the world.

Regulated, Capital-Intensive Businesses

We have two very large businesses, BNSF and MidAmerican Energy, that have important common characteristics distinguishing them from our many other businesses. Consequently, we assign them their own sector in this letter and also split out their combined financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is the huge investment they have in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is not needed: Both businesses have earning power that even under terrible business conditions amply covers their interest requirements. In a less than robust economy during 2011, for example, BNSF's interest coverage was 9.5x. At MidAmerican, meanwhile, two key factors ensure its ability to service debt under all circumstances: The stability of earnings that is inherent in our exclusively offering an essential service and a diversity of earnings streams, which shield it from the actions of any single regulatory body.

Measured by ton-miles, rail moves 42% of America's inter-city freight, and BNSF moves more than any other railroad – about 37% of the industry total. A little math will tell you that about 15% of *all* inter-city ton-miles of freight in the U.S. is transported by BNSF. It is no exaggeration to characterize railroads as the circulatory system of our economy. Your railroad is the largest artery.

All of this places a huge responsibility on us. We must, without fail, maintain and improve our 23,000 miles of track along with 13,000 bridges, 80 tunnels, 6,900 locomotives and 78,600 freight cars. This job requires us to have ample financial resources under *all* economic scenarios and to have the human talent that can instantly and effectively deal with the vicissitudes of nature, such as the widespread flooding BNSF labored under last summer.

To fulfill its societal obligation, BNSF regularly invests far more than its depreciation charge, with the excess amounting to \$1.8 billion in 2011. The three other major U.S. railroads are making similar outlays. Though many people decry our country's inadequate infrastructure spending, that criticism cannot be levied against the railroad industry. It is pouring money – *funds from the private sector* – into the investment projects needed to provide better and more extensive service in the future. If railroads were not making these huge expenditures, our country's publicly-financed highway system would face even greater congestion and maintenance problems than exist today.

Massive investments of the sort that BNSF is making would be foolish if it could not earn appropriate returns on the incremental sums it commits. But I am confident it will do so because of the value it delivers. Many years ago Ben Franklin counseled, "Keep thy shop, and thy shop will keep thee." Translating this to our regulated businesses, he might today say, "Take care of your customer, and the regulator – your customer's representative – will take care of you." Good behavior by each party begets good behavior in return.

At MidAmerican, we participate in a similar “social compact.” We are expected to put up ever-increasing sums to satisfy the future needs of our customers. If we meanwhile operate reliably and efficiently, we know that we will obtain a fair return on these investments.

MidAmerican, 89.8% owned by Berkshire, supplies 2.5 million customers in the U.S. with electricity, operating as the largest supplier in Iowa, Utah and Wyoming and as an important provider in six other states as well. Our pipelines transport 8% of the country’s natural gas. Obviously, many millions of Americans depend on us every day. They haven’t been disappointed.

When MidAmerican purchased Northern Natural Gas pipeline in 2002, that company’s performance as a pipeline was rated dead last, 43 out of 43, by the leading authority in the field. In the most recent report, Northern Natural was ranked second. The top spot was held by our other pipeline, Kern River.

In its electric business, MidAmerican has a comparable record. In the most recent survey of customer satisfaction, MidAmerican’s U.S. utilities ranked second among 60 utility groups surveyed. The story was far different not many years back when MidAmerican acquired these properties.

MidAmerican will have 3,316 megawatts of wind generation in operation by the end of 2012, far more than any other regulated electric utility in the country. The total amount that we have invested or committed to wind is a staggering \$6 billion. We can make this sort of investment because MidAmerican retains *all* of its earnings, unlike other utilities that generally pay out most of what they earn. In addition, late last year we took on two solar projects – one 100%-owned in California and the other 49%-owned in Arizona – that will cost about \$3 billion to construct. Many more wind and solar projects will almost certainly follow.

As you can tell by now, I am proud of what has been accomplished for our society by Matt Rose at BNSF and by Greg Abel at MidAmerican. I am also both proud and grateful for what they have accomplished for Berkshire shareholders. Below are the relevant figures:

<i>MidAmerican</i>	<i>Earnings (in millions)</i>	
	<i>2011</i>	<i>2010</i>
U.K. utilities	\$ 469	\$ 333
Iowa utility	279	279
Western utilities	771	783
Pipelines	388	378
HomeServices	39	42
Other (net)	36	47
Operating earnings before corporate interest and taxes	1,982	1,862
Interest, other than to Berkshire	(323)	(323)
Interest on Berkshire junior debt	(13)	(30)
Income tax	(315)	(271)
Net earnings	<u>\$1,331</u>	<u>\$1,238</u>
Earnings applicable to Berkshire*	\$1,204	\$1,131

*Includes interest earned by Berkshire (net of related income taxes) of \$8 in 2011 and \$19 in 2010.

<i>BNSF</i> <i>(Historical accounting through 2/12/10; purchase accounting subsequently)</i>	<i>(in millions)</i>	
	<i>2011</i>	<i>2010</i>
Revenues	\$19,548	\$16,850
Operating earnings	5,310	4,495
Interest (Net)	560	507
Pre-Tax earnings	4,741	3,988
Net earnings	2,972	2,459

In the book value recorded on our balance sheet, BNSF and MidAmerican carry substantial goodwill components totaling \$20 billion. In each instance, however, Charlie and I believe current intrinsic value is far greater than book value.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/11 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 4,241	Notes payable	\$ 1,611
Accounts and notes receivable	6,584	Other current liabilities	<u>15,124</u>
Inventory	8,975	Total current liabilities	16,735
Other current assets	<u>631</u>		
Total current assets	20,431		
Goodwill and other intangibles	24,755	Deferred taxes	4,661
Fixed assets	17,866	Term debt and other liabilities	6,214
Other assets	<u>3,661</u>	Non-controlling interests	2,410
	<u>\$66,713</u>	Berkshire equity	<u>36,693</u>
			<u>\$66,713</u>

Earnings Statement (in millions)

	<u>2011**</u>	<u>2010</u>	<u>2009</u>
Revenues	\$72,406	\$66,610	\$61,665
Operating expenses (including depreciation of \$1,431 in 2011, \$1,362 in 2010 and \$1,422 in 2009)	67,239	62,225	59,509
Interest expense	<u>130</u>	<u>111</u>	<u>98</u>
Pre-tax earnings	5,037*	4,274*	2,058*
Income taxes and non-controlling interests	1,998	1,812	945
Net earnings	<u>\$ 3,039</u>	<u>\$ 2,462</u>	<u>\$ 1,113</u>

*Does not include purchase-accounting adjustments.

**Includes earnings of Lubrizol from September 16.

This group of companies sells products ranging from lollipops to jet airplanes. Some of the businesses enjoy terrific economics, measured by earnings on unleveraged net *tangible* assets that run from 25% after-tax to more than 100%. Others produce good returns in the area of 12-20%. A few, however, have very poor returns, a result of some serious mistakes I made in my job of capital allocation. These errors came about because I misjudged either the competitive strength of the business being purchased or the future economics of the industry in which it operated. I try to look out ten or twenty years when making an acquisition, but sometimes my eyesight has been poor. Charlie's has been better; he voted no more than "present" on several of my errant purchases.

Berkshire's newer shareholders may be puzzled over our decision to hold on to my mistakes. After all, their earnings can never be consequential to Berkshire's valuation, and problem companies require more managerial time than winners. Any management consultant or Wall Street advisor would look at our laggards and say "dump them."

That won't happen. For 29 years, we have regularly laid out Berkshire's economic principles in these reports (pages 93-98) and Number 11 describes our general reluctance to sell poor performers (which, in most cases, lag because of industry factors rather than managerial shortcomings). Our approach is far from Darwinian, and many of you may disapprove of it. I can understand your position. However, we have made – and continue to make – a commitment to the sellers of businesses we buy that we will retain those businesses through thick and thin. So far, the dollar cost of that commitment has not been substantial and may well be offset by the goodwill it builds among prospective sellers looking for the right permanent home for their treasured business and loyal associates. These owners know that what they get with us can't be delivered by others and that our commitments will be good for many decades to come.

Please understand, however, that Charlie and I are neither masochists nor Pollyannas. If either of the failings we set forth in Rule 11 is present – if the business will likely be a cash drain over the longer term, or if labor strife is endemic – we will take prompt and decisive action. Such a situation has happened only a couple of times in our 47-year history, and none of the businesses we now own is in straits requiring us to consider disposing of it.

* * * * *

The steady and substantial comeback in the U.S. economy since mid-2009 is clear from the earnings shown at the front of this section. This compilation includes 54 of our companies. But one of these, Marmon, is itself the owner of 140 operations in eleven distinct business sectors. In short, when you look at Berkshire, you are looking across corporate America. So let's dig a little deeper to gain a greater insight into what has happened in the last few years.

The four housing-related companies in this section (a group that excludes Clayton, which is carried under Finance and Financial Products) had aggregate pre-tax earnings of \$227 million in 2009, \$362 million in 2010 and \$359 million in 2011. If you subtract these earnings from those in the combined statement, you will see that our multiple and diverse *non-housing* operations earned \$1,831 million in 2009, \$3,912 million in 2010 and \$4,678 million in 2011. About \$291 million of the 2011 earnings came from the Lubrizol acquisition. The profile of the remaining 2011 earnings – \$4,387 million – illustrates the comeback of much of America from the devastation wrought by the 2008 financial panic. Though housing-related businesses remain in the emergency room, most other businesses have left the hospital with their health fully restored.

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Almost all of our managers delivered outstanding performances last year, among them those managers who run housing-related businesses and were therefore fighting hurricane-force headwinds. Here are a few examples:

- Vic Mancinelli again set a record at CTB, our agricultural equipment operation. We purchased CTB in 2002 for \$139 million. It has subsequently distributed \$180 million to Berkshire, last year earned \$124 million pre-tax and has \$109 million in cash. Vic has made a number of bolt-on acquisitions over the years, including a meaningful one he signed up after yearend.
- TTI, our electric components distributor, increased its sales to a record \$2.1 billion, up 12.4% from 2010. Earnings also hit a record, up 127% from 2007, the year in which we purchased the business. In 2011, TTI performed far better than the large publicly-traded companies in its field. That's no surprise: Paul Andrews and his associates have been besting them for years. Charlie and I are delighted that Paul negotiated a large bolt-on acquisition early in 2012. We hope more follow.
- Iscar, our 80%-owned cutting-tools operation, continues to amaze us. Its sales growth and overall performance are unique in its industry. Iscar's managers – Eitan Wertheimer, Jacob Harpaz and Danny Goldman – are brilliant strategists and operators. When the economic world was cratering in November 2008, they stepped up to buy Tungaloy, a leading Japanese cutting-tool manufacturer. Tungaloy suffered significant damage when the tsunami hit north of Tokyo last spring. But you wouldn't know that now: Tungaloy went on to set a sales record in 2011. I visited the Iwaki plant in November and was inspired by the dedication and enthusiasm of Tungaloy's management, as well as its staff. They are a wonderful group and deserve your admiration and thanks.
- McLane, our huge distribution company that is run by Grady Rosier, added important new customers in 2011 and set a pre-tax earnings record of \$370 million. Since its purchase in 2003 for \$1.5 billion, the company has had pre-tax earnings of \$2.4 billion and also increased its LIFO reserve by \$230 million because the prices of the retail products it distributes (candy, gum, cigarettes, etc.) have risen. Grady runs a logistical machine second to none. You can look for bolt-ons at McLane, particularly in our new wine-and-spirits distribution business.

- Jordan Hansell took over at NetJets in April and delivered 2011 pre-tax earnings of \$227 million. That is a particularly impressive performance because the sale of new planes was slow during most of the year. In December, however, there was an uptick that was more than seasonally normal. How permanent it will be is uncertain.

A few years ago NetJets was my number one worry: Its costs were far out of line with revenues, and cash was hemorrhaging. Without Berkshire's support, NetJets would have gone broke. These problems are behind us, and Jordan is now delivering steady profits from a well-controlled and smoothly-running operation. NetJets is proceeding on a plan to enter China with some first-class partners, a move that will widen our business "moat." No other fractional-ownership operator has remotely the size and breadth of the NetJets operation, and none ever will. NetJets' unrelenting focus on safety and service has paid off in the marketplace.

- It's a joy to watch Marmon's progress under Frank Ptak's leadership. In addition to achieving internal growth, Frank regularly makes bolt-on acquisitions that, in aggregate, will materially increase Marmon's earning power. (He did three, costing about \$270 million, in the last few months.) Joint ventures around the world are another opportunity for Marmon. At midyear Marmon partnered with the Kundalia family in an Indian crane operation that is already delivering substantial profits. This is Marmon's second venture with the family, following a successful wire and cable partnership instituted a few years ago.

Of the eleven major sectors in which Marmon operates, ten delivered gains in earnings last year. You can be confident of higher earnings from Marmon in the years ahead.

- "Buy commodities, sell brands" has long been a formula for business success. It has produced enormous and sustained profits for Coca-Cola since 1886 and Wrigley since 1891. On a smaller scale, we have enjoyed good fortune with this approach at See's Candy since we purchased it 40 years ago.

Last year See's had record pre-tax earnings of \$83 million, bringing its total since we bought it to \$1.65 billion. Contrast that figure with our purchase price of \$25 million and our yearend carrying-value (net of cash) of less than zero. (Yes, you read that right; capital employed at See's fluctuates seasonally, hitting a low after Christmas.) Credit Brad Kinstler for taking the company to new heights since he became CEO in 2006.

- Nebraska Furniture Mart (80% owned) set an earnings record in 2011, netting more than ten times what it did in 1983, when we acquired our stake.

But that's not the big news. More important was NFM's acquisition of a 433-acre tract north of Dallas on which we will build what is almost certain to be the highest-volume home-furnishings store in the country. Currently, that title is shared by our two stores in Omaha and Kansas City, each of which had record-setting sales of more than \$400 million in 2011. It will be several years before the Texas store is completed, but I look forward to cutting the ribbon at the opening. (At Berkshire, the managers do the work; I take the bows.)

Our new store, which will offer an unequalled variety of merchandise sold at prices that can't be matched, will bring huge crowds from near and far. This drawing power and our extensive holdings of land at the site should enable us to attract a number of other major stores. (If any high-volume retailers are reading this, contact me.)

Our experience with NFM and the Blumkin family that runs it has been a real joy. The business was built by Rose Blumkin (known to all as "Mrs. B"), who started the company in 1937 with \$500 and a dream. She sold me our interest when she was 89 and worked until she was 103. (After retiring, she died the next year, a sequence I point out to any other Berkshire manager who even thinks of retiring.)

Mrs. B's son, Louie, now 92, helped his mother build the business after he returned from World War II and, along with his wife, Fran, has been my friend for 55 years. In turn, Louie's sons, Ron and Irv, have taken the company to new heights, first opening the Kansas City store and now gearing up for Texas.

The “boys” and I have had many great times together, and I count them among my best friends. The Blumkins are a remarkable family. Never inclined to let an extraordinary gene pool go to waste, I am rejoicing these days because several members of the fourth Blumkin generation have joined NFM.

Overall, the intrinsic value of the businesses in this Berkshire sector significantly exceeds their book value. For many of the smaller companies, however, this is not true. I have made more than my share of mistakes buying small companies. Charlie long ago told me, “If something’s not worth doing at all, it’s not worth doing well,” and I should have listened harder. In any event, our large purchases have generally worked well – extraordinarily well in a few cases – and overall this sector is a winner for us.

* * * * *

Certain shareholders have told me they hunger for more discussions of accounting arcana. So here’s a bit of GAAP-mandated nonsense I hope both of them enjoy.

Common sense would tell you that our varied subsidiaries should be carried on our books at their cost plus the earnings they have retained since our purchase (unless their economic value has materially decreased, in which case an appropriate write-down must be taken). And that’s essentially the reality at Berkshire – except for the weird situation at Marmon.

We purchased 64% of the company in 2008 and put this interest on our books at our cost, \$4.8 billion. So far, so good. Then, in early 2011, pursuant to our original contract with the Pritzker family, we purchased an additional 16%, paying \$1.5 billion as called for by a formula that reflected Marmon’s increased value. In this instance, however, we were required to immediately write off \$614 million of the purchase price retroactive to the end of 2010. (Don’t ask!) Obviously, this write-off had no connection to economic reality. The excess of Marmon’s intrinsic value over its carrying value is widened by this meaningless write-down.

Finance and Financial Products

This sector, our smallest, includes two rental companies, XTRA (trailers) and CORT (furniture), and Clayton Homes, the country’s leading producer and financer of manufactured homes. Aside from these 100%-owned subsidiaries, we also include in this category a collection of financial assets and our 50% interest in Berkadia Commercial Mortgage.

It’s instructive to look at what transpired at our three operating businesses after the economy fell off a cliff in late 2008, because their experiences illuminate the fractured recovery that later came along.

Results at our two leasing companies mirrored the “non-housing” economy. Their combined pre-tax earnings were \$13 million in 2009, \$53 million in 2010 and \$155 million in 2011, an improvement reflecting the steady recovery we have seen in almost all of our non-housing businesses. In contrast, Clayton’s world of manufactured housing (just like site-built housing) has endured a veritable depression, experiencing no recovery to date. Manufactured housing sales in the nation were 49,789 homes in 2009, 50,046 in 2010 and 51,606 in 2011. (When housing was booming in 2005, they were 146,744.)

Despite these difficult times, Clayton has continued to operate profitably, largely because its mortgage portfolio has performed well under trying circumstances. Because we are the largest lender in the manufactured homes sector and are also normally lending to lower-and-middle-income families, you might expect us to suffer heavy losses during a housing meltdown. But by sticking to old-fashioned loan policies – meaningful down payments and monthly payments with a sensible relationship to regular income – Clayton has kept losses to acceptable levels. It has done so even though many of our borrowers have had negative equity for some time.

As is well-known, the U.S. went off the rails in its home-ownership and mortgage-lending policies, and for these mistakes our economy is now paying a huge price. All of us participated in the destructive behavior – government, lenders, borrowers, the media, rating agencies, you name it. At the core of the folly was the almost universal belief that the value of houses was certain to increase over time and that any dips would be inconsequential. The acceptance of this premise justified almost any price and practice in housing transactions. Homeowners everywhere felt richer and rushed to “monetize” the increased value of their homes by refinancings. These massive cash infusions fueled a consumption binge throughout our economy. It all seemed great fun while it lasted. (A largely unnoted fact: Large numbers of people who have “lost” their house through foreclosure have actually realized a profit because they carried out refinancings earlier that gave them cash in excess of their cost. In these cases, the evicted homeowner was the winner, and the victim was the lender.)

In 2007, the bubble burst, just as all bubbles must. We are now in the fourth year of a cure that, though long and painful, is sure to succeed. Today, household formations are consistently exceeding housing starts.

Clayton's earnings should improve materially when the nation's excess housing inventory is worked off. As I see things today, however, I believe the intrinsic value of the three businesses in this sector does not differ materially from their book value.

Investments

Below we show our common stock investments that at yearend had a market value of more than \$1 billion.

			12/31/11	
<u>Shares</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>Cost*</u>	<u>Market</u>
			<i>(in millions)</i>	
151,610,700	American Express Company	13.0	\$ 1,287	\$ 7,151
200,000,000	The Coca-Cola Company	8.8	1,299	13,994
29,100,937	ConocoPhillips	2.3	2,027	2,121
63,905,931	International Business Machines Corp.	5.5	10,856	11,751
31,416,127	Johnson & Johnson	1.2	1,880	2,060
79,034,713	Kraft Foods Inc.	4.5	2,589	2,953
20,060,390	Munich Re	11.3	2,990	2,464
3,947,555	POSCO	5.1	768	1,301
72,391,036	The Procter & Gamble Company	2.6	464	4,829
25,848,838	Sanofi	1.9	2,055	1,900
291,577,428	Tesco plc	3.6	1,719	1,827
78,060,769	U.S. Bancorp	4.1	2,401	2,112
39,037,142	Wal-Mart Stores, Inc.	1.1	1,893	2,333
400,015,828	Wells Fargo & Company	7.6	9,086	11,024
	Others		6,895	9,171
	Total Common Stocks Carried at Market		<u>\$48,209</u>	<u>\$76,991</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

We made few changes in our investment holdings during 2011. But three moves were important: our purchases of IBM and Bank of America and the \$1 billion addition we made to our Wells Fargo position.

The banking industry is back on its feet, and Wells Fargo is prospering. Its earnings are strong, its assets solid and its capital at record levels. At Bank of America, some huge mistakes were made by prior management. Brian Moynihan has made excellent progress in cleaning these up, though the completion of that process will take a number of years. Concurrently, he is nurturing a huge and attractive underlying business that will endure long after today's problems are forgotten. Our warrants to buy 700 million Bank of America shares will likely be of great value before they expire.

As was the case with Coca-Cola in 1988 and the railroads in 2006, I was late to the IBM party. I have been reading the company's annual report for more than 50 years, but it wasn't until a Saturday in March last year that my thinking crystallized. As Thoreau said, "It's not what you look at that matters, it's what you see."

Todd Combs built a \$1.75 billion portfolio (at cost) last year, and Ted Weschler will soon create one of similar size. Each of them receives 80% of his performance compensation from his own results and 20% from his partner's. When our quarterly filings report relatively small holdings, these are not likely to be buys I made (though the media often overlook that point) but rather holdings denoting purchases by Todd or Ted.

One additional point about these two new arrivals. Both Ted and Todd will be helpful to the next CEO of Berkshire in making acquisitions. They have excellent “business minds” that grasp the economic forces likely to determine the future of a wide variety of businesses. They are aided in their thinking by an understanding of what is predictable and what is unknowable.

* * * * *

There is little new to report on our derivatives positions, which we have described in detail in past reports. (Annual reports since 1977 are available at www.berkshirehathaway.com.) One important industry change, however, must be noted: Though our existing contracts have very minor collateral requirements, the rules have changed for new positions. Consequently, we will not be initiating any major derivatives positions. We shun contracts of any type that could require the instant posting of collateral. The possibility of some sudden and huge posting requirement – arising from an out-of-the-blue event such as a worldwide financial panic or massive terrorist attack – is inconsistent with our primary objectives of redundant liquidity and unquestioned financial strength.

Our insurance-like derivatives contracts, whereby we pay if various issues included in high-yield bond indices default, are coming to a close. The contracts that most exposed us to losses have already expired, and the remainder will terminate soon. In 2011, we paid out \$86 million on two losses, bringing our total payments to \$2.6 billion. We are almost certain to realize a final “underwriting profit” on this portfolio because the premiums we received were \$3.4 billion, and our future losses are apt to be minor. In addition, we will have averaged about \$2 billion of float over the five-year life of these contracts. This successful result during a time of great credit stress underscores the importance of obtaining a premium that is commensurate with the risk.

Charlie and I continue to believe that our equity-put positions will produce a significant profit, considering both the \$4.2 billion of float we will have held for more than fifteen years and the \$222 million profit we’ve already realized on contracts that we repurchased. At yearend, Berkshire’s book value reflected a liability of \$8.5 billion for the remaining contracts; if they had all come due at that time our payment would have been \$6.2 billion.

The Basic Choices for Investors and the One We Strongly Prefer

Investing is often described as the process of laying out money now in the expectation of receiving more money in the future. At Berkshire we take a more demanding approach, defining investing as the transfer to others of purchasing power now with the reasoned expectation of receiving more purchasing power – *after taxes have been paid on nominal gains* – in the future. More succinctly, investing is forgoing consumption now in order to have the ability to consume more at a later date.

From our definition there flows an important corollary: The riskiness of an investment is *not* measured by beta (a Wall Street term encompassing volatility and often used in measuring risk) but rather by the probability – the *reasoned* probability – of that investment causing its owner a loss of purchasing-power over his contemplated holding period. Assets can fluctuate greatly in price and not be risky as long as they are reasonably certain to deliver increased purchasing power over their holding period. And as we will see, a non-fluctuating asset can be laden with risk.

Investment possibilities are both many and varied. There are three major categories, however, and it’s important to understand the characteristics of each. So let’s survey the field.

- Investments that are denominated in a given currency include money-market funds, bonds, mortgages, bank deposits, and other instruments. Most of these currency-based investments are thought of as “safe.” In truth they are among the most dangerous of assets. Their beta may be zero, but their risk is huge.

Over the past century these instruments have destroyed the purchasing power of investors in many countries, even as the holders continued to receive timely payments of interest and principal. This ugly result, moreover, will forever recur. Governments determine the ultimate value of money, and systemic forces will sometimes cause them to gravitate to policies that produce inflation. From time to time such policies spin out of control.

Even in the U.S., where the wish for a stable currency is strong, the dollar has fallen a staggering 86% in value since 1965, when I took over management of Berkshire. It takes no less than \$7 today to buy what \$1 did at that time. Consequently, a tax-free institution would have needed 4.3% interest annually from bond investments over that period to simply maintain its purchasing power. Its managers would have been kidding themselves if they thought of *any* portion of that interest as “income.”

For tax-paying investors like you and me, the picture has been far worse. During the same 47-year period, continuous rolling of U.S. Treasury bills produced 5.7% annually. That sounds satisfactory. But if an individual investor paid personal income taxes at a rate averaging 25%, this 5.7% return would have yielded *nothing* in the way of real income. This investor's visible income tax would have stripped him of 1.4 points of the stated yield, and the invisible inflation tax would have devoured the remaining 4.3 points. It's noteworthy that the implicit inflation "tax" was more than triple the explicit income tax that our investor probably thought of as his main burden. "In God We Trust" may be imprinted on our currency, but the hand that activates our government's printing press has been all too human.

High interest rates, of course, can compensate purchasers for the inflation risk they face with currency-based investments – and indeed, rates in the early 1980s did that job nicely. Current rates, however, do not come close to offsetting the purchasing-power risk that investors assume. Right now bonds should come with a warning label.

Under today's conditions, therefore, I do not like currency-based investments. Even so, Berkshire holds significant amounts of them, primarily of the short-term variety. At Berkshire the need for ample liquidity occupies center stage and will *never* be slighted, however inadequate rates may be. Accommodating this need, we primarily hold U.S. Treasury bills, the only investment that can be counted on for liquidity under the most chaotic of economic conditions. Our working level for liquidity is \$20 billion; \$10 billion is our absolute minimum.

Beyond the requirements that liquidity and regulators impose on us, we will purchase currency-related securities only if they offer the possibility of unusual gain – either because a particular credit is mispriced, as can occur in periodic junk-bond debacles, or because rates rise to a level that offers the possibility of realizing substantial capital gains on high-grade bonds when rates fall. Though we've exploited both opportunities in the past – and may do so again – we are now 180 degrees removed from such prospects. Today, a wry comment that Wall Streeter Shelby Cullom Davis made long ago seems apt: "Bonds promoted as offering risk-free returns are now priced to deliver return-free risk."

- The second major category of investments involves assets that will never produce anything, but that are purchased in the buyer's hope that someone else – who also knows that the assets will be forever unproductive – will pay more for them in the future. Tulips, of all things, briefly became a favorite of such buyers in the 17th century.

This type of investment requires an expanding pool of buyers, who, in turn, are enticed because they believe the buying pool will expand still further. Owners are *not* inspired by what the asset itself can produce – it will remain lifeless forever – but rather by the belief that others will desire it even more avidly in the future.

The major asset in this category is gold, currently a huge favorite of investors who fear almost all other assets, especially paper money (of whose value, as noted, they are right to be fearful). Gold, however, has two significant shortcomings, being neither of much use nor procreative. True, gold has some industrial and decorative utility, but the demand for these purposes is both limited and incapable of soaking up new production. Meanwhile, if you own one ounce of gold for an eternity, you will still own one ounce at its end.

What motivates most gold purchasers is their belief that the ranks of the fearful will grow. During the past decade that belief has proved correct. Beyond that, the rising price has on its own generated additional buying enthusiasm, attracting purchasers who see the rise as validating an investment thesis. As "bandwagon" investors join any party, they create their own truth – *for a while*.

Over the past 15 years, both Internet stocks and houses have demonstrated the extraordinary excesses that can be created by combining an initially sensible thesis with well-publicized rising prices. In these bubbles, an army of originally skeptical investors succumbed to the "proof" delivered by the market, and the pool of buyers – for a time – expanded sufficiently to keep the bandwagon rolling. But bubbles blown large enough inevitably pop. And then the old proverb is confirmed once again: "What the wise man does in the beginning, the fool does in the end."

Today the world's gold stock is about 170,000 metric tons. If all of this gold were melded together, it would form a cube of about 68 feet per side. (Picture it fitting comfortably within a baseball infield.) At \$1,750 per ounce – gold's price as I write this – its value would be \$9.6 trillion. Call this cube pile A.

Let's now create a pile B costing an equal amount. For that, we could buy *all* U.S. cropland (400 million acres with output of about \$200 billion annually), plus 16 Exxon Mobils (the world's most profitable company, one earning more than \$40 billion annually). After these purchases, we would have about \$1 trillion left over for walking-around money (no sense feeling strapped after this buying binge). Can you imagine an investor with \$9.6 trillion selecting pile A over pile B?

Beyond the staggering valuation given the existing stock of gold, current prices make today's annual production of gold command about \$160 billion. Buyers – whether jewelry and industrial users, frightened individuals, or speculators – must continually absorb this additional supply to merely maintain an equilibrium at present prices.

A century from now the 400 million acres of farmland will have produced staggering amounts of corn, wheat, cotton, and other crops – and will continue to produce that valuable bounty, whatever the currency may be. Exxon Mobil will probably have delivered trillions of dollars in dividends to its owners and will also hold assets worth many more trillions (and, remember, you get 16 Exxons). The 170,000 tons of gold will be unchanged in size and still incapable of producing anything. You can fondle the cube, but it will not respond.

Admittedly, when people a century from now are fearful, it's likely many will still rush to gold. I'm confident, however, that the \$9.6 trillion current valuation of pile A will compound over the century at a rate far inferior to that achieved by pile B.

- Our first two categories enjoy maximum popularity at peaks of fear: Terror over economic collapse drives individuals to currency-based assets, most particularly U.S. obligations, and fear of currency collapse fosters movement to sterile assets such as gold. We heard "cash is king" in late 2008, just when cash should have been deployed rather than held. Similarly, we heard "cash is trash" in the early 1980s just when fixed-dollar investments were at their most attractive level in memory. On those occasions, investors who required a supportive crowd paid dearly for that comfort.

My own preference – and you knew this was coming – is our third category: investment in productive assets, whether businesses, farms, or real estate. Ideally, these assets should have the ability in inflationary times to deliver output that will retain its purchasing-power value while requiring a minimum of new capital investment. Farms, real estate, and many businesses such as Coca-Cola, IBM and our own See's Candy meet that double-barreled test. Certain other companies – think of our regulated utilities, for example – fail it because inflation places heavy capital requirements on them. To earn more, their owners must invest more. Even so, these investments will remain superior to nonproductive or currency-based assets.

Whether the currency a century from now is based on gold, seashells, shark teeth, or a piece of paper (as today), people will be willing to exchange a couple of minutes of their daily labor for a Coca-Cola or some See's peanut brittle. In the future the U.S. population will move more goods, consume more food, and require more living space than it does now. People will forever exchange what they produce for what others produce.

Our country's businesses will continue to efficiently deliver goods and services wanted by our citizens. Metaphorically, these commercial "cows" will live for centuries and give ever greater quantities of "milk" to boot. Their value will be determined not by the medium of exchange but rather by their capacity to deliver milk. Proceeds from the sale of the milk will compound for the owners of the cows, just as they did during the 20th century when the Dow increased from 66 to 11,497 (and paid loads of dividends as well). Berkshire's goal will be to increase its ownership of first-class businesses. Our first choice will be to own them in their entirety – but we will also be owners by way of holding sizable amounts of marketable stocks. I believe that over any extended period of time this category of investing will prove to be the runaway winner among the three we've examined. More important, it will be *by far* the safest.

The Annual Meeting

The annual meeting will be held on Saturday, May 5th at the CenturyLink Center (renamed from “Qwest”). Last year, Carrie Kizer debuted as the ringmaster and earned a lifetime assignment. Everyone loved the job she did – especially me.

Soon after the 7 a.m. opening of the doors, we will have a new activity: The Newspaper Tossing Challenge. Late last year, Berkshire purchased the Omaha World-Herald and, in my meeting with its shareholder-employees, I told of the folding and throwing skills I developed while delivering 500,000 papers as a teenager.

I immediately saw skepticism in the eyes of the audience. That was no surprise to me. After all, the reporters’ mantra is: “If your mother says she loves you, check it out.” So now I have to back up my claim. At the meeting, I will take on all comers in making 35-foot tosses of the World-Herald to a Clayton porch. Any challenger whose paper lands closer to the doorstep than mine will receive a dilly bar. I’ve asked Dairy Queen to supply several for the contest, though I doubt that any will be needed. We will have a large stack of papers. Grab one. Fold it (no rubber bands). Take your best shot. Make my day.

At 8:30, a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (with a break for lunch at the CenturyLink’s stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day’s question periods, please do so while *Charlie* is talking.

The best reason to exit, of course, is to *shop*. We will help you do so by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. In a nine-hour period, we sold 1,249 pairs of Justin boots, 11,254 pounds of See’s candy, 8,000 Quikut knives (that’s 15 knives per minute) and 6,126 pairs of Wells Lamont gloves, a Marmon product whose very existence was news to me. (The product I focus on is money.) But you can do better. Remember: Anyone who says money can’t buy happiness simply hasn’t shopped at our meeting.

Among the new exhibitors this year will be Brooks, our running-shoe company. Brooks has been gobbling up market share and in 2011 had a sales gain of 34%, its tenth consecutive year of record volume. Drop by and congratulate Jim Weber, the company’s CEO. And be sure to buy a couple of pairs of limited edition “Berkshire Hathaway Running Shoes.”

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least half of you, I believe we can.

Be sure to visit the Bookworm. It will carry more than 35 books and DVDs, including a couple of new ones. I recommend *MiTek*, an informative history of one of our very successful subsidiaries. You’ll learn how my interest in the company was originally piqued by my receiving in the mail a hunk of ugly metal whose purpose I couldn’t fathom. Since we bought MiTek in 2001, it has made 33 “tuck-in” acquisitions, almost all successful. I think you’ll also like a short book that Peter Bevelin has put together explaining Berkshire’s investment and operating principles. It sums up what Charlie and I have been saying over the years in annual reports and at annual meetings. Should you need to ship your book purchases, a shipping service will be available nearby.

If you are a big spender – or aspire to become one – visit Elliott Aviation on the east side of the Omaha airport between noon and 5:00 p.m. on Saturday. There we will have a fleet of NetJets aircraft that will get your pulse racing. Come by bus; leave by private jet. I’ll OK your credit.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City versus Omaha. The drive between the two cities is about 2½ hours, and it may be that you can save significant money, particularly if you had planned to rent a car in Omaha. Spend the savings with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” discount pricing. Last year the store did \$32.7 million of business during its annual meeting sale, a volume that exceeds the yearly sales of most furniture stores. To obtain the Berkshire discount, you must make your purchases between Tuesday, May 1st and Monday, May 7th inclusive, and also present your meeting credential. The period’s special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 4th. The second, the main gala, will be held on Sunday, May 6th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m. On Sunday, around 2 p.m., I will be clerking at Borsheims, desperate to beat my sales figure from last year. So come take advantage of me. Ask me for my “Crazy Warren” price.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 30th through Saturday, May 12th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world’s top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Two non-experts – Charlie and I – will also be at the tables.

Gorat’s and Piccolo’s will again be open exclusively for Berkshire shareholders on Sunday, May 6th. Both will be serving until 10 p.m., with Gorat’s opening at 1 p.m. and Piccolo’s opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. (Actuarial tables tell me that I can consume another 12 million calories before my death. I’m terrified at the thought of leaving any of these behind, so will be frontloading on Sunday.) Remember: To make a reservation at Gorat’s, call 402-551-3733 on April 1st (*but not before*) and at Piccolo’s, call 402-342-9038. At Piccolo’s, show some class and order a giant root beer float for dessert. Only sissies get the small one.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be e-mailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the dozen or so he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is selected.)

This year we are adding a second panel of three financial analysts who follow Berkshire. They are Cliff Gallant of KBW, Jay Gelb of Barclays Capital and Gary Ransom of Dowling and Partners. These analysts will bring their own Berkshire-specific questions and alternate with the journalists and the audience.

Charlie and I believe that all shareholders should have access to new Berkshire information simultaneously and should also have adequate time to analyze it, which is why we try to issue financial information after the market close on a Friday. We do not talk one-on-one to large institutional investors or analysts. Our new panel will let analysts ask questions – perhaps even a few technical ones – in a manner that may be helpful to many shareholders.

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists and analysts will come up with some tough ones, and that's the way we like it. All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and 18 from the audience. If there is some extra time, we will take more from the audience. Audience questioners will be determined by drawings that will take place at 8:15 a.m. at each of the 13 microphones located in the arena and main overflow room.

* * * * *

For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars, who run their businesses as if they were the only asset owned by their families. I believe their mindset to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most have no financial need to work; the joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 23 men and women who work with me at our corporate office (all on one floor, which is the way we intend to keep it!).

This group efficiently deals with a multitude of SEC and other regulatory requirements and files a 17,839-page Federal income tax return – hello, Guinness! – as well as state and foreign returns. Additionally, they respond to countless shareholder and media inquiries, get out the annual report, prepare for the country's largest annual meeting, coordinate the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: They deal with 48 universities (selected from 200 applicants) who will send students to Omaha this school year for a day with me and also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers for lunch. No CEO has it better.

This home office crew, along with our operating managers, has my deepest thanks and deserves yours as well. Come to Omaha – the cradle of capitalism – on May 5th and tell them so.

February 25, 2012

Warren E. Buffett
Chairman of the Board

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	0.7
1998	48.3	28.6	19.7
1999	0.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(0.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
2010	13.0	15.1	(2.1)
2011	4.6	2.1	2.5
2012	14.4	16.0	(1.6)
Compounded Annual Gain – 1965-2012	19.7%	9.4%	10.3
Overall Gain – 1964-2012	586,817%	7,433%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

In 2012, Berkshire achieved a total gain for its shareholders of \$24.1 billion. We used \$1.3 billion of that to repurchase our stock, which left us with an increase in net worth of \$22.8 billion for the year. The per-share book value of both our Class A and Class B stock increased by 14.4%. Over the last 48 years (that is, since present management took over), book value has grown from \$19 to \$114,214, a rate of 19.7% compounded annually.*

A number of good things happened at Berkshire last year, but let's first get the bad news out of the way.

- When the partnership I ran took control of Berkshire in 1965, I could never have dreamed that a year in which we had a gain of \$24.1 billion would be subpar, in terms of the comparison we present on the facing page.

But subpar it was. For the ninth time in 48 years, Berkshire's percentage increase in book value was less than the S&P's percentage gain (a calculation that includes dividends as well as price appreciation). In eight of those nine years, it should be noted, the S&P had a gain of 15% or more. We do better when the wind is in our face.

To date, we've never had a five-year period of underperformance, having managed 43 times to surpass the S&P over such a stretch. (The record is on page 103.) But the S&P has now had gains in each of the last four years, outpacing us over that period. If the market continues to advance in 2013, our streak of five-year wins will end.

One thing of which you can be certain: Whatever Berkshire's results, my partner Charlie Munger, the company's Vice Chairman, and I will not change yardsticks. It's our *job* to increase intrinsic business value – for which we use book value as a *significantly understated* proxy – at a faster rate than the market gains of the S&P. If we do so, Berkshire's share price, though unpredictable from year to year, will itself outpace the S&P over time. If we fail, however, our management will bring no value to our investors, who themselves can earn S&P returns by buying a low-cost index fund.

Charlie and I believe the gain in Berkshire's intrinsic value will over time likely surpass the S&P returns by a small margin. We're confident of that because we have some outstanding businesses, a cadre of terrific operating managers and a shareholder-oriented culture. Our relative performance, however, is almost certain to be better when the market is down or flat. In years when the market is particularly strong, expect us to fall short.

- The second disappointment in 2012 was my inability to make a major acquisition. I pursued a couple of elephants, but came up empty-handed.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

Our luck, however, changed early this year. In February, we agreed to buy 50% of a holding company that will own all of H. J. Heinz. The other half will be owned by a small group of investors led by Jorge Paulo Lemann, a renowned Brazilian businessman and philanthropist.

We couldn't be in better company. Jorge Paulo is a long-time friend of mine and an extraordinary manager. His group and Berkshire will each contribute about \$4 billion for common equity in the holding company. Berkshire will also invest \$8 billion in preferred shares that pay a 9% dividend. The preferred has two other features that materially increase its value: at some point it will be redeemed at a significant premium price and the preferred also comes with warrants permitting us to buy 5% of the holding company's common stock for a nominal sum.

Our total investment of about \$12 billion soaks up much of what Berkshire earned last year. But we still have plenty of cash and are generating more at a good clip. So it's back to work; Charlie and I have again donned our safari outfits and resumed our search for elephants.

Now to some good news from 2012:

- Last year I told you that BNSF, Iscar, Lubrizol, Marmon Group and MidAmerican Energy – our five most profitable non-insurance companies – were likely to earn more than \$10 billion pre-tax in 2012. They delivered. Despite tepid U.S. growth and weakening economies throughout much of the world, our “powerhouse five” had aggregate earnings of \$10.1 billion, about \$600 million more than in 2011.

Of this group, only MidAmerican, then earning \$393 million pre-tax, was owned by Berkshire eight years ago. Subsequently, we purchased another three of the five on an all-cash basis. In acquiring the fifth, BNSF, we paid about 70% of the cost in cash, and for the remainder, issued shares that increased the amount outstanding by 6.1%. Consequently, the \$9.7 billion gain in annual earnings delivered Berkshire by the five companies has been accompanied by only minor dilution. That satisfies our goal of not simply growing, but rather increasing *per-share* results.

Unless the U.S. economy tanks – which we don’t expect – our powerhouse five should again deliver higher earnings in 2013. The five outstanding CEOs who run them will see to that.

- Though I failed to land a major acquisition in 2012, the managers of our subsidiaries did far better. We had a record year for “bolt-on” purchases, spending about \$2.3 billion for 26 companies that were melded into our existing businesses. These transactions were completed without Berkshire issuing *any* shares.

Charlie and I love these acquisitions: Usually they are low-risk, burden headquarters not at all, and expand the scope of our proven managers.

- Our insurance operations shot the lights out last year. While giving Berkshire \$73 billion of *free* money to invest, they also delivered a \$1.6 billion underwriting gain, the tenth consecutive year of profitable underwriting. This is truly having your cake and eating it too.

GEICO led the way, continuing to gobble up market share without sacrificing underwriting discipline. Since 1995, when we obtained control, GEICO’s share of the personal-auto market has grown from 2.5% to 9.7%. Premium volume meanwhile increased from \$2.8 billion to \$16.7 billion. Much more growth lies ahead.

The credit for GEICO’s extraordinary performance goes to Tony Nicely and his 27,000 associates. And to that cast, we should add our Gecko. Neither rain nor storm nor gloom of night can stop him; the little lizard just soldiers on, telling Americans how they can save big money by going to GEICO.com.

When I count my blessings, I count GEICO twice.

- Todd Combs and Ted Weschler, our new investment managers, have proved to be smart, models of integrity, helpful to Berkshire in many ways beyond portfolio management, and a perfect cultural fit. We hit the jackpot with these two. In 2012 each outperformed the S&P 500 by double-digit margins. They left me in the dust as well.

Consequently, we have increased the funds managed by each to almost \$5 billion (some of this emanating from the pension funds of our subsidiaries). Todd and Ted are young and will be around to manage Berkshire's massive portfolio long after Charlie and I have left the scene. You can rest easy when they take over.

- Berkshire's yearend employment totaled a record 288,462 (see page 106 for details), up 17,604 from last year. Our headquarters crew, however, remained unchanged at 24. No sense going crazy.
- Berkshire's "Big Four" investments – American Express, Coca-Cola, IBM and Wells Fargo – all had good years. Our ownership interest in each of these companies increased during the year. We purchased additional shares of Wells Fargo (our ownership now is 8.7% versus 7.6% at yearend 2011) and IBM (6.0% versus 5.5%). Meanwhile, stock repurchases at Coca-Cola and American Express raised our percentage ownership. Our equity in Coca-Cola grew from 8.8% to 8.9% and our interest at American Express from 13.0% to 13.7%.

Berkshire's ownership interest in all four companies is likely to increase in the future. Mae West had it right: "Too much of a good thing can be wonderful."

The four companies possess marvelous businesses and are run by managers who are both talented and shareholder-oriented. At Berkshire we much prefer owning a non-controlling but substantial portion of a wonderful business to owning 100% of a so-so business. Our flexibility in capital allocation gives us a significant advantage over companies that limit themselves only to acquisitions they can operate.

Going by our yearend share count, our portion of the "Big Four's" 2012 earnings amounted to \$3.9 billion. In the earnings we report to you, however, we include only the dividends we receive – about \$1.1 billion. But make no mistake: The \$2.8 billion of earnings we do not report is every bit as valuable to us as what we record.

The earnings that the four companies retain are often used for repurchases – which enhance our share of future earnings – and also for funding business opportunities that are usually advantageous. Over time we expect substantially greater earnings from these four investees. If we are correct, dividends to Berkshire will increase and, even more important, so will our unrealized capital gains (which, for the four, totaled \$26.7 billion at yearend).

- There was a lot of hand-wringing last year among CEOs who cried "uncertainty" when faced with capital-allocation decisions (despite many of their businesses having enjoyed record levels of both earnings and cash). At Berkshire, we didn't share their fears, instead spending a record \$9.8 billion on plant and equipment in 2012, about 88% of it in the United States. That's 19% more than we spent in 2011, our previous high. Charlie and I love investing large sums in worthwhile projects, whatever the pundits are saying. We instead heed the words from Gary Allan's new country song, "Every Storm Runs Out of Rain."

We will keep our foot to the floor and will almost certainly set still another record for capital expenditures in 2013. Opportunities abound in America.

* * * * *

A thought for my fellow CEOs: Of course, the immediate future is uncertain; America has faced the unknown since 1776. It's just that sometimes people focus on the myriad of uncertainties that always exist while at other times they ignore them (usually because the recent past has been uneventful).

American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favor. (The Dow Jones Industrials advanced from 66 to 11,497 in the 20th Century, a staggering 17,320% increase that materialized despite four costly wars, a Great Depression and many recessions. And don't forget that shareholders received substantial dividends throughout the century as well.)

Since the basic game is so favorable, Charlie and I believe it's a terrible mistake to try to dance in and out of it based upon the turn of tarot cards, the predictions of "experts," or the ebb and flow of business activity. The risks of being out of the game are huge compared to the risks of being in it.

My own history provides a dramatic example: I made my first stock purchase in the spring of 1942 when the U.S. was suffering major losses throughout the Pacific war zone. Each day's headlines told of more setbacks. Even so, there was no talk about uncertainty; *every* American I knew believed we would prevail.

The country's success since that perilous time boggles the mind: On an inflation-adjusted basis, GDP per capita more than *quadrupled* between 1941 and 2012. Throughout that period, *every* tomorrow has been uncertain. America's destiny, however, has always been clear: ever-increasing abundance.

If you are a CEO who has some large, profitable project you are shelving because of short-term worries, call Berkshire. Let us unburden you.

* * * * *

In summary, Charlie and I hope to build per-share intrinsic value by (1) improving the earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) participating in the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. We will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Those building blocks rest on a rock-solid foundation. A century hence, BNSF and MidAmerican Energy will continue to play major roles in the American economy. Insurance, moreover, will always be essential for both businesses and individuals – and no company brings greater resources to that arena than Berkshire. As we view these and other strengths, Charlie and I like your company's prospects.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (or, for that matter, any other stock). In our 2010 annual report, however, we laid out the three elements – one of which was qualitative – that we believe are the keys to a sensible estimate of Berkshire's intrinsic value. That discussion is reproduced in full on pages 104-105.

Here is an update of the two quantitative factors: In 2012 our per-share investments increased 15.7% to \$113,786, and our per-share pre-tax earnings from businesses other than insurance and investments also increased 15.7% to \$8,085.

Since 1970, our per-share investments have increased at a rate of 19.4% compounded annually, and our per-share earnings figure has grown at a 20.8% clip. It is no coincidence that the price of Berkshire stock over the 42-year period has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both areas, but our strong emphasis will always be on building operating earnings.

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Now, let's examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. Lumping them together therefore impedes analysis. So we'll present them as four separate businesses, which is how Charlie and I view them.

Insurance

Let's look first at insurance, Berkshire's core operation and the engine that has propelled our expansion over the years.

Property-casualty ("P/C") insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit. Though individual policies and claims come and go, the amount of float we hold remains quite stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

<u>Year</u>	<u>Float (in \$ millions)</u>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2012	73,125

Last year I told you that our float was likely to level off or even decline a bit in the future. Our insurance CEOs set out to prove me wrong and *did*, increasing float last year by \$2.5 billion. I now expect a further increase in 2013. But further gains will be tough to achieve. On the plus side, GEICO's float will almost certainly grow. In National Indemnity's reinsurance division, however, we have a number of run-off contracts whose float drifts downward. If we do experience a decline in float at some future time, it will be *very* gradual – at the outside no more than 2% in any year.

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it. That's like your taking out a loan and having the bank pay *you* interest.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous in most years that it causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. For example, State Farm, by far the country's largest insurer and a well-managed company besides, incurred an underwriting loss in eight of the eleven years ending in 2011. (Their financials for 2012 are not yet available.) There are a lot of ways to lose money in insurance, and the industry never ceases searching for new ones.

As noted in the first section of this report, we have now operated at an underwriting profit for ten consecutive years, our pre-tax gain for the period having totaled \$18.6 billion. Looking ahead, I believe we will continue to underwrite profitably in most years. If we do, our float will be better than free money.

So how does our attractive float affect the calculations of intrinsic value? When Berkshire's book value is calculated, the *full* amount of our float is deducted as a liability, just as if we had to pay it out tomorrow and were unable to replenish it. But that's an incorrect way to look at float, which should instead be viewed as a revolving fund. If float is both costless and long-enduring, which I believe Berkshire's will be, the true value of this liability is *dramatically* less than the accounting liability.

A partial offset to this overstated liability is \$15.5 billion of "goodwill" that is attributable to our insurance companies and included in book value as an asset. In effect, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance business sustains large and prolonged underwriting losses, any goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that's not the case at Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay to purchase an insurance operation producing float *of similar quality* – to be far in excess of its historic carrying value. The value of our float is one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

Let me emphasize once again that cost-free float is *not* an outcome to be expected for the P/C industry as a whole: There is very little “Berkshire-quality” float existing in the insurance world. In 37 of the 45 years ending in 2011, the industry’s premiums have been inadequate to cover claims plus expenses. Consequently, the industry’s overall return on tangible equity has for many decades fallen far short of the average return realized by American industry, a sorry performance almost certain to continue.

A further unpleasant reality adds to the industry’s dim prospects: Insurance earnings are now benefitting from “legacy” bond portfolios that deliver much higher yields than will be available when funds are reinvested during the next few years – and perhaps for many years beyond that. Today’s bond portfolios are, in effect, wasting assets. Earnings of insurers will be hurt in a significant way as bonds mature and are rolled over.

* * * * *

Berkshire’s outstanding economics exist only because we have some terrific managers running some extraordinary insurance operations. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, run by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources. Indeed, we are *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a \$250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because it has so many streams of earnings. All other major insurers and reinsurers would meanwhile be far in the red, with some facing insolvency.

From a standing start in 1985, Ajit has created an insurance business with float of \$35 billion and a significant cumulative underwriting profit, a feat that no other insurance CEO has come close to matching. He has thus added a great many billions of dollars to the value of Berkshire. If you meet Ajit at the annual meeting, bow deeply.

* * * * *

We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can’t be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can’t turn their back on business that is being eagerly written by their competitors. That old line, “The other guy is doing it, so we must as well,” spells trouble in any business, but none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been better than cost-free under his leadership, and we expect that, on average, it will continue to be. We are particularly enthusiastic about General Re's international life reinsurance business, which has achieved consistent and profitable growth since we acquired the company in 1998.

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Finally, there is GEICO, the insurer on which I cut my teeth 62 years ago. GEICO is run by Tony Nicely, who joined the company at 18 and completed 51 years of service in 2012.

I rub my eyes when I look at what Tony has accomplished. Last year, it should be noted, his record was considerably better than is indicated by GEICO's GAAP underwriting profit of \$680 million. Because of a change in accounting rules at the beginning of the year, we recorded a charge to GEICO's underwriting earnings of \$410 million. This item had *nothing* to do with 2012's operating results, changing neither cash, revenues, expenses nor taxes. In effect, the writedown simply widened the already huge difference between GEICO's intrinsic value and the value at which we carry it on our books.

GEICO earned its underwriting profit, moreover, despite the company suffering its largest single loss in history. The cause was Hurricane Sandy, which cost GEICO more than three times the loss it sustained from Katrina, the previous record-holder. We insured 46,906 vehicles that were destroyed or damaged in the storm, a staggering number reflecting GEICO's leading market share in the New York metropolitan area.

Last year GEICO enjoyed a meaningful increase in both the renewal rate for existing policyholders ("persistency") and in the percentage of rate quotations that resulted in sales ("closures"). Big dollars ride on those two factors: A sustained gain in persistency of a bare one percentage point increases intrinsic value by more than \$1 billion. GEICO's gains in 2012 offer dramatic proof that when people check the company's prices, they usually find they can save important sums. (Give us a try at 1-800-847-7536 or GEICO.com. Be sure to mention that you are a shareholder; that fact will usually result in a discount.)

* * * * *

In addition to our three major insurance operations, we own a group of smaller companies, most of them plying their trade in odd corners of the insurance world. In aggregate, these companies have consistently delivered an underwriting profit. Moreover, as the table below shows, they also provide us with substantial float. Charlie and I treasure these companies and their managers.

Late in 2012, we enlarged this group by acquiring Guard Insurance, a Wilkes-Barre company that writes workers compensation insurance, primarily for smaller businesses. Guard's annual premiums total about \$300 million. The company has excellent prospects for growth in both its traditional business and new lines it has begun to offer.

<u>Insurance Operations</u>	<u>Underwriting Profit</u>		<u>Yearend Float</u>	
	<u>2012</u>	<u>2011</u>	<u>(in millions)</u>	<u>2011</u>
BH Reinsurance	\$ 304	\$(714)	\$34,821	\$33,728
General Re	355	144	20,128	19,714
GEICO	680*	576	11,578	11,169
Other Primary	286	242	6,598	5,960
	<u>\$1,625</u>	<u>\$ 248</u>	<u>\$73,125</u>	<u>\$70,571</u>

*After a \$410 million charge against earnings arising from an industry-wide accounting change.

Among large insurance operations, Berkshire's impresses me as the best in the world. It was our lucky day when, in March 1967, Jack Ringwalt sold us his two property-casualty insurers for \$8.6 million.

Regulated, Capital-Intensive Businesses

We have two major operations, BNSF and MidAmerican Energy, that have important common characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each business has earning power that even under terrible conditions amply covers its interest requirements. In last year's tepid economy, for example, BNSF's interest coverage was 9.6x. (Our definition of coverage is pre-tax earnings/interest, *not* EBITDA/interest, a commonly-used measure we view as deeply flawed.) At MidAmerican, meanwhile, two key factors ensure its ability to service debt under all circumstances: the company's recession-resistant earnings, which result from our exclusively offering an essential service, and its great diversity of earnings streams, which shield it from being seriously harmed by any single regulatory body.

Every day, our two subsidiaries power the American economy in major ways:

- BNSF carries about 15% (measured by ton-miles) of *all* inter-city freight, whether it is transported by truck, rail, water, air, or pipeline. Indeed, we move more ton-miles of goods than *anyone* else, a fact making BNSF the most important artery in our economy's circulatory system.

BNSF also moves its cargo in an extraordinarily fuel-efficient and environmentally friendly way, carrying a ton of freight about 500 miles on a single gallon of diesel fuel. Trucks taking on the same job guzzle about four times as much fuel.

- MidAmerican's electric utilities serve regulated retail customers in ten states. Only one utility holding company serves more states. In addition, we are the leader in renewables: first, from a standing start nine years ago, we now account for 6% of the country's wind generation capacity. Second, when we complete three projects now under construction, we will own about 14% of U.S. solar-generation capacity.

Projects like these require huge capital investments. Upon completion, indeed, our renewables portfolio will have cost \$13 billion. We relish making such commitments if they promise reasonable returns – and on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need massive investment in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. And it is in our self-interest to conduct our operations in a manner that earns the approval of our regulators and the people they represent.

Our managers must think today of what the country will need far down the road. Energy and transportation projects can take many years to come to fruition; a growing country simply can't afford to get behind the curve.

We have been doing our part to make sure that doesn't happen. Whatever you may have heard about our country's crumbling infrastructure in no way applies to BNSF or railroads generally. America's rail system has never been in better shape, a consequence of huge investments by the industry. We are not, however, resting on our laurels: BNSF will spend about \$4 billion on the railroad in 2013, roughly double its depreciation charge and more than any railroad has spent in a single year.

In Matt Rose, at BNSF, and Greg Abel, at MidAmerican, we have two outstanding CEOs. They are extraordinary managers who have developed businesses that serve both their customers and owners well. Each has my gratitude and each deserves yours. Here are the key figures for their businesses:

<i>MidAmerican (89.8% owned)</i>	<i>Earnings (in millions)</i>	
	<i>2012</i>	<i>2011</i>
U.K. utilities	\$ 429	\$ 469
Iowa utility	236	279
Western utilities	737	771
Pipelines	383	388
HomeServices	82	39
Other (net)	91	36
Operating earnings before corporate interest and taxes	1,958	1,982
Interest	314	336
Income taxes	172	315
Net earnings	<u>\$ 1,472</u>	<u>\$ 1,331</u>
Earnings applicable to Berkshire	\$ 1,323	\$ 1,204

<i>BNSF</i>	<i>Earnings (in millions)</i>	
	<i>2012</i>	<i>2011</i>
Revenues	\$20,835	\$19,548
Operating expenses	<u>14,835</u>	<u>14,247</u>
Operating earnings before interest and taxes	6,000	5,301
Interest (net)	623	560
Income taxes	<u>2,005</u>	<u>1,769</u>
Net earnings	<u>\$ 3,372</u>	<u>\$ 2,972</u>

Sharp-eyed readers will notice an incongruity in the MidAmerican earnings tabulation. What in the world is HomeServices, a real estate brokerage operation, doing in a section entitled “Regulated, Capital-Intensive Businesses?”

Well, its ownership came with MidAmerican when we bought control of that company in 2000. At that time, I focused on MidAmerican’s utility operations and barely noticed HomeServices, which then owned only a few real estate brokerage companies.

Since then, however, the company has regularly added residential brokers – three in 2012 – and now has about 16,000 agents in a string of major U.S. cities. (Our real estate brokerage companies are listed on page 107.) In 2012, our agents participated in \$42 billion of home sales, up 33% from 2011.

Additionally, HomeServices last year purchased 67% of the Prudential and Real Living franchise operations, which together license 544 brokerage companies throughout the country and receive a small royalty on their sales. We have an arrangement to purchase the balance of those operations within five years. In the coming years, we will gradually rebrand both our franchisees and the franchise firms we own as Berkshire Hathaway HomeServices.

Ron Peltier has done an outstanding job in managing HomeServices during a depressed period. Now, as the housing market continues to strengthen, we expect earnings to rise significantly.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/12 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 5,338	Notes payable	\$ 1,454
Accounts and notes receivable	7,382	Other current liabilities	<u>8,527</u>
Inventory	9,675	Total current liabilities	9,981
Other current assets	<u>734</u>		
Total current assets	23,129		
Goodwill and other intangibles	26,017	Deferred taxes	4,907
Fixed assets	18,871	Term debt and other liabilities ..	5,826
Other assets	<u>3,416</u>	Non-controlling interests	2,062
	<u>\$71,433</u>	Berkshire equity	<u>48,657</u>
			<u>\$71,433</u>

Earnings Statement (in millions)

	<u>2012</u>	<u>2011*</u>	<u>2010</u>
Revenues	\$83,255	\$72,406	\$66,610
Operating expenses	76,978	67,239	62,225
Interest expense	<u>146</u>	<u>130</u>	<u>111</u>
Pre-tax earnings	6,131	5,037	4,274
Income taxes and non-controlling interests	<u>2,432</u>	<u>1,998</u>	<u>1,812</u>
Net earnings	<u>\$ 3,699</u>	<u>\$ 3,039</u>	<u>\$ 2,462</u>

*Includes earnings of Lubrizol from September 16.

Our income and expense data conforming to Generally Accepted Accounting Principles (“GAAP”) is on page 29. In contrast, the operating expense figures above are non-GAAP. In particular, they exclude some purchase-accounting items, primarily the amortization of certain intangible assets. We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the real expenses and profits of the businesses aggregated in the table.

I won’t explain all of the adjustments – some are small and arcane – but serious investors should understand the disparate nature of intangible assets: Some truly deplete over time while others never lose value. With software, for example, amortization charges are very real expenses. Charges against other intangibles such as the amortization of customer relationships, however, arise through purchase-accounting rules and are clearly not real expenses. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when calculating earnings – even though from an investor’s viewpoint they could not be more different.

In the GAAP-compliant figures we show on page 29, amortization charges of \$600 million for the companies included in this section are deducted as expenses. We would call about 20% of these “real” – and indeed that is the portion we have included in the table above – and the rest not. This difference has become significant because of the many acquisitions we have made.

“Non-real” amortization expense also looms large at some of our major investees. IBM has made many small acquisitions in recent years and now regularly reports “adjusted operating earnings,” a non-GAAP figure that excludes certain purchase-accounting adjustments. Analysts focus on this number, as they should.

A “non-real” amortization charge at Wells Fargo, however, is not highlighted by the company and never, to my knowledge, has been noted in analyst reports. The earnings that Wells Fargo reports are heavily burdened by an “amortization of core deposits” charge, the implication being that these deposits are disappearing at a fairly rapid clip. Yet core deposits regularly *increase*. The charge last year was about \$1.5 billion. In *no* sense, except GAAP accounting, is this whopping charge an expense.

And that ends today’s accounting lecture. Why is no one shouting “More, more?”

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The crowd of companies in this section sell products ranging from lollipops to jet airplanes. Some of the businesses enjoy terrific economics, measured by earnings on unleveraged net *tangible* assets that run from 25% after-tax to more than 100%. Others produce good returns in the area of 12-20%. A few, however, have very poor returns, a result of some serious mistakes I made in my job of capital allocation.

More than 50 years ago, Charlie told me that it was far better to buy a wonderful business at a fair price than to buy a fair business at a wonderful price. Despite the compelling logic of his position, I have sometimes reverted to my old habit of bargain-hunting, with results ranging from tolerable to terrible. Fortunately, my mistakes have usually occurred when I made smaller purchases. Our large acquisitions have generally worked out well and, in a few cases, more than well.

Viewed as a single entity, therefore, the companies in this group are an excellent business. They employ \$22.6 billion of net tangible assets and, on that base, earned 16.3% after-tax.

Of course, a business with terrific economics can be a bad investment if the price paid is excessive. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for intangible assets. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Furthermore, the intrinsic value of the businesses, in aggregate, exceeds their carrying value by a good margin. Even so, the difference between intrinsic value and carrying value in the insurance and regulated-industry segments is *far* greater. It is there that the huge winners reside.

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Marmon provides an example of a clear and substantial gap existing between book value and intrinsic value. Let me explain the odd origin of this differential.

Last year I told you that we had purchased additional shares in Marmon, raising our ownership to 80% (up from the 64% we acquired in 2008). I also told you that GAAP accounting required us to immediately record the 2011 purchase on our books at far less than what we paid. I’ve now had a year to think about this weird accounting rule, but I’ve yet to find an explanation that makes *any* sense – nor can Charlie or Marc Hamburg, our CFO, come up with one. My confusion increases when I am told that if we hadn’t already owned 64%, the 16% we purchased in 2011 would have been entered on our books at our cost.

In 2012 (and in early 2013, retroactive to yearend 2012) we acquired an additional 10% of Marmon and the same bizarre accounting treatment was required. The \$700 million write-off we immediately incurred had no effect on earnings but did reduce book value and, therefore, 2012’s gain in net worth.

The cost of our recent 10% purchase implies a \$12.6 billion value for the 90% of Marmon we now own. Our balance-sheet carrying value for the 90%, however, is \$8 billion. Charlie and I believe our current purchase represents excellent value. If we are correct, our Marmon holding is worth at least \$4.6 billion more than its carrying value.

Marmon is a diverse enterprise, comprised of about 150 companies operating in a wide variety of industries. Its largest business involves the ownership of tank cars that are leased to a variety of shippers, such as oil and chemical companies. Marmon conducts this business through two subsidiaries, Union Tank Car in the U.S. and Procor in Canada.

Union Tank Car has been around a long time, having been owned by the Standard Oil Trust until that empire was broken up in 1911. Look for its UTLX logo on tank cars when you watch trains roll by. As a Berkshire shareholder, you own the cars with that insignia. When you spot a UTLX car, puff out your chest a bit and enjoy the same satisfaction that John D. Rockefeller undoubtedly experienced as he viewed *his* fleet a century ago.

Tank cars are owned by either shippers or lessors, not by railroads. At yearend Union Tank Car and Procor together owned 97,000 cars having a net book value of \$4 billion. A new car, it should be noted, costs upwards of \$100,000. Union Tank Car is also a major manufacturer of tank cars – some of them to be sold but most to be owned by it and leased out. Today, its order book extends well into 2014.

At both BNSF and Marmon, we are benefitting from the resurgence of U.S. oil production. In fact, our railroad is now transporting about 500,000 barrels of oil daily, roughly 10% of the total produced in the “lower 48” (i.e. not counting Alaska and offshore). All indications are that BNSF’s oil shipments will grow substantially in coming years.

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Space precludes us from going into detail about the many other businesses in this segment. Company-specific information about the 2012 operations of some of the larger units appears on pages 76 to 79.

Finance and Financial Products

This sector, our smallest, includes two rental companies, XTRA (trailers) and CORT (furniture), as well as Clayton Homes, the country’s leading producer and financer of manufactured homes. Aside from these 100%-owned subsidiaries, we also include in this category a collection of financial assets and our 50% interest in Berkadia Commercial Mortgage.

We include Clayton in this sector because it owns and services 332,000 mortgages, totaling \$13.7 billion. In large part, these loans have been made to lower and middle-income families. Nevertheless, the loans have performed well throughout the housing collapse, thereby validating our conviction that a reasonable down payment and a sensible payments-to-income ratio will ward off outsized foreclosure losses, even during stressful times.

Clayton also produced 25,872 manufactured homes last year, up 13.5% from 2011. That output accounted for about 4.8% of all single-family residences built in the country, a share that makes Clayton America’s number one homebuilder.

CORT and XTRA are leaders in their industries as well. Our expenditures for new rental equipment at XTRA totaled \$256 million in 2012, more than double its depreciation expense. While competitors fret about today’s uncertainties, XTRA is preparing for tomorrow.

Berkadia continues to do well. Our partners at Leucadia do most of the work in this venture, an arrangement that Charlie and I happily embrace.

Here’s the pre-tax earnings recap for this sector:

	<u>2012</u>	<u>2011</u>
	<i>(in millions)</i>	
Berkadia	\$ 35	\$ 25
Clayton	255	154
CORT	42	29
XTRA	106	126
Net financial income*	<u>410</u>	<u>440</u>
	<u>\$848</u>	<u>\$774</u>

*Excludes capital gains or losses

Investments

Below we show our common stock investments that at yearend had a market value of more than \$1 billion.

<u>Shares</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>Cost*</u>	<u>Market</u>
(in millions)				
151,610,700	American Express Company	13.7	\$ 1,287	\$ 8,715
400,000,000	The Coca-Cola Company	8.9	1,299	14,500
24,123,911	ConocoPhillips	2.0	1,219	1,399
22,999,600	DIRECTV	3.8	1,057	1,154
68,115,484	International Business Machines Corp.	6.0	11,680	13,048
28,415,250	Moody's Corporation	12.7	287	1,430
20,060,390	Munich Re	11.3	2,990	3,599
20,668,118	Phillips 66	3.3	660	1,097
3,947,555	POSCO	5.1	768	1,295
52,477,678	The Procter & Gamble Company	1.9	336	3,563
25,848,838	Sanofi	2.0	2,073	2,438
415,510,889	Tesco plc	5.2	2,350	2,268
78,060,769	U.S. Bancorp	4.2	2,401	2,493
54,823,433	Wal-Mart Stores, Inc.	1.6	2,837	3,741
456,170,061	Wells Fargo & Company	8.7	10,906	15,592
	Others		<u>7,646</u>	<u>11,330</u>
	Total Common Stocks Carried at Market		<u>\$49,796</u>	<u>\$87,662</u>

*This is our actual purchase price and also our tax basis; GAAP “cost” differs in a few cases because of write-ups or write-downs that have been required.

One point about the composition of this list deserves mention. In Berkshire’s past annual reports, every stock itemized in this space has been bought by me, in the sense that I made the decision to buy it for Berkshire. But starting with this list, any investment made by Todd Combs or Ted Weschler – or a combined purchase by them – that meets the dollar threshold for the list (\$1 billion this year) will be included. Above is the first such stock, DIRECTV, which both Todd and Ted hold in their portfolios and whose combined holdings at the end of 2012 were valued at the \$1.15 billion shown.

Todd and Ted also manage the pension funds of certain Berkshire subsidiaries, while others, for regulatory reasons, are managed by outside advisers. We do not include holdings of the pension funds in our annual report tabulations, though their portfolios often overlap Berkshire’s.

* * * * *

We continue to wind down the part of our derivatives portfolio that involved the assumption by Berkshire of insurance-like risks. (Our electric and gas utility businesses, however, will continue to use derivatives for operational purposes.) New commitments would require us to post collateral and, with minor exceptions, we are unwilling to do that. Markets can behave in extraordinary ways, and we have no interest in exposing Berkshire to some out-of-the-blue event in the financial world that might require our posting mountains of cash on a moment’s notice.

Charlie and I believe in operating with many redundant layers of liquidity, and we avoid any sort of obligation that could drain our cash in a material way. That reduces our returns in 99 years out of 100. But we will survive in the 100th while many others fail. And we will sleep well in all 100.

The derivatives we have sold that provide credit protection for corporate bonds will all expire in the next year. It's now almost certain that our profit from these contracts will approximate \$1 billion pre-tax. We also received very substantial sums upfront on these derivatives, and the "float" attributable to them has averaged about \$2 billion over their five-year lives. All told, these derivatives have provided a more-than-satisfactory result, especially considering the fact that we were guaranteeing corporate credits – mostly of the high-yield variety – throughout the financial panic and subsequent recession.

In our other major derivatives commitment, we sold long-term puts on four leading stock indices in the U.S., U.K., Europe and Japan. These contracts were initiated between 2004 and 2008 and even under the worst of circumstances have only minor collateral requirements. In 2010 we unwound about 10% of our exposure at a profit of \$222 million. The remaining contracts expire between 2018 and 2026. Only the index value at expiration date counts; our counterparties have no right to early termination.

Berkshire received premiums of \$4.2 billion when we wrote the contracts that remain outstanding. If all of these contracts had come due at yearend 2011, we would have had to pay \$6.2 billion; the corresponding figure at yearend 2012 was \$3.9 billion. With this large drop in immediate settlement liability, we reduced our GAAP liability at yearend 2012 to \$7.5 billion from \$8.5 billion at the end of 2011. Though it's no sure thing, Charlie and I believe it likely that the final liability will be considerably less than the amount we currently carry on our books. In the meantime, we can invest the \$4.2 billion of float derived from these contracts as we see fit.

We Buy Some Newspapers . . . Newspapers?

During the past fifteen months, we acquired 28 daily newspapers at a cost of \$344 million. This may puzzle you for two reasons. First, I have long told you in these letters and at our annual meetings that the circulation, advertising and profits of the newspaper industry overall are *certain* to decline. That prediction still holds. Second, the properties we purchased fell far short of meeting our oft-stated size requirements for acquisitions.

We can address the second point easily. Charlie and I love newspapers and, *if their economics make sense*, will buy them even when they fall far short of the size threshold we would require for the purchase of, say, a widget company. Addressing the first point requires me to provide a more elaborate explanation, including some history.

News, to put it simply, is what people don't know that they want to know. And people will seek their news – what's important to *them* – from whatever sources provide the best combination of immediacy, ease of access, reliability, comprehensiveness and low cost. The relative importance of these factors varies with the nature of the news and the person wanting it.

Before television and the Internet, newspapers were the *primary* source for an incredible variety of news, a fact that made them indispensable to a very high percentage of the population. Whether your interests were international, national, local, sports or financial quotations, your newspaper usually was first to tell you the latest information. Indeed, your paper contained so much you wanted to learn that you received your money's worth, even if only a small number of its pages spoke to your specific interests. Better yet, advertisers typically paid almost all of the product's cost, and readers rode their coattails.

Additionally, the ads themselves delivered information of vital interest to hordes of readers, in effect providing even more "news." Editors would cringe at the thought, but for many readers learning what jobs or apartments were available, what supermarkets were carrying which weekend specials, or what movies were showing where and when was far more important than the views expressed on the editorial page.

In turn, the local paper was indispensable to advertisers. If Sears or Safeway built stores in Omaha, they required a “megaphone” to tell the city’s residents why their stores should be visited *today*. Indeed, big department stores and grocers vied to outshout their competition with multi-page spreads, knowing that the goods they advertised would fly off the shelves. With no other megaphone remotely comparable to that of the newspaper, ads sold themselves.

As long as a newspaper was the only one in its community, its profits were certain to be extraordinary; whether it was managed well or poorly made little difference. (As one Southern publisher famously confessed, “I owe my exalted position in life to two great American institutions – nepotism and monopoly.”)

Over the years, almost all cities became one-newspaper towns (or harbored two competing papers that joined forces to operate as a single economic unit). This contraction was inevitable because most people wished to read and pay for only one paper. When competition existed, the paper that gained a significant lead in circulation almost automatically received the most ads. That left ads drawing readers and readers drawing ads. This symbiotic process spelled doom for the weaker paper and became known as “survival of the fittest.”

Now the world has changed. Stock market quotes and the details of national sports events are old news long before the presses begin to roll. The Internet offers extensive information about both available jobs and homes. Television bombards viewers with political, national and international news. In one area of interest after another, newspapers have therefore lost their “primacy.” And, as their audiences have fallen, so has advertising. (Revenues from “help wanted” classified ads – long a huge source of income for newspapers – have plunged more than 90% in the past 12 years.)

Newspapers continue to reign supreme, however, in the delivery of local news. If you want to know what’s going on in *your town* – whether the news is about the mayor or taxes or high school football – there is no substitute for a local newspaper that is doing its job. A reader’s eyes may glaze over after they take in a couple of paragraphs about Canadian tariffs or political developments in Pakistan; a story about the reader himself or his neighbors will be read to the end. Wherever there is a pervasive sense of community, a paper that serves the special informational needs of that community will remain indispensable to a significant portion of its residents.

Even a valuable product, however, can self-destruct from a faulty business strategy. And that process has been underway during the past decade at almost all papers of size. Publishers – including Berkshire in Buffalo – have offered their paper free on the Internet while charging meaningful sums for the physical specimen. How could this lead to anything other than a sharp and steady drop in sales of the printed product? Falling circulation, moreover, makes a paper less essential to advertisers. Under these conditions, the “virtuous circle” of the past reverses.

The Wall Street Journal went to a pay model early. But the main exemplar for local newspapers is the *Arkansas Democrat-Gazette*, published by Walter Hussman, Jr. Walter also adopted a pay format early, and over the past decade his paper has retained its circulation far better than any other large paper in the country. Despite Walter’s powerful example, it’s only been in the last year or so that other papers, including Berkshire’s, have explored pay arrangements. Whatever works best – and the answer is not yet clear – will be copied widely.

* * * * *

Charlie and I believe that papers delivering comprehensive and reliable information to tightly-bound communities *and* having a sensible Internet strategy will remain viable for a long time. We do not believe that success will come from cutting either the news content or frequency of publication. Indeed, skimpy news coverage will almost certainly lead to skimpy readership. And the less-than-daily publication that is now being tried in some large towns or cities – while it may improve profits in the short term – seems certain to diminish the papers’ relevance over time. Our goal is to keep our papers loaded with content of interest to our readers and to be paid appropriately by those who find us useful, whether the product they view is in their hands or on the Internet.

Our confidence is buttressed by the availability of Terry Kroeger's outstanding management group at the *Omaha World-Herald*, a team that has the ability to oversee a large group of papers. The individual papers, however, will be independent in their news coverage and editorial opinions. (I voted for Obama; of our 12 dailies that endorsed a presidential candidate, 10 opted for Romney.)

Our newspapers are certainly not insulated from the forces that have been driving revenues downward. Still, the six small dailies we owned throughout 2012 had unchanged revenues for the year, a result far superior to that experienced by big-city dailies. Moreover, the two large papers we operated throughout the year – *The Buffalo News* and the *Omaha World-Herald* – held their revenue loss to 3%, which was also an above-average outcome. Among newspapers in America's 50 largest metropolitan areas, our Buffalo and Omaha papers rank near the top in circulation penetration of their home territories.

This popularity is no accident: Credit the editors of those papers – Margaret Sullivan at the *News* and Mike Reilly at the *World-Herald* — for delivering information that has made their publications indispensable to community-interested readers. (Margaret, I regret to say, recently left us to join *The New York Times*, whose job offers are tough to turn down. That paper made a great hire, and we wish her the best.)

Berkshire's cash earnings from its papers will almost certainly trend downward over time. Even a sensible Internet strategy will not be able to prevent modest erosion. At our cost, however, I believe these papers will meet or exceed our economic test for acquisitions. Results to date support that belief.

Charlie and I, however, still operate under economic principle 11 (detailed on page 99) and will not continue the operation of *any* business doomed to unending losses. One daily paper that we acquired in a bulk purchase from Media General was significantly unprofitable under that company's ownership. After analyzing the paper's results, we saw no remedy for the losses and reluctantly shut it down. All of our remaining dailies, however, should be profitable for a long time to come. (They are listed on page 108.) At appropriate prices – and that means at a *very* low multiple of current earnings – we will purchase more papers of the type we like.

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A milestone in Berkshire's newspaper operations occurred at yearend when Stan Lipsey retired as publisher of *The Buffalo News*. It's no exaggeration for me to say that the *News* might now be extinct were it not for Stan.

Charlie and I acquired the *News* in April 1977. It was an evening paper, dominant on weekdays but lacking a Sunday edition. Throughout the country, the circulation trend was toward morning papers. Moreover, Sunday was becoming ever more critical to the profitability of metropolitan dailies. Without a Sunday paper, the *News* was destined to lose out to its morning competitor, which had a fat and entrenched Sunday product.

We therefore began to print a Sunday edition late in 1977. And then all hell broke loose. Our competitor sued us, and District Judge Charles Brieant, Jr. authored a harsh ruling that crippled the introduction of our paper. His ruling was later reversed – after 17 long months – in a 3-0 sharp rebuke by the Second Circuit Court of Appeals. While the appeal was pending, we lost circulation, hemorrhaged money and stood in constant danger of going out of business.

Enter Stan Lipsey, a friend of mine from the 1960s, who, with his wife, had sold Berkshire a small Omaha weekly. I found Stan to be an extraordinary newspaperman, knowledgeable about every aspect of circulation, production, sales and editorial. (He was a key person in gaining that small weekly a Pulitzer Prize in 1973.) So when I was in big trouble at the *News*, I asked Stan to leave his comfortable way of life in Omaha to take over in Buffalo.

He never hesitated. Along with Murray Light, our editor, Stan persevered through four years of very dark days until the *News* won the competitive struggle in 1982. Ever since, despite a difficult Buffalo economy, the performance of the *News* has been exceptional. As both a friend and as a manager, Stan is simply the best.

Dividends

A number of Berkshire shareholders – including some of my good friends – would like Berkshire to pay a cash dividend. It puzzles them that we relish the dividends we receive from most of the stocks that Berkshire owns, but pay out nothing ourselves. So let's examine when dividends do and don't make sense for shareholders.

A profitable company can allocate its earnings in various ways (which are not mutually exclusive). A company's management should first examine reinvestment possibilities offered by its current business – projects to become more efficient, expand territorially, extend and improve product lines or to otherwise widen the economic moat separating the company from its competitors.

I ask the managers of our subsidiaries to unendingly focus on moat-widening opportunities, and they find many that make economic sense. But sometimes our managers misfire. The usual cause of failure is that they start with the answer they want and then work backwards to find a supporting rationale. Of course, the process is subconscious; that's what makes it so dangerous.

Your chairman has not been free of this sin. In Berkshire's 1986 annual report, I described how twenty years of management effort and capital improvements in our original textile business were an exercise in futility. I *wanted* the business to succeed and *wished* my way into a series of bad decisions. (I even bought *another* New England textile company.) But wishing makes dreams come true only in Disney movies; it's poison in business.

Despite such past miscues, our first priority with available funds will always be to examine whether they can be *intelligently* deployed in our various businesses. Our record \$12.1 billion of fixed-asset investments and bolt-on acquisitions in 2012 demonstrate that this is a fertile field for capital allocation at Berkshire. And here we have an advantage: Because we operate in so many areas of the economy, we enjoy a range of choices far wider than that open to most corporations. In deciding what to do, we can water the flowers and skip over the weeds.

Even after we deploy hefty amounts of capital in our current operations, Berkshire will regularly generate a lot of additional cash. Our next step, therefore, is to search for acquisitions unrelated to our current businesses. Here our test is simple: Do Charlie and I think we can effect a transaction that is likely to leave our shareholders wealthier on a per-share basis than they were prior to the acquisition?

I have made plenty of mistakes in acquisitions and will make more. Overall, however, our record is satisfactory, which means that our shareholders are *far* wealthier today than they would be if the funds we used for acquisitions had instead been devoted to share repurchases or dividends.

But, to use the standard disclaimer, past performance is no guarantee of future results. That's particularly true at Berkshire: Because of our present size, making acquisitions that are both meaningful and sensible is now more difficult than it has been during most of our years.

Nevertheless, a large deal still offers us possibilities to add materially to per-share intrinsic value. BNSF is a case in point: It is now worth considerably more than our carrying value. Had we instead allocated the funds required for this purchase to dividends or repurchases, you and I would have been worse off. Though large transactions of the BNSF kind will be rare, there are still some whales in the ocean.

The third use of funds – repurchases – is sensible for a company when its shares sell at a meaningful discount to conservatively calculated intrinsic value. Indeed, disciplined repurchases are the *surest* way to use funds intelligently: It's hard to go wrong when you're buying dollar bills for 80¢ or less. We explained our criteria for repurchases in last year's report and, if the opportunity presents itself, we will buy large quantities of our stock. We originally said we would not pay more than 110% of book value, but that proved unrealistic. Therefore, we increased the limit to 120% in December when a large block became available at about 116% of book value.

But never forget: In repurchase decisions, price is all-important. Value is *destroyed* when purchases are made above intrinsic value. The directors and I believe that continuing shareholders are benefitted in a meaningful way by purchases up to our 120% limit.

And that brings us to dividends. Here we have to make a few assumptions and use some math. The numbers will require careful reading, but they are essential to understanding the case for and against dividends. So bear with me.

We'll start by assuming that you and I are the equal owners of a business with \$2 million of net worth. The business earns 12% on tangible net worth – \$240,000 – and can reasonably expect to earn the same 12% on reinvested earnings. Furthermore, there are outsiders who always wish to buy into our business at 125% of net worth. Therefore, the value of what we each own is now \$1.25 million.

You would like to have the two of us shareholders receive one-third of our company's annual earnings and have two-thirds be reinvested. That plan, you feel, will nicely balance your needs for both current income and capital growth. So you suggest that we pay out \$80,000 of current earnings and retain \$160,000 to increase the future earnings of the business. In the first year, your dividend would be \$40,000, and as earnings grew and the one-third payout was maintained, so too would your dividend. In total, dividends and stock value would increase 8% each year (12% earned on net worth less 4% of net worth paid out).

After ten years our company would have a net worth of \$4,317,850 (the original \$2 million compounded at 8%) and your dividend in the upcoming year would be \$86,357. Each of us would have shares worth \$2,698,656 (125% of our half of the company's net worth). And we would live happily ever after – with dividends and the value of our stock continuing to grow at 8% annually.

There is an alternative approach, however, that would leave us even happier. Under this scenario, we would leave *all* earnings in the company and each sell 3.2% of our shares annually. Since the shares would be sold at 125% of book value, this approach would produce the same \$40,000 of cash initially, a sum that would grow annually. Call this option the “sell-off” approach.

Under this “sell-off” scenario, the net worth of our company increases to \$6,211,696 after ten years (\$2 million compounded at 12%). Because we would be selling shares each year, our *percentage* ownership would have declined, and, after ten years, we would each own 36.12% of the business. Even so, your share of the net worth of the company at that time would be \$2,243,540. And, remember, every dollar of net worth attributable to each of us can be sold for \$1.25. Therefore, the market value of your remaining shares would be \$2,804,425, about 4% greater than the value of your shares if we had followed the dividend approach.

Moreover, your annual cash receipts from the sell-off policy would now be running 4% more than you would have received under the dividend scenario. Voila! – you would have both more cash to spend annually *and* more capital value.

This calculation, of course, assumes that our hypothetical company can earn an average of 12% annually on net worth and that its shareholders can sell their shares for an average of 125% of book value. To that point, the S&P 500 earns considerably more than 12% on net worth and sells at a price far above 125% of that net worth. Both assumptions also seem reasonable for Berkshire, though certainly not assured.

Moreover, on the plus side, there also is a possibility that the assumptions will be exceeded. If they are, the argument for the sell-off policy becomes even stronger. Over Berkshire's history – admittedly one that won't come close to being repeated – the sell-off policy would have produced results for shareholders *dramatically* superior to the dividend policy.

Aside from the favorable math, there are two further – *and important* – arguments for a sell-off policy. First, dividends impose a specific cash-out policy upon all shareholders. If, say, 40% of earnings is the policy, those who wish 30% or 50% will be thwarted. Our 600,000 shareholders cover the waterfront in their desires for cash. It is safe to say, however, that a great many of them – perhaps even most of them – are in a net-savings mode and logically should prefer no payment at all.

The sell-off alternative, on the other hand, lets each shareholder make his own choice between cash receipts and capital build-up. One shareholder can elect to cash out, say, 60% of annual earnings while other shareholders elect 20% or nothing at all. Of course, a shareholder in our dividend-paying scenario could turn around and use his dividends to purchase more shares. But he would take a beating in doing so: He would both incur taxes and also pay a 25% premium to get his dividend reinvested. (Keep remembering, open-market purchases of the stock take place at 125% of book value.)

The second disadvantage of the dividend approach is of equal importance: The tax consequences for *all* taxpaying shareholders are inferior – usually *far* inferior – to those under the sell-off program. Under the dividend program, all of the cash received by shareholders each year is taxed whereas the sell-off program results in tax on only the gain portion of the cash receipts.

Let me end this math exercise – and I can hear you cheering as I put away the dentist drill – by using my own case to illustrate how a shareholder’s regular disposals of shares can be accompanied by an *increased* investment in his or her business. For the last seven years, I have annually given away about 4 1/4% of my Berkshire shares. Through this process, my original position of 712,497,000 B-equivalent shares (split-adjusted) has decreased to 528,525,623 shares. Clearly my ownership *percentage* of the company has significantly decreased.

Yet my investment in the business has actually increased: The book value of my current interest in Berkshire considerably exceeds the book value attributable to my holdings of seven years ago. (The actual figures are \$28.2 billion for 2005 and \$40.2 billion for 2012.) In other words, I now have *far* more money working for me at Berkshire even though my ownership of the company has materially decreased. It’s also true that my share of both Berkshire’s intrinsic business value and the company’s normal earning power is far greater than it was in 2005. Over time, I expect this accretion of value to continue – albeit in a decidedly irregular fashion – even as I now annually give away more than 4 1/2% of my shares (the increase having occurred because I’ve recently doubled my lifetime pledges to certain foundations).

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Above all, dividend policy should always be clear, consistent and rational. A capricious policy will confuse owners and drive away would-be investors. Phil Fisher put it wonderfully 54 years ago in Chapter 7 of his *Common Stocks and Uncommon Profits*, a book that ranks behind only *The Intelligent Investor* and the 1940 edition of *Security Analysis* in the all-time-best list for the serious investor. Phil explained that you can successfully run a restaurant that serves hamburgers or, alternatively, one that features Chinese food. But you can’t switch capriciously between the two and retain the fans of either.

Most companies pay consistent dividends, generally trying to increase them annually and cutting them very reluctantly. Our “Big Four” portfolio companies follow this sensible and understandable approach and, in certain cases, also repurchase shares quite aggressively.

We applaud their actions and hope they continue on their present paths. We like increased dividends, and we love repurchases at appropriate prices.

At Berkshire, however, we have consistently followed a different approach that we know has been sensible and that we hope has been made understandable by the paragraphs you have just read. We will stick with this policy as long as we believe our assumptions about the book-value buildup and the market-price premium seem reasonable. If the prospects for either factor change materially for the worse, we will reexamine our actions.

The Annual Meeting

The annual meeting will be held on Saturday, May 4th at the CenturyLink Center. Carrie Sova will be in charge. (Though that’s a new name, it’s the same wonderful Carrie as last year; she got married in June to a very lucky guy.) All of our headquarters group pitches in to help her; the whole affair is a homemade production, and I couldn’t be more proud of those who put it together.

The doors will open at 7 a.m., and at 7:30 we will have our second International Newspaper Tossing Challenge. The target will be the porch of a Clayton Home, precisely 35 feet from the throwing line. Last year I successfully fought off all challengers. But now Berkshire has acquired a large number of newspapers and with them came much tossing talent (or so the throwers claim). Come see whether their talent matches their talk. Better yet, join in. The papers will be 36 to 42 pages and you must fold them yourself (no rubber bands).

At 8:30, a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (with a break for lunch at the CenturyLink's stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course, is to *shop*. We will help you do so by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. In a nine-hour period, we sold 1,090 pairs of Justin boots, (that's a pair every 30 seconds), 10,010 pounds of See's candy, 12,879 Quikut knives (24 knives per minute) and 5,784 pairs of Wells Lamont gloves, always a hot item. But you can do better. Remember: Anyone who says money can't buy happiness simply hasn't shopped at our meeting.

Last year, Brooks, our running shoe company, exhibited for the first time and ran up sales of \$150,000. Brooks is on fire: Its volume in 2012 grew 34%, and that was on top of a similar 34% gain in 2011. The company's management expects another jump of 23% in 2013. We will again have a special commemorative shoe to offer at the meeting.

On Sunday at 8 a.m., we will initiate the "Berkshire 5K," a race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that you will receive with your credentials for the meeting. We will have plenty of categories for competition, including one for the media. (It will be fun to report on *their* performance.) Regretfully, I will forego running; *someone* has to man the starting gun.

I should warn you that we have a lot of home-grown talent. Ted Weschler has run the marathon in 3:01. Jim Weber, Brooks' dynamic CEO, is another speedster with a 3:31 best. Todd Combs specializes in the triathlon, but has been clocked at 22 minutes in the 5K.

That, however, is just the beginning: Our directors are also fleet of foot (that is, *some* of our directors are). Steve Burke has run an amazing 2:39 Boston marathon. (It's a family thing; his wife, Gretchen, finished the New York marathon in 3:25.) Charlotte Guyman's best is 3:37, and Sue Decker crossed the tape in New York in 3:36. Charlie did not return his questionnaire.

GEICO will have a booth in the shopping area, staffed by a number of its top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least half of you, I believe we can.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, including a couple of new ones. Carol Loomis, who has been invaluable to me in editing this letter since 1977, has recently authored *Tap Dancing to Work: Warren Buffett on Practically Everything*. She and I have cosigned 500 copies, available exclusively at the meeting.

The Outsiders, by William Thorndike, Jr., is an outstanding book about CEOs who excelled at capital allocation. It has an insightful chapter on our director, Tom Murphy, overall the best business manager I've ever met. I also recommend *The Clash of the Cultures* by Jack Bogle and Laura Rittenhouse's *Investing Between the Lines*. Should you need to ship your book purchases, a shipping service will be available nearby.

The *Omaha World-Herald* will again have a booth, offering a few books it has recently published. Red-blooded Husker fans – is there any Nebraskan who isn't one? – will surely want to purchase *Unbeatables*. It tells the story of Nebraska football during 1993-97, a golden era in which Tom Osborne's teams went 60-3.

If you are a big spender – or aspire to become one – visit Signature Aviation on the east side of the Omaha airport between noon and 5:00 p.m. on Saturday. There we will have a fleet of NetJets aircraft that will get your pulse racing. Come by bus; leave by private jet. Live a little.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City versus Omaha. The drive between the two cities is about 2½ hours, and it may be that you can save significant money, particularly if you had planned to rent a car in Omaha. Spend the savings with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” discount pricing. Last year the store did \$35.9 million of business during its annual meeting sale, an all-time record that makes other retailers turn green. To obtain the Berkshire discount, you must make your purchases between Tuesday, April 30th and Monday, May 6th inclusive, and also present your meeting credential. The period’s special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 3rd. The second, the main gala, will be held on Sunday, May 5th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m. In recent years, our three-day volume has far exceeded sales in all of December, normally a jeweler’s best month.

Around 1 p.m. on Sunday, I will begin clerking at Borsheims. Last year my sales totaled \$1.5 million. This year I won’t quit until I hit \$2 million. Because I need to leave well before sundown, I will be desperate to do business. Come take advantage of me. Ask for my “Crazy Warren” price.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 29th through Saturday, May 11th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world’s top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Don’t play them for money.

Gorat’s and Piccolo’s will again be open exclusively for Berkshire shareholders on Sunday, May 5th. Both will be serving until 10 p.m., with Gorat’s opening at 1 p.m. and Piccolo’s opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat’s, call 402-551-3733 on April 1st (*but not before*) and at Piccolo’s call 402-342-9038. At Piccolo’s, order a giant root beer float for dessert. Only sissies get the small one. (I once saw Bill Gates polish off two of the giant variety *after* a full-course dinner; that’s when I knew he would make a great director.)

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be emailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any email you send them. (In your email, let the journalist know if you would like your name mentioned if your question is selected.)

Last year we had a second panel of three analysts who follow Berkshire. All were insurance specialists, and shareholders subsequently indicated they wanted a little more variety. Therefore, this year we will have one insurance analyst, Cliff Gallant of Nomura Securities. Jonathan Brandt of Ruane, Cunniff & Goldfarb will join the analyst panel to ask questions that deal with our non-insurance operations.

Finally – to spice things up – we would like to add to the panel a credentialed bear on Berkshire, preferably one who is short the stock. Not yet having a bear identified, we would like to hear from applicants. The only requirement is that you be an investment professional and negative on Berkshire. The three analysts will bring their own Berkshire-specific questions and alternate with the journalists and the audience in asking them.

Charlie and I believe that all shareholders should have access to new Berkshire information simultaneously and should also have adequate time to analyze it, which is why we try to issue financial information after the market close on a Friday and why our annual meeting is held on Saturdays. We do not talk one-on-one to large institutional investors or analysts. Our hope is that the journalists and analysts will ask questions that will further educate shareholders about their investment.

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists and analysts will come up with some tough ones, and that's the way we like it. All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and 18 from the audience. If there is some extra time, we will take more from the audience. Audience questioners will be determined by drawings that will take place at 8:15 a.m. at each of the 11 microphones located in the arena and main overflow room.

* * * * *

For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars, who run their businesses as if they were the only asset owned by their families. I believe their mindset to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most have no financial need to work; the joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 23 men and women who work with me at our corporate office (all on one floor, which is the way we intend to keep it!).

This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 21,500-page Federal income tax return as well as state and foreign returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year they dealt with 48 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers for lunch. No CEO has it better; I truly do feel like tap dancing to work every day.

This home office crew, along with our operating managers, has my deepest thanks and deserves yours as well. Come to Omaha – the cradle of capitalism – on May 4th and chime in.

March 1, 2013

Warren E. Buffett
Chairman of the Board

Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	0.7
1998	48.3	28.6	19.7
1999	0.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(0.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
2010	13.0	15.1	(2.1)
2011	4.6	2.1	2.5
2012	14.4	16.0	(1.6)
2013	18.2	32.4	(14.2)
Compounded Annual Gain – 1965–2013	19.7%	9.8%	9.9
Overall Gain – 1964–2013	693,518%	9,841%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2013 was \$34.2 billion. That gain was *after* our deducting \$1.8 billion of charges – meaningless economically, as I will explain later – that arose from our purchase of the minority interests in Marmon and Iscar. After those charges, the per-share book value of both our Class A and Class B stock increased by 18.2%. Over the last 49 years (that is, since present management took over), book value has grown from \$19 to \$134,973, a rate of 19.7% compounded annually.*

On the facing page, we show our long-standing performance measurement: The yearly change in Berkshire's per-share book value versus the market performance of the S&P 500. What counts, of course, is per-share *intrinsic* value. But that's a subjective figure, and book value is useful as a rough tracking indicator. (An extended discussion of intrinsic value is included in our Owner-Related Business Principles on pages 103 - 108. Those principles have been included in our reports for 30 years, and we urge new and prospective shareholders to read them.)

As I've long told you, Berkshire's intrinsic value far exceeds its book value. Moreover, the difference has widened considerably in recent years. That's why our 2012 decision to authorize the repurchase of shares at 120% of book value made sense. Purchases at that level benefit continuing shareholders because per-share intrinsic value exceeds that percentage of book value by a meaningful amount. We did not purchase shares during 2013, however, because the stock price did not descend to the 120% level. If it does, we will be aggressive.

Charlie Munger, Berkshire's vice chairman and my partner, and I believe both Berkshire's book value and intrinsic value will outperform the S&P in years when the market is down or moderately up. We expect to fall short, though, in years when the market is strong – as we did in 2013. We have underperformed in ten of our 49 years, with all but one of our shortfalls occurring when the S&P gain exceeded 15%.

Over the stock market cycle between yearends 2007 and 2013, we overperformed the S&P. Through full cycles in future years, we expect to do that again. If we fail to do so, we will not have earned our pay. After all, you could always own an index fund and be assured of S&P results.

The Year at Berkshire

On the operating front, just about everything turned out well for us last year – in certain cases *very* well. Let me count the ways:

- We completed two large acquisitions, spending almost \$18 billion to purchase all of NV Energy and a major interest in H. J. Heinz. Both companies fit us well and will be prospering a century from now.

With the Heinz purchase, moreover, we created a partnership template that may be used by Berkshire in future acquisitions of size. Here, we teamed up with investors at 3G Capital, a firm led by my friend, Jorge Paulo Lemann. His talented associates – Bernardo Hees, Heinz's new CEO, and Alex Behring, its Chairman – are responsible for operations.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

Berkshire is the financing partner. In that role, we purchased \$8 billion of Heinz preferred stock that carries a 9% coupon but also possesses other features that should increase the preferred's annual return to 12% or so. Berkshire and 3G each purchased half of the Heinz common stock for \$4.25 billion.

Though the Heinz acquisition has some similarities to a "private equity" transaction, there is a crucial difference: Berkshire never intends to sell a share of the company. What we would like, rather, is to buy more, and that could happen: Certain 3G investors may sell some or all of their shares in the future, and we might increase our ownership at such times. Berkshire and 3G could also decide at some point that it would be mutually beneficial if we were to exchange some of our preferred for common shares (at an equity valuation appropriate to the time).

Our partnership took control of Heinz in June, and operating results so far are encouraging. Only minor earnings from Heinz, however, are reflected in those we report for Berkshire this year: One-time charges incurred in the purchase and subsequent restructuring of operations totaled \$1.3 billion. Earnings in 2014 will be substantial.

With Heinz, Berkshire now owns 8½ companies that, were they stand-alone businesses, would be in the Fortune 500. Only 491½ to go.

NV Energy, purchased for \$5.6 billion by MidAmerican Energy, our utility subsidiary, supplies electricity to about 88% of Nevada's population. This acquisition fits nicely into our existing electric-utility operation and offers many possibilities for large investments in renewable energy. NV Energy will *not* be MidAmerican's last major acquisition.

- MidAmerican is one of our "Powerhouse Five" – a collection of large non-insurance businesses that, in aggregate, had a record \$10.8 billion of pre-tax earnings in 2013, up \$758 million from 2012. The other companies in this sainted group are BNSF, Iscar, Lubrizol and Marmon.

Of the five, only MidAmerican, then earning \$393 million pre-tax, was owned by Berkshire nine years ago. Subsequently, we purchased another three of the five on an all-cash basis. In acquiring the fifth, BNSF, we paid about 70% of the cost in cash, and, for the remainder, issued shares that increased the number outstanding by 6.1%. In other words, the \$10.4 billion gain in annual earnings delivered Berkshire by the five companies over the nine-year span has been accompanied by only minor dilution. That satisfies our goal of not simply growing, but rather increasing *per-share* results.

If the U.S. economy continues to improve in 2014, we can expect earnings of our Powerhouse Five to improve also – perhaps by \$1 billion or so pre-tax.

- Our many dozens of smaller non-insurance businesses earned \$4.7 billion pre-tax last year, up from \$3.9 billion in 2012. Here, too, we expect further gains in 2014.
- Berkshire's extensive insurance operation again operated at an underwriting profit in 2013 – that makes 11 years in a row – and increased its float. During that 11-year stretch, our float – money that doesn't belong to us but that we can invest for Berkshire's benefit – has grown from \$41 billion to \$77 billion. Concurrently, our underwriting profit has aggregated \$22 billion pre-tax, including \$3 billion realized in 2013. And all of this all began with our 1967 purchase of National Indemnity for \$8.6 million.

We now own a wide variety of exceptional insurance operations. Best known is GEICO, the car insurer Berkshire acquired in full at yearend 1995 (having for many years prior owned a partial interest). GEICO in 1996 ranked number seven among U.S. auto insurers. Now, GEICO is number two, having recently passed Allstate. The reasons for this amazing growth are simple: low prices and reliable service. You can do yourself a favor by calling 1-800-847-7536 or checking Geico.com to see if you, too, can cut your insurance costs. Buy some of Berkshire's other products with the savings.

- While Charlie and I search for elephants, our many subsidiaries are regularly making bolt-on acquisitions. Last year, we contracted for 25 of these, scheduled to cost \$3.1 billion in aggregate. These transactions ranged from \$1.9 million to \$1.1 billion in size.

Charlie and I encourage these deals. They deploy capital in activities that fit with our existing businesses and that will be managed by our corps of expert managers. The result is no more work for us and more earnings for you. Many more of these bolt-on deals will be made in future years. In aggregate, they will be meaningful.

- Last year we invested \$3.5 billion in the surest sort of bolt-on: the purchase of additional shares in two wonderful businesses that we already controlled. In one case – Marmon – our purchases brought us to the 100% ownership we had signed up for in 2008. In the other instance – Iscar – the Wertheimer family elected to exercise a put option it held, selling us the 20% of the business it retained when we bought control in 2006.

These purchases added about \$300 million pre-tax to our current earning power and also delivered us \$800 million of cash. Meanwhile, the same nonsensical accounting rule that I described in last year's letter required that we enter these purchases on our books at \$1.8 billion less than we paid, a process that reduced Berkshire's book value. (The charge was made to "capital in excess of par value"; figure *that* one out.) This weird accounting, you should understand, instantly increased Berkshire's excess of intrinsic value over book value by the same \$1.8 billion.

- Our subsidiaries spent a record \$11 billion on plant and equipment during 2013, roughly twice our depreciation charge. About 89% of that money was spent in the United States. Though we invest abroad as well, the mother lode of opportunity resides in America.
- In a year in which most equity managers found it impossible to outperform the S&P 500, both Todd Combs and Ted Weschler handily did so. Each now runs a portfolio exceeding \$7 billion. They've earned it.

I must again confess that their investments outperformed mine. (Charlie says I should add "by a lot.") If such humiliating comparisons continue, I'll have no choice but to cease talking about them.

Todd and Ted have also created significant value for you in several matters unrelated to their portfolio activities. Their contributions are just beginning: Both men have Berkshire blood in their veins.

- Berkshire's yearend employment – counting Heinz – totaled a record 330,745, up 42,283 from last year. The increase, I must admit, included one person at our Omaha home office. (Don't panic: The headquarters gang still fits comfortably on one floor.)
- Berkshire increased its ownership interest last year in each of its "Big Four" investments – American Express, Coca-Cola, IBM and Wells Fargo. We purchased additional shares of Wells Fargo (increasing our ownership to 9.2% versus 8.7% at yearend 2012) and IBM (6.3% versus 6.0%). Meanwhile, stock repurchases at Coca-Cola and American Express raised our percentage ownership. Our equity in Coca-Cola grew from 8.9% to 9.1% and our interest in American Express from 13.7% to 14.2%. And, if you think tenths of a percent aren't important, ponder this math: For the four companies in aggregate, each increase of one-tenth of a percent in our share of their equity raises Berkshire's share of their annual earnings by \$50 million.

The four companies possess excellent businesses and are run by managers who are both talented and shareholder-oriented. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business; it's better to have a partial interest in the Hope diamond than to own all of a rhinestone.

Going by our yearend holdings, our portion of the "Big Four's" 2013 earnings amounted to \$4.4 billion. In the earnings we report to you, however, we include only the dividends we receive – about \$1.4 billion last year. But make no mistake: The \$3 billion of their earnings we don't report is every bit as valuable to us as the portion Berkshire records.

The earnings that these four companies retain are often used for repurchases of their own stock – a move that enhances our share of future earnings – as well as for funding business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees will grow substantially over time. If they do, dividends to Berkshire will increase and, even more important, our unrealized capital gains will, too. (For the four, unrealized gains already totaled \$39 billion at yearend.)

Our flexibility in capital allocation – our willingness to invest large sums passively in non-controlled businesses – gives us a significant advantage over companies that limit themselves to acquisitions they can operate. Woody Allen stated the general idea when he said: "The advantage of being bi-sexual is that it doubles your chances for a date on Saturday night." Similarly, our appetite for *either* operating businesses or passive investments doubles our chances of finding sensible uses for our endless gusher of cash.

* * * * *

Late in 2009, amidst the gloom of the Great Recession, we agreed to buy BNSF, the largest purchase in Berkshire's history. At the time, I called the transaction an "all-in wager on the economic future of the United States."

That kind of commitment was nothing new for us: We've been making similar wagers ever since Buffett Partnership Ltd. acquired control of Berkshire in 1965. For good reason, too. Charlie and I have always considered a "bet" on ever-rising U.S. prosperity to be very close to a sure thing.

Indeed, who has ever benefited during the past 237 years by betting *against* America? If you compare our country's present condition to that existing in 1776, you have to rub your eyes in wonder. And the dynamism embedded in our market economy will continue to work its magic. America's best days lie ahead.

With this tailwind working for us, Charlie and I hope to build Berkshire's per-share intrinsic value by (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. We will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Those building blocks rest on a rock-solid foundation. A century hence, BNSF and MidAmerican Energy will still be playing major roles in our economy. Insurance will concomitantly be essential for both businesses and individuals – and no company brings greater human and financial resources to that business than Berkshire.

Moreover, we will *always* maintain supreme financial strength, operating with at least \$20 billion of cash equivalents and never incurring material amounts of short-term obligations. As we view these and other strengths, Charlie and I like your company's prospects. We feel fortunate to be entrusted with its management.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (nor, in fact, for any other stock). In our 2010 annual report, however, we laid out the three elements – one of them qualitative – that we believe are the keys to a sensible estimate of Berkshire’s intrinsic value. That discussion is reproduced in full on pages 109 - 110.

Here is an update of the two quantitative factors: In 2013 our per-share investments increased 13.6% to \$129,253 and our pre-tax earnings from businesses other than insurance and investments increased 12.8% to \$9,116 per share.

Since 1970, our per-share investments have increased at a rate of 19.3% compounded annually, and our earnings figure has grown at a 20.6% clip. It is no coincidence that the price of Berkshire stock over the 43-year period has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both sectors, but we will most strongly focus on building operating earnings.

* * * * *

Now, let’s examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. So we’ll present them as four separate businesses, which is how Charlie and I view them (though there are important and *enduring* advantages to having them all under one roof). Our goal is to provide you with the information we would wish to have if our positions were reversed, with you being the reporting manager and we the absentee shareholders. (But don’t get any ideas!)

Insurance

“Our investment in the insurance companies reflects a first major step in our efforts to achieve a more diversified base of earning power.”

— 1967 Annual Report

Let’s look first at insurance, Berkshire’s core operation and the engine that has consistently propelled our expansion since that 1967 report was published.

Property-casualty (“P/C”) insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers’ compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call “float” – that will eventually go to others. Meanwhile, insurers get to invest this float for their benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

<u>Year</u>	<u>Float (in \$ millions)</u>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2013	77,240

Further gains in float will be tough to achieve. On the plus side, GEICO’s float will almost certainly grow. In National Indemnity’s reinsurance division, however, we have a number of run-off contracts whose float drifts downward. If we do experience a decline in float at some future time, it will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate demands for sums that are large compared to our cash resources. (In this respect, property-casualty insurance differs in an important way from certain forms of life insurance.)

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous in most years that it causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. For example, State Farm, by far the country's largest insurer and a well-managed company besides, incurred an underwriting loss in nine of the twelve years ending in 2012 (the latest year for which their financials are available, as I write this). Competitive dynamics almost guarantee that the insurance industry – despite the float income all companies enjoy – will continue its dismal record of earning subnormal returns as compared to other businesses.

As noted in the first section of this report, we have now operated at an underwriting profit for eleven consecutive years, our pre-tax gain for the period having totaled \$22 billion. Looking ahead, I believe we will continue to underwrite profitably in most years. Doing so is the daily focus of *all* of our insurance managers who know that while float is valuable, it can be drowned by poor underwriting results.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a liability, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as strictly a liability is incorrect; it should instead be viewed as a revolving fund. Daily, we pay old claims – some \$17 billion to more than five million claimants in 2013 – and that reduces float. Just as surely, we each day write new business and thereby generate new claims that add to float. If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability.

A counterpart to this overstated liability is \$15.5 billion of “goodwill” that is attributable to our insurance companies and included in book value as an asset. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance business sustains large and prolonged underwriting losses, any goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay to purchase an insurance operation possessing float of *similar quality* to that we have – to be far in excess of its historic carrying value. The value of our float is one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

* * * * *

Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that possess strong, hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources. Indeed, we are *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a \$250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because of its many streams of earnings. And we would remain awash in cash, looking for large opportunities if the catastrophe caused markets to go into shock. All other major insurers and reinsurers would meanwhile be far in the red, with some facing insolvency.

From a standing start in 1985, Ajit has created an insurance business with float of \$37 billion and a large cumulative underwriting profit, a feat no other insurance CEO has come close to matching. Ajit's mind is an idea factory that is always looking for more lines of business he can add to his current assortment.

One venture materialized last June when he formed Berkshire Hathaway Specialty Insurance (“BHSI”). This initiative took us into commercial insurance, where we were instantly accepted by both major insurance brokers and corporate risk managers throughout America. These professionals recognize that no other insurer can match the financial strength of Berkshire, which guarantees that legitimate claims arising many years in the future will be paid promptly and fully.

BHSI is led by Peter Eastwood, an experienced underwriter who is widely respected in the insurance world. Peter has assembled a spectacular team that is already writing a substantial amount of business with many Fortune 500 companies and with smaller operations as well. BHSI will be a major asset for Berkshire, one that will generate volume in the billions within a few years. Give Peter a Berkshire greeting when you see him at the annual meeting.

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We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, “The other guy is doing it, so we must as well,” spells trouble in any business, but in none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been better than cost-free under his leadership, and we expect that, on average, to continue. We are particularly enthusiastic about General Re's international life reinsurance business, which has grown consistently and profitably since we acquired the company in 1998.

It can be remembered that soon after we purchased General Re, the company was beset by problems that caused commentators – and me as well, briefly – to believe I had made a huge mistake. That day is long gone. General Re is now a gem.

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Finally, there is GEICO, the insurer on which I cut my teeth 63 years ago. GEICO is managed by Tony Nicely, who joined the company at 18 and completed 52 years of service in 2013. Tony became CEO in 1993, and since then the company has been flying.

When I was first introduced to GEICO in January 1951, I was blown away by the huge cost advantage the company enjoyed compared to the expenses borne by the giants of the industry. That operational efficiency continues today and is an all-important asset. No one *likes* to buy auto insurance. But almost everyone likes to drive. The insurance needed is a major expenditure for most families. Savings matter to them – and *only* a low-cost operation can deliver these.

GEICO's cost advantage is the factor that has enabled the company to gobble up market share year after year. Its low costs create a moat – an *enduring* one – that competitors are unable to cross. Meanwhile, our little gecko continues to tell Americans how GEICO can save them important money. With our latest reduction in operating costs, his story has become even more compelling.

In 1995, we purchased the half of GEICO that we didn't already own, paying \$1.4 billion more than the net tangible assets we acquired. That's "goodwill," and it will forever remain unchanged on our books. As GEICO's business grows, however, so does its *true* economic goodwill. I believe that figure to be approaching \$20 billion.

* * * * *

In addition to our three major insurance operations, we own a group of smaller companies, most of them plying their trade in odd corners of the insurance world. In aggregate, these companies are a growing operation that consistently delivers an underwriting profit. Moreover, as the table below shows, they also provide us with substantial float. Charlie and I treasure these companies and their managers.

<u>Insurance Operations</u>	<u>Underwriting Profit</u>		<u>Yearend Float</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
BH Reinsurance	\$1,294	\$ 304	\$37,231	\$34,821
General Re	283	355	20,013	20,128
GEICO	1,127	680	12,566	11,578
Other Primary	385	286	7,430	6,598
	<u>\$3,089</u>	<u>\$1,625</u>	<u>\$77,240</u>	<u>\$73,125</u>

* * * * *

Simply put, insurance is the sale of promises. The "customer" pays money now; the insurer promises to pay money in the future if certain events occur.

Sometimes, the promise will not be tested for decades. (Think of life insurance bought by those in their 20s.) Therefore, both the ability and willingness of the insurer to pay – even if economic chaos prevails when payment time arrives – is all-important.

Berkshire's promises have no equal, a fact affirmed in recent years by the actions of the world's largest and most sophisticated insurers, some of which have wanted to shed themselves of huge and exceptionally long-lived liabilities, particularly those involving asbestos claims. That is, these insurers wished to "cede" their liabilities to a reinsurer. Choosing the wrong reinsurer, however – one that down the road proved to be financially strapped or a bad actor – would put the original insurer in danger of getting the liabilities right back in its lap.

Almost without exception, the largest insurers seeking aid came to Berkshire. Indeed, in the largest such transaction ever recorded, Lloyd's in 2007 turned over to us both many thousands of known claims arising from policies written before 1993 and an unknown but huge number of claims from that same period sure to materialize in the future. (Yes, we will be receiving claims decades from now that apply to events taking place prior to 1993.)

Berkshire's ultimate payments arising from the Lloyd's transaction are today unknowable. What is certain, however, is that Berkshire will pay all valid claims up to the \$15 billion limit of our policy. No other insurer's promise would have given Lloyd's the comfort provided by its agreement with Berkshire. The CEO of the entity then handling Lloyd's claims said it best: "Names [the original insurers at Lloyd's] wanted to sleep easy at night, and we think we've just bought them the world's best mattress."

* * * * *

Berkshire's great managers, premier financial strength and a variety of business models possessing wide moats form something unique in the insurance world. The combination is a huge asset for Berkshire shareholders that will only get more valuable with time.

Regulated, Capital-Intensive Businesses

"Though there are many regulatory restraints in the utility industry, it's possible that we will make additional commitments in the field. If we do, the amounts involved could be large."

— 1999 Annual Report

We have two major operations, BNSF and MidAmerican Energy, that share important characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions will far exceed its interest requirements. Last year, for example, BNSF's interest coverage was 9:1. (Our definition of coverage is pre-tax earnings/interest, *not* EBITDA/interest, a commonly-used measure we view as seriously flawed.)

At MidAmerican, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies exclusively offering an essential service. The second is enjoyed by few other utilities: a great diversity of earnings streams, which shield us from being seriously harmed by any single regulatory body. Now, with the acquisition of NV Energy, MidAmerican's earnings base has further broadened. This particular strength, supplemented by Berkshire's ownership, has enabled MidAmerican and its utility subsidiaries to significantly lower their cost of debt. This advantage benefits both us *and* our customers.

Every day, our two subsidiaries power the American economy in major ways:

- BNSF carries about 15% (measured by ton-miles) of *all* inter-city freight, whether it is transported by truck, rail, water, air, or pipeline. Indeed, we move more ton-miles of goods than *anyone* else, a fact establishing BNSF as the most important artery in our economy's circulatory system. Its hold on the number-one position strengthened in 2013.

BNSF, like all railroads, also moves its cargo in an extraordinarily fuel-efficient and environmentally friendly way, carrying a ton of freight about 500 miles on a single gallon of diesel fuel. Trucks taking on the same job guzzle about four times as much fuel.

- MidAmerican's utilities serve regulated retail customers in eleven states. No utility company stretches further. In addition, we are the leader in renewables: From a standing start nine years ago, MidAmerican now accounts for 7% of the country's wind generation capacity, with more on the way. Our share in solar – most of which is still in construction – is even larger.

MidAmerican can make these investments because it retains *all* of its earnings. Here's a little known fact: Last year MidAmerican retained more dollars of earnings – by far – than any other American electric utility. We and our regulators see this as an important advantage – one almost certain to exist five, ten and twenty years from now.

When our current projects are completed, MidAmerican's renewables portfolio will have cost \$15 billion. We relish making such commitments as long as they promise reasonable returns. And, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need massive investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is meanwhile in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Tangible proof of our dedication to that duty was delivered last year in a poll of customer satisfaction covering 52 holding companies and their 101 operating electric utilities. Our MidAmerican group ranked number one, with 95.3% of respondents giving us a “very satisfied” vote and not a single customer rating us “dissatisfied.” The bottom score in the survey, incidentally, was a dismal 34.5%.

All three of our companies were ranked far lower by this measure before they were acquired by MidAmerican. The extraordinary customer satisfaction we have achieved is of great importance as we expand: Regulators in states we hope to enter are glad to see us, knowing we will be responsible operators.

Our railroad has been diligent as well in anticipating the needs of its customers. Whatever you may have heard about our country’s crumbling infrastructure in no way applies to BNSF or railroads generally. America’s rail system has never been in better shape, a consequence of huge investments by the industry. We are not, however, resting: BNSF spent \$4 billion on the railroad in 2013, double its depreciation charge and a single-year record for any railroad. And, we will spend considerably more in 2014. Like Noah, who foresaw early on the need for dependable transportation, we know it’s our job to plan ahead.

Leading our two capital-intensive companies are Greg Abel, at MidAmerican, and the team of Matt Rose and Carl Ice at BNSF. The three are extraordinary managers who have my gratitude and deserve yours as well. Here are the key figures for their businesses:

<i>MidAmerican (89.8% owned)</i>	<i>Earnings (in millions)</i>		
	<i>2013</i>	<i>2012</i>	<i>2011</i>
U.K. utilities	\$ 362	\$ 429	\$ 469
Iowa utility	230	236	279
Western utilities	982	737	771
Pipelines	385	383	388
HomeServices	139	82	39
Other (net)	4	91	36
Operating earnings before corporate interest and taxes	2,102	1,958	1,982
Interest	296	314	336
Income taxes	170	172	315
Net earnings	<u>\$ 1,636</u>	<u>\$ 1,472</u>	<u>\$ 1,331</u>
Earnings applicable to Berkshire	\$ 1,470	\$ 1,323	\$ 1,204

<i>BNSF</i>	<i>Earnings (in millions)</i>		
	<i>2013</i>	<i>2012</i>	<i>2011</i>
Revenues	\$22,014	\$20,835	\$19,548
Operating expenses	15,357	14,835	14,247
Operating earnings before interest and taxes	6,657	6,000	5,301
Interest (net)	729	623	560
Income taxes	2,135	2,005	1,769
Net earnings	<u>\$ 3,793</u>	<u>\$ 3,372</u>	<u>\$ 2,972</u>

Ron Peltier continues to build HomeServices, MidAmerican's real estate brokerage subsidiary. Last year his operation made four acquisitions, the most significant being Fox & Roach, a Philadelphia-based company that is the largest single-market realtor in the country.

HomeServices now has 22,114 agents (listed by geography on page 112), up 38% from 2012. HomeServices also owns 67% of the Prudential and Real Living franchise operations, which are in the process of rebranding their franchisees as Berkshire Hathaway HomeServices. If you haven't yet, many of you will soon be seeing our name on "for sale" signs.

Manufacturing, Service and Retailing Operations

"See that store," Warren says, pointing at Nebraska Furniture Mart. "That's a really good business."

"Why don't you buy it?" I said.

"It's privately held," Warren said.

"Oh," I said.

"I might buy it anyway," Warren said. "Someday."

— *Supermoney* by Adam Smith (1972)

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/13 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 6,625	Notes payable	\$ 1,615
Accounts and notes receivable	7,749	Other current liabilities	8,965
Inventory	9,945	Total current liabilities	10,580
Other current assets	<u>716</u>		
Total current assets	25,035		
Goodwill and other intangibles	25,617	Deferred taxes	5,184
Fixed assets	19,389	Term debt and other liabilities	4,405
Other assets	<u>4,274</u>	Non-controlling interests	456
	<u>\$74,315</u>	Berkshire equity	53,690
			<u>\$74,315</u>

Earnings Statement (in millions)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Revenues	\$95,291	\$83,255	\$72,406
Operating expenses	88,414	76,978	67,239
Interest expense	<u>135</u>	<u>146</u>	<u>130</u>
Pre-tax earnings	6,742	6,131	5,037
Income taxes and non-controlling interests	<u>2,512</u>	<u>2,432</u>	<u>1,998</u>
Net earnings	<u>\$ 4,230</u>	<u>\$ 3,699</u>	<u>\$ 3,039</u>

Our income and expense data conforming to Generally Accepted Accounting Principles ("GAAP") is on page 29. In contrast, the operating expense figures above are non-GAAP and exclude some purchase-accounting items (primarily the amortization of certain intangible assets). We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the true economic expenses and profits of the businesses aggregated in the table than do GAAP figures.

I won't explain all of the adjustments – some are tiny and arcane – but serious investors should understand the disparate nature of intangible assets: Some truly deplete over time while others in no way lose value. With software, for example, amortization charges are very real expenses. Charges against other intangibles such as the amortization of customer relationships, however, arise through purchase-accounting rules and are clearly not real costs. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when earnings are calculated – even though from an investor's viewpoint they could not be more different.

In the GAAP-compliant figures we show on page 29, amortization charges of \$648 million for the companies included in this section are deducted as expenses. We would call about 20% of these "real," the rest not. This difference has become significant because of the many acquisitions we have made. It will almost certainly rise further as we acquire more companies.

Eventually, of course, the non-real charges disappear when the assets to which they're related become fully amortized. But this usually takes 15 years and – alas – it will be my successor whose reported earnings get the benefit of their expiration.

Every dime of depreciation expense we report, however, is a real cost. And that's true at almost all other companies as well. When Wall Streeters tout EBITDA as a valuation guide, button your wallet.

Our public reports of earnings will, of course, continue to conform to GAAP. To embrace reality, however, remember to add back most of the amortization charges we report.

* * * * *

The crowd of companies in this section sells products ranging from lollipops to jet airplanes. Some of these businesses, measured by earnings on unleveraged net *tangible* assets, enjoy terrific economics, producing profits that run from 25% after-tax to far more than 100%. Others generate good returns in the area of 12% to 20%. A few, however, have very poor returns, a result of some serious mistakes I made in my job of capital allocation. I was not misled: I simply was wrong in my evaluation of the economic dynamics of the company or the industry in which it operated.

Fortunately, my blunders usually involved relatively small acquisitions. Our large buys have generally worked out well and, in a few cases, more than well. I have not, however, made my last mistake in purchasing either businesses or stocks. Not everything works out as planned.

Viewed as a single entity, the companies in this group are an excellent business. They employed an average of \$25 billion of net tangible assets during 2013 and, with large quantities of excess cash and little leverage, earned 16.7% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if the purchase price is excessive. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for goodwill. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Furthermore, the intrinsic value of these businesses, in aggregate, exceeds their carrying value by a good margin. Even so, the difference between intrinsic value and carrying value in the insurance and regulated-industry segments is *far* greater. It is there that the truly big winners reside.

* * * * *

We have far too many companies in this group to comment on them individually. Moreover, both current and potential competitors read this report. In a few of our businesses we might be disadvantaged if they knew our numbers. So, in some of our operations that are not of a size material to an evaluation of Berkshire, we only disclose what is required. You can find a good bit of detail about many of our operations, however, on pages 80-84.

I can't resist, however, giving you an update on Nebraska Furniture Mart's expansion into Texas. I'm not covering this event because of its *economic* importance to Berkshire – it takes more than a new store to move the needle on Berkshire's \$225 billion equity base. But I've now worked 30 years with the marvelous Blumkin family, and I'm excited about the remarkable store – truly Texas-sized – it is building at The Colony, in the northern part of the Dallas metropolitan area.

When the store is completed next year, NFM will have – under one roof, and on a 433-acre site – 1.8 million square feet of retail and supporting warehouse space. View the project's progress at www.nfm.com/texas. NFM already owns the two highest-volume home furnishings stores in the country (in Omaha and Kansas City, Kansas), each doing about \$450 million annually. I predict the Texas store will blow these records away. If you live anywhere near Dallas, come check us out.

I think back to August 30, 1983 – my birthday – when I went to see Mrs. B (Rose Blumkin), carrying a 1 ¼-page purchase proposal for NFM that I had drafted. (It's reproduced on pages 114 - 115.) Mrs. B accepted my offer without changing a word, and we completed the deal without the involvement of investment bankers or lawyers (an experience that can only be described as heavenly). Though the company's financial statements were unaudited, I had no worries. Mrs. B simply told me what was what, and her word was good enough for me.

Mrs. B was 89 at the time and worked until 103 – definitely my kind of woman. Take a look at NFM's financial statements from 1946 on pages 116 - 117. Everything NFM now owns comes from (a) that \$72,264 of net worth and \$50 – no zeros omitted – of cash the company then possessed, and (b) the incredible talents of Mrs. B, her son, Louie, and his sons Ron and Irv.

The punch line to this story is that Mrs. B never spent a day in school. Moreover, she emigrated from Russia to America knowing not a word of English. But she loved her adopted country: At Mrs. B's request, the family always sang *God Bless America* at its gatherings.

Aspiring business managers should look hard at the plain, but rare, attributes that produced Mrs. B's incredible success. Students from 40 universities visit me every year, and I have them start the day with a visit to NFM. If they absorb Mrs. B's lessons, they need none from me.

Finance and Financial Products

"Clayton's loan portfolio will likely grow to at least \$5 billion in not too many years and, with sensible credit standards in place, should deliver significant earnings."

— 2003 Annual Report

This sector, our smallest, includes two rental companies, XTRA (trailers) and CORT (furniture), as well as Clayton Homes, the country's leading producer and financer of manufactured homes. Aside from these 100%-owned subsidiaries, we also include in this category a collection of financial assets and our 50% interest in Berkadia Commercial Mortgage.

Clayton is placed in this section because it owns and services 326,569 mortgages, totaling \$13.6 billion. In recent years, as manufactured home sales plummeted, a high percentage of Clayton's earnings came from this mortgage business.

In 2013, however, the sale of new homes began to pick up and earnings from both manufacturing and retailing are again becoming significant. Clayton remains America's number one homebuilder: Its 2013 output of 29,547 homes accounted for about 4.7% of all single-family residences built in the country. Kevin Clayton, Clayton's CEO, has done a magnificent job of guiding the company through the severe housing depression. Now, his job – definitely more fun these days – includes the prospect of another earnings gain in 2014.

CORT and XTRA are leaders in their industries as well. And Jeff Pederson and Bill Franz will keep them on top. We are backing their plans through purchases of equipment that enlarge their rental potential.

Here's the pre-tax earnings recap for this sector:

	<u>2013</u>	<u>2012</u> (in millions)	<u>2011</u>
Berkadia	\$ 80	\$ 35	\$ 25
Clayton	416	255	154
CORT	40	42	29
XTRA	125	106	126
Net financial income*	324	410	440
	<u>\$985</u>	<u>\$848</u>	<u>\$ 774</u>

* Excludes capital gains or losses

Investments

"Our stock portfolio . . . was worth approximately \$17 million less than its carrying value [cost] . . . it is our belief that, over a period of years, the overall portfolio will prove to be worth more than its cost."

— 1974 Annual Report

Below we list our fifteen common stock investments that at yearend had the largest market value.

<u>Shares**</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>Cost*</u>	<u>Market</u> (in millions)
151,610,700	American Express Company	14.2	\$ 1,287	\$ 13,756
400,000,000	The Coca-Cola Company	9.1	1,299	16,524
22,238,900	DIRECTV	4.2	1,017	1,536
41,129,643	Exxon Mobil Corp.	0.9	3,737	4,162
13,062,594	The Goldman Sachs Group, Inc.	2.8	750	2,315
68,121,984	International Business Machines Corp.	6.3	11,681	12,778
24,669,778	Moody's Corporation	11.5	248	1,936
20,060,390	Munich Re	11.2	2,990	4,415
20,668,118	Phillips 66	3.4	660	1,594
52,477,678	The Procter & Gamble Company	1.9	336	4,272
22,169,930	Sanofi	1.7	1,747	2,354
301,046,076	Tesco plc	3.7	1,699	1,666
96,117,069	U.S. Bancorp	5.3	3,002	3,883
56,805,984	Wal-Mart Stores, Inc.	1.8	2,976	4,470
483,470,853	Wells Fargo & Company	9.2	11,871	21,950
	Others		11,281	19,894
	Total Common Stocks Carried at Market . . .		<u>\$56,581</u>	<u>\$117,505</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required under its rules.

**Excludes shares held by Berkshire subsidiary pension funds.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for \$5 billion. At yearend these shares were worth \$10.9 billion. We are likely to purchase the shares just before expiration of our option. In the meantime, it is important for you to realize that Bank of America is, in effect, our fifth largest equity investment and one we value highly.

In addition to our equity holdings, we also invest substantial sums in bonds. Usually, we've done well in these. But not always.

Most of you have never heard of Energy Future Holdings. Consider yourselves lucky; I certainly wish I hadn't. The company was formed in 2007 to effect a giant leveraged buyout of electric utility assets in Texas. The equity owners put up \$8 billion and borrowed a massive amount in addition. About \$2 billion of the debt was purchased by Berkshire, pursuant to a decision I made without consulting with Charlie. That was a *big* mistake.

Unless natural gas prices soar, EFH will almost certainly file for bankruptcy in 2014. Last year, we sold our holdings for \$259 million. While owning the bonds, we received \$837 million in cash interest. Overall, therefore, we suffered a pre-tax loss of \$873 million. Next time I'll call Charlie.

A few of our subsidiaries – primarily electric and gas utilities – use derivatives in their operations. Otherwise, we have not entered into any derivative contracts for some years, and our existing positions continue to run off. The contracts that have expired have delivered large profits as well as several billion dollars of medium-term float. Though there are no guarantees, we expect a similar result from those remaining on our books.

Some Thoughts About Investing

Investment is most intelligent when it is most businesslike.

— *The Intelligent Investor* by Benjamin Graham

It is fitting to have a Ben Graham quote open this discussion because I owe so much of what I know about investing to him. I will talk more about Ben a bit later, and I will even sooner talk about common stocks. But let me first tell you about two small non-stock investments that I made long ago. Though neither changed my net worth by much, they are instructive.

This tale begins in Nebraska. From 1973 to 1981, the Midwest experienced an explosion in farm prices, caused by a widespread belief that runaway inflation was coming and fueled by the lending policies of small rural banks. Then the bubble burst, bringing price declines of 50% or more that devastated both leveraged farmers and their lenders. Five times as many Iowa and Nebraska banks failed in that bubble's aftermath than in our recent Great Recession.

In 1986, I purchased a 400-acre farm, located 50 miles north of Omaha, from the FDIC. It cost me \$280,000, considerably less than what a failed bank had lent against the farm a few years earlier. I knew nothing about operating a farm. But I have a son who loves farming and I learned from him both how many bushels of corn and soybeans the farm would produce and what the operating expenses would be. From these estimates, I calculated the normalized return from the farm to then be about 10%. I also thought it was likely that productivity would improve over time and that crop prices would move higher as well. Both expectations proved out.

I needed no unusual knowledge or intelligence to conclude that the investment had no downside and potentially had substantial upside. There would, of course, be the occasional bad crop and prices would sometimes disappoint. But so what? There would be some unusually good years as well, and I would never be under any pressure to sell the property. Now, 28 years later, the farm has tripled its earnings and is worth five times or more what I paid. I still know nothing about farming and recently made just my second visit to the farm.

In 1993, I made another small investment. Larry Silverstein, Salomon's landlord when I was the company's CEO, told me about a New York retail property adjacent to NYU that the Resolution Trust Corp. was selling. Again, a bubble had popped – this one involving commercial real estate – and the RTC had been created to dispose of the assets of failed savings institutions whose optimistic lending practices had fueled the folly.

Here, too, the analysis was simple. As had been the case with the farm, the unleveraged current yield from the property was about 10%. But the property had been undermanaged by the RTC, and its income would increase when several vacant stores were leased. Even more important, the largest tenant – who occupied around 20% of the project's space – was paying rent of about \$5 per foot, whereas other tenants averaged \$70. The expiration of this bargain lease in nine years was certain to provide a major boost to earnings. The property's location was also superb: NYU wasn't going anywhere.

I joined a small group, including Larry and my friend Fred Rose, that purchased the parcel. Fred was an experienced, high-grade real estate investor who, with his family, would manage the property. And manage it they did. As old leases expired, earnings tripled. Annual distributions now exceed 35% of our original equity investment. Moreover, our original mortgage was refinanced in 1996 and again in 1999, moves that allowed several special distributions totaling more than 150% of what we had invested. I've yet to view the property.

Income from both the farm and the NYU real estate will probably increase in the decades to come. Though the gains won't be dramatic, the two investments will be solid and satisfactory holdings for my lifetime and, subsequently, for my children and grandchildren.

I tell these tales to illustrate certain fundamentals of investing:

- You don't need to be an expert in order to achieve satisfactory investment returns. But if you aren't, you must recognize your limitations and follow a course certain to work reasonably well. Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick "no."
- Focus on the future productivity of the asset you are considering. If you don't feel comfortable making a rough estimate of the asset's future earnings, just forget it and move on. No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you undertake.
- If you instead focus on the prospective price change of a contemplated purchase, you are speculating. There is nothing improper about that. I know, however, that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first toss; *none* of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is *never* a reason to buy it.
- With my two small investments, I thought *only* of what the properties would produce and cared not at all about their daily valuations. Games are won by players who focus on the playing field – not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.
- Forming macro opinions or listening to the macro or market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: "You don't know how easy this game is until you get into that broadcasting booth.")

- My two purchases were made in 1986 and 1993. What the economy, interest rates, or the stock market might do in the years immediately following – 1987 and 1994 – was of no importance to me in making those investments. I can't remember what the headlines or pundits were saying at the time. Whatever the chatter, corn would keep growing in Nebraska and students would flock to NYU.

There is one major difference between my two small investments and an investment in stocks. Stocks provide you minute-to-minute valuations for your holdings whereas I have yet to see a quotation for either my farm or the New York real estate.

It should be an enormous advantage for investors in stocks to have those wildly fluctuating valuations placed on their holdings – and for some investors, it is. After all, if a moody fellow with a farm bordering my property yelled out a price every day to me at which he would either buy my farm or sell me his – and those prices varied widely over short periods of time depending on his mental state – how in the world could I be other than benefited by his erratic behavior? If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming.

Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments.

Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of “Don’t just sit there, *do* something.” For these investors, liquidity is transformed from the unqualified benefit it should be to a curse.

A “flash crash” or some other extreme market fluctuation can’t hurt an investor any more than an erratic and mouthy neighbor can hurt my farm investment. Indeed, tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your *friend* when investing; a euphoric world is your enemy.

During the extraordinary financial panic that occurred late in 2008, I never gave a thought to selling my farm or New York real estate, even though a severe recession was clearly brewing. And, if I had owned 100% of a solid business with good long-term prospects, it would have been foolish for me to even consider dumping it. So why would I have sold my stocks that were small participations in wonderful businesses? True, any one of them might eventually disappoint, but as a group they were certain to do well. Could anyone really believe the earth was going to swallow up the incredible productive assets and unlimited human ingenuity existing in America?

* * * * *

When Charlie and I buy stocks – which we think of as small portions of businesses – our analysis is very similar to that which we use in buying entire businesses. We first have to decide whether we can sensibly estimate an earnings range for five years out, or more. If the answer is yes, we will buy the stock (or business) if it sells at a reasonable price in relation to the bottom boundary of our estimate. If, however, we lack the ability to estimate future earnings – which is usually the case – we simply move on to other prospects. In the 54 years we have worked together, we have *never* foregone an attractive purchase because of the macro or political environment, or the views of other people. In fact, these subjects never come up when we make decisions.

It’s vital, however, that we recognize the perimeter of our “circle of competence” and stay well inside of it. Even then, we will make some mistakes, both with stocks and businesses. But they will not be the disasters that occur, for example, when a long-rising market induces purchases that are based on anticipated price behavior and a desire to be where the action is.

Most investors, of course, have not made the study of business prospects a priority in their lives. If wise, they will conclude that they do not know enough about specific businesses to predict their future earning power.

I have good news for these non-professionals: The typical investor doesn't need this skill. In aggregate, American business has done wonderfully over time and will continue to do so (though, most assuredly, in *unpredictable* fits and starts). In the 20th Century, the Dow Jones Industrials index advanced from 66 to 11,497, paying a rising stream of dividends to boot. The 21st Century will witness further gains, almost certain to be substantial. The goal of the non-professional should not be to pick winners – neither he nor his “helpers” can do that – but should rather be to own a cross-section of businesses that in aggregate are bound to do well. A low-cost S&P 500 index fund will achieve this goal.

That's the “what” of investing for the non-professional. The “when” is also important. The main danger is that the timid or beginning investor will enter the market at a time of extreme exuberance and then become disillusioned when paper losses occur. (Remember the late Barton Biggs' observation: “A bull market is like sex. It feels best just before it ends.”) The antidote to that kind of mistiming is for an investor to accumulate shares over a long period and never to sell when the news is bad and stocks are well off their highs. Following those rules, the “know-nothing” investor who both diversifies and *keeps his costs minimal* is virtually certain to get satisfactory results. Indeed, the unsophisticated investor who is realistic about his shortcomings is likely to obtain better long-term results than the knowledgeable professional who is blind to even a single weakness.

If “investors” frenetically bought and sold farmland to each other, neither the yields nor prices of their crops would be increased. The only consequence of such behavior would be decreases in the overall earnings realized by the farm-owning population because of the substantial costs it would incur as it sought advice and switched properties.

Nevertheless, both individuals and institutions will constantly be urged to be active by those who profit from giving advice or effecting transactions. The resulting frictional costs can be huge and, for investors in aggregate, devoid of benefit. So ignore the chatter, keep your costs minimal, and invest in stocks as you would in a farm.

My money, I should add, is where my mouth is: What I advise here is essentially identical to certain instructions I've laid out in my will. One bequest provides that cash will be delivered to a trustee for my wife's benefit. (I have to use cash for individual bequests, because *all* of my Berkshire shares will be fully distributed to certain philanthropic organizations over the ten years following the closing of my estate.) My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's.) I believe the trust's long-term results from this policy will be superior to those attained by most investors – whether pension funds, institutions or individuals – who employ high-fee managers.

* * * * *

And now back to Ben Graham. I learned most of the thoughts in this investment discussion from Ben's book *The Intelligent Investor*, which I bought in 1949. My financial life changed with that purchase.

Before reading Ben's book, I had wandered around the investing landscape, devouring everything written on the subject. Much of what I read fascinated me: I tried my hand at charting and at using market indicia to predict stock movements. I sat in brokerage offices watching the tape roll by, and I listened to commentators. All of this was fun, but I couldn't shake the feeling that I wasn't getting anywhere.

In contrast, Ben's ideas were explained logically in elegant, easy-to-understand prose (without Greek letters or complicated formulas). For me, the key points were laid out in what later editions labeled Chapters 8 and 20. (The original 1949 edition numbered its chapters differently.) These points guide my investing decisions today.

A couple of interesting sidelights about the book: Later editions included a postscript describing an unnamed investment that was a bonanza for Ben. Ben made the purchase in 1948 when he was writing the first edition and – brace yourself – the mystery company was GEICO. If Ben had not recognized the special qualities of GEICO when it was still in its infancy, my future and Berkshire's would have been far different.

The 1949 edition of the book also recommended a railroad stock that was then selling for \$17 and earning about \$10 per share. (One of the reasons I admired Ben was that he had the guts to use current examples, leaving himself open to sneers if he stumbled.) In part, that low valuation resulted from an accounting rule of the time that required the railroad to exclude from its reported earnings the substantial retained earnings of affiliates.

The recommended stock was Northern Pacific, and its most important affiliate was Chicago, Burlington and Quincy. These railroads are now important parts of BNSF (Burlington Northern Santa Fe), which is today fully owned by Berkshire. When I read the book, Northern Pacific had a market value of about \$40 million. Now its successor (having added a great many properties, to be sure) *earns* that amount every four days.

I can't remember what I paid for that first copy of *The Intelligent Investor*. Whatever the cost, it would underscore the truth of Ben's adage: Price is what you pay, value is what you get. Of all the investments I ever made, buying Ben's book was the best (except for my purchase of two marriage licenses).

* * * * *

Local and state financial problems are accelerating, in large part because public entities promised pensions they couldn't afford. Citizens and public officials typically under-appreciated the gigantic financial tapeworm that was born when promises were made that conflicted with a willingness to fund them. Unfortunately, pension mathematics today remain a mystery to most Americans.

Investment policies, as well, play an important role in these problems. In 1975, I wrote a memo to Katharine Graham, then chairman of The Washington Post Company, about the pitfalls of pension promises and the importance of investment policy. That memo is reproduced on pages 118 - 136.

During the next decade, you will read a lot of news – *bad* news – about public pension plans. I hope my memo is helpful to you in understanding the necessity for prompt remedial action where problems exist.

The Annual Meeting

The annual meeting will be held on Saturday, May 3rd at the CenturyLink Center. Carrie Sova, our talented ringmaster, will be in charge, and all of our headquarters group will pitch in to help her. Our gang both does a better job than professional event planners would and – yes – saves us money.

CenturyLink's doors will open at 7 a.m., and at 7:30 we will have our third International Newspaper Tossing Challenge. Our target will be a Clayton Home porch, precisely 35 feet from the throwing line. I tossed about 500,000 papers when I was a teenager, so I think I'm pretty good. Challenge me: I'll buy a Dilly Bar for anyone who lands his or her throw closer to the doorstep than I do. The papers will be 36 to 42 pages, and you must fold them yourself (no rubber bands allowed).

At 8:30, a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (with a break for lunch at CenturyLink's stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course, is to *shop*. We'll assist you by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. In a nine-hour period, we sold 1,062 pairs of Justin boots (that's a pair every 32 seconds), 12,792 pounds of See's candy, 11,162 Quikut knives (21 knives per minute) and 6,344 pairs of Wells Lamont gloves, always a hot item. This year, Charlie and I will have competing ketchup bottles for sale. Naturally, the one with Charlie's picture will be heavily discounted. But, if you help, my bottle will outsell his. This is important, so don't let me down.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them the next day at our second annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that you will receive with your tickets for the meeting. Entrants will find themselves running alongside many of Berkshire's managers, directors and associates.

GEICO will have a booth in the shopping area, staffed by a number of its top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least half of you, I believe we can.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, among them a couple of new titles. One is Max Olson's compilation of Berkshire letters going back to 1965. The book includes an index that I find particularly useful, specifying page numbers for individuals, companies and subject matter. I also recommend *Forty Chances* by my son, Howard. You'll enjoy it.

If you are a big spender – or aspire to become one – visit Signature Flight Support on the east side of the Omaha airport between noon and 5 p.m. on Saturday. There, we will have a fleet of NetJets aircraft sure to set your pulse racing. Come by bus; leave by private jet. Live a little.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City versus Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money, particularly if you had planned to rent a car in Omaha. Spend the savings with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. Last year in the week surrounding the meeting, the store did \$40.2 million of business, breaking its previous record by 12%. It also set a single day record of \$8.2 million on Saturday, selling nearly \$1 million of mattresses alone.

To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, April 29th and Monday, May 5th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 2nd. The second, the main gala, will be held on Sunday, May 4th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m. In recent years, our three-day volume has far exceeded sales in all of December, normally a jeweler's best month.

About 1:15 p.m. on Sunday, I will begin clerking at Borsheims. Ask for my “Crazy Warren” quote on the item of your choice. As I get older, my pricing gets ever more ridiculous. Come take advantage of me.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 28th through Saturday, May 10th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world’s top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Don’t play them for money.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. Last year, she made Americans – and especially me – proud with her performance at the Olympics.

I met Ariel when she was nine and even then I was unable to score a point against her. Now, she’s a freshman at Princeton and the U.S. Women’s Champion. If you don’t mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates and I will lead off and try to soften her up.

Gorat’s and Piccolo’s will again be open exclusively for Berkshire shareholders on Sunday, May 4th. Both will be serving until 10 p.m., with Gorat’s opening at 1 p.m. and Piccolo’s opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat’s, call 402-551-3733 on April 1st (*but not before*) and for Piccolo’s call 402-342-9038. At Piccolo’s order a giant root beer float for dessert. Only sissies get the small one.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be e-mailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is selected.)

We will also have a panel of three analysts who follow Berkshire. This year the insurance specialist will be Jay Gelb of Barclays. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb.

And we will again have a credentialed bear on Berkshire. We would like to hear from applicants who are short Berkshire (please include evidence of your position). The three analysts will bring their own Berkshire-specific questions and alternate with the journalists and the audience in asking them.

Charlie and I believe that all shareholders should have access to new Berkshire information simultaneously and should also have adequate time to analyze it. That’s why we try to issue financial information late on Fridays or early on Saturdays and why our annual meeting is held on Saturdays. We do not talk one-on-one to large institutional investors or analysts, but rather treat *all* shareholders the same. Our hope is that the journalists and analysts will ask questions that further educate our owners about their investment.

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists and analysts will come up with some tough ones, and that's the way we like it. All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and 18 from the audience. If there is some extra time, we will take more from the audience. Audience questioners will be determined by drawings that will take place at 8:15 a.m. at each of the 15 microphones located in the arena and main overflow room.

* * * * *

For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars, who run their businesses as if they were the only asset owned by their families. I believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most have no financial need to work; the joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 24 men and women who work with me at our corporate office. This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 23,000-page Federal income tax return as well as state and foreign returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and French fries (smothered in ketchup, of course) for lunch. No CEO has it better; I truly do feel like tap dancing to work every day.

In closing, I think it's become appropriate to ignore our "no pictures" policy and let you view our remarkable home-office crew. Below is a photo from our Christmas lunch. Two people couldn't make it; otherwise you are looking at all of those who staff Berkshire's headquarters. They are truly miracle-workers.

Next year's letter will review our 50 years at Berkshire and speculate a bit about the next 50. In the meantime, come to Omaha on May 3rd and enjoy our Woodstock for Capitalists.

February 28, 2014

Warren E. Buffett
Chairman of the Board



A power lunch, Berkshire-style

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
Compounded Annual Gain – 1965-2014	19.4%	21.6%	9.9%
Overall Gain – 1964-2014	751,113%	1,826,163%	11,196%

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

A note to readers: Fifty years ago, today's management took charge at Berkshire. For this Golden Anniversary, Warren Buffett and Charlie Munger each wrote his views of what has happened at Berkshire during the past 50 years and what each expects during the next 50. Neither changed a word of his commentary after reading what the other had written. Warren's thoughts begin on page 24 and Charlie's on page 39. Shareholders, particularly new ones, may find it useful to read those letters before reading the report on 2014, which begins below.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2014 was \$18.3 billion, which increased the per-share book value of both our Class A and Class B stock by 8.3%. Over the last 50 years (that is, since present management took over), per-share book value has grown from \$19 to \$146,186, a rate of 19.4% compounded annually.*

During our tenure, we have consistently compared the yearly performance of the S&P 500 to the change in Berkshire's per-share book value. We've done that because book value has been a crude, but useful, *tracking device* for the number that really counts: intrinsic business value.

In our early decades, the relationship between book value and intrinsic value was much closer than it is now. That was true because Berkshire's assets were then largely securities whose values were continuously restated to reflect their current market prices. In Wall Street parlance, most of the assets involved in the calculation of book value were "marked to market."

Today, our emphasis has shifted in a major way to owning and operating large businesses. Many of these are worth far more than their cost-based carrying value. But that amount is *never* revalued upward no matter how much the value of these companies has increased. Consequently, the gap between Berkshire's intrinsic value and its book value has materially widened.

With that in mind, we have added a new set of data – the historical record of Berkshire's stock price – to the performance table on the facing page. Market prices, let me stress, have their limitations in the short term. Monthly or yearly movements of stocks are often erratic and not indicative of changes in intrinsic value. Over time, however, stock prices and intrinsic value almost invariably converge. Charlie Munger, Berkshire Vice Chairman and my partner, and I believe that has been true at Berkshire: In our view, the increase in Berkshire's per-share intrinsic value over the past 50 years is roughly equal to the 1,826,163% gain in market price of the company's shares.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

The Year at Berkshire

It was a good year for Berkshire on all major fronts, except one. Here are the important developments:

- Our “Powerhouse Five” – a collection of Berkshire’s largest non-insurance businesses – had a record \$12.4 billion of pre-tax earnings in 2014, up \$1.6 billion from 2013.* The companies in this sainted group are Berkshire Hathaway Energy (formerly MidAmerican Energy), BNSF, IMC (I’ve called it Iscar in the past), Lubrizol and Marmon.

Of the five, only Berkshire Hathaway Energy, then earning \$393 million, was owned by us a decade ago. Subsequently we purchased another three of the five on an all-cash basis. In acquiring the fifth, BNSF, we paid about 70% of the cost in cash and, for the remainder, issued Berkshire shares that increased the number outstanding by 6.1%. In other words, the \$12 billion gain in annual earnings delivered Berkshire by the five companies over the ten-year span has been accompanied by only minor dilution. That satisfies our goal of not simply increasing earnings, but making sure we also increase *per-share* results.

If the U.S. economy continues to improve in 2015, we expect earnings of our Powerhouse Five to improve as well. The gain could reach \$1 billion, in part because of bolt-on acquisitions by the group that have already closed or are under contract.

- Our bad news from 2014 comes from our group of five as well and is unrelated to earnings. During the year, BNSF disappointed many of its customers. These shippers depend on us, and service failures can badly hurt their businesses.

BNSF is, by far, Berkshire’s most important non-insurance subsidiary and, to improve its performance, we will spend \$6 billion on plant and equipment in 2015. That sum is nearly 50% more than any other railroad has spent in a single year and is a truly extraordinary amount, whether compared to revenues, earnings or depreciation charges.

Though weather, which was particularly severe last year, will always cause railroads a variety of operating problems, our responsibility is to do *whatever it takes* to restore our service to industry-leading levels. That can’t be done overnight: The extensive work required to increase system capacity sometimes disrupts operations while it is underway. Recently, however, our outsized expenditures are beginning to show results. During the last three months, BNSF’s performance metrics have materially improved from last year’s figures.

- Our many dozens of smaller non-insurance businesses earned \$5.1 billion last year, up from \$4.7 billion in 2013. Here, as with our Powerhouse Five, we expect further gains in 2015. Within this group, we have two companies that last year earned between \$400 million and \$600 million, six that earned between \$250 million and \$400 million, and seven that earned between \$100 million and \$250 million. This collection of businesses will increase in both number and earnings. Our ambitions have no finish line.
- Berkshire’s huge and growing insurance operation again operated at an underwriting profit in 2014 – that makes 12 years in a row – and increased its float. During that 12-year stretch, our float – money that doesn’t belong to us but that we can invest for Berkshire’s benefit – has grown from \$41 billion to \$84 billion. Though neither that gain nor the size of our float is reflected in Berkshire’s earnings, float generates significant investment income because of the assets it allows us to hold.

* Throughout this letter, as well as in the “Golden Anniversary” letters included later in this report, all earnings are stated on a pre-tax basis unless otherwise designated.

Meanwhile, our underwriting profit totaled \$24 billion during the twelve-year period, including \$2.7 billion earned in 2014. And all of this began with our 1967 purchase of National Indemnity for \$8.6 million.

- While Charlie and I search for new businesses to buy, our many subsidiaries are regularly making bolt-on acquisitions. Last year was particularly fruitful: We contracted for 31 bolt-ons, scheduled to cost \$7.8 billion in aggregate. The size of these transactions ranged from \$400,000 to \$2.9 billion. However, the largest acquisition, Duracell, will not close until the second half of this year. It will then be placed under Marmon's jurisdiction.

Charlie and I encourage bolt-ons, *if* they are sensibly-priced. (Most deals offered us aren't.) They deploy capital in activities that fit with our existing businesses and that will be managed by our corps of expert managers. This means no more work for us, yet more earnings, a combination we find particularly appealing. We will make many more of these bolt-on deals in future years.

- Two years ago my friend, Jorge Paulo Lemann, asked Berkshire to join his 3G Capital group in the acquisition of Heinz. My affirmative response was a no-brainer: I knew immediately that this partnership would work well from both a personal and financial standpoint. And it most definitely has.

I'm not embarrassed to admit that Heinz is run far better under Alex Behring, Chairman, and Bernardo Hees, CEO, than would be the case if I were in charge. They hold themselves to extraordinarily high performance standards and are never satisfied, even when their results far exceed those of competitors.

We expect to partner with 3G in more activities. Sometimes our participation will only involve a financing role, as was the case in the recent acquisition of Tim Hortons by Burger King. Our favored arrangement, however, will usually be to link up as a *permanent* equity partner (who, in some cases, contributes to the financing of the deal as well). Whatever the structure, we feel good when working with Jorge Paulo.

Berkshire also has fine partnerships with Mars and Leucadia, and we may form new ones with them or with other partners. Our participation in any joint activities, whether as a financing or equity partner, will be limited to friendly transactions.

- In October, we contracted to buy Van Tuyl Automotive, a group of 78 automobile dealerships that is exceptionally well-run. Larry Van Tuyl, the company's owner, and I met some years ago. He then decided that if he were ever to sell his company, its home should be Berkshire. Our purchase was recently completed, and we are now "car guys."

Larry and his dad, Cecil, spent 62 years building the group, following a strategy that made owner-partners of all local managers. Creating this mutuality of interests proved over and over to be a winner. Van Tuyl is now the fifth-largest automotive group in the country, with per-dealership sales figures that are outstanding.

In recent years, Jeff Rachor has worked alongside Larry, a successful arrangement that will continue. There are about 17,000 dealerships in the country, and ownership transfers always require approval by the relevant auto manufacturer. Berkshire's job is to perform in a manner that will cause manufacturers to welcome further purchases by us. If we do this – and if we can buy dealerships at sensible prices – we will build a business that before long will be multiples the size of Van Tuyl's \$9 billion of sales.

With the acquisition of Van Tuyl, Berkshire now owns 9½ companies that would be listed on the Fortune 500 were they independent (Heinz is the ½). That leaves 490½ fish in the sea. Our lines are out.

- Our subsidiaries spent a record \$15 billion on plant and equipment during 2014, well over twice their depreciation charges. About 90% of that money was spent in the United States. Though we will always invest abroad as well, the mother lode of opportunities runs through America. The treasures that have been uncovered up to now are dwarfed by those still untapped. Through dumb luck, Charlie and I were born in the United States, and we are forever grateful for the staggering advantages this accident of birth has given us.
- Berkshire's yearend employees – including those at Heinz – totaled a record 340,499, up 9,754 from last year. The increase, I am proud to say, included no gain at headquarters (where 25 people work). No sense going crazy.
- Berkshire increased its ownership interest last year in each of its “Big Four” investments – American Express, Coca-Cola, IBM and Wells Fargo. We purchased additional shares of IBM (increasing our ownership to 7.8% versus 6.3% at yearend 2013). Meanwhile, stock repurchases at Coca-Cola, American Express and Wells Fargo raised our percentage ownership of each. Our equity in Coca-Cola grew from 9.1% to 9.2%, our interest in American Express increased from 14.2% to 14.8% and our ownership of Wells Fargo grew from 9.2% to 9.4%. And, if you think tenths of a percent aren't important, ponder this math: For the four companies in aggregate, each increase of one-tenth of a percent in our ownership raises Berkshire's portion of their annual earnings by \$50 million.

These four investees possess excellent businesses and are run by managers who are both talented and shareholder-oriented. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business. It's better to have a partial interest in the Hope Diamond than to own all of a rhinestone.

If Berkshire's yearend holdings are used as the marker, our portion of the “Big Four's” 2014 earnings before discontinued operations amounted to \$4.7 billion (compared to \$3.3 billion only three years ago). In the earnings we report to you, however, we include only the dividends we receive – about \$1.6 billion last year. (Again, three years ago the dividends were \$862 million.) But make no mistake: The \$3.1 billion of these companies' earnings we don't report are every bit as valuable to us as the portion Berkshire records.

The earnings these investees retain are often used for repurchases of their own stock – a move that enhances Berkshire's share of future earnings without requiring us to lay out a dime. Their retained earnings also fund business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees, in aggregate, will grow substantially over time (though 2015 will be a tough year for the group, in part because of the strong dollar). If the expected gains materialize, dividends to Berkshire will increase and, even more important, so will our unrealized capital gains. (For the package of four, our unrealized gains already totaled \$42 billion at yearend.)

Our flexibility in capital allocation – our willingness to invest large sums passively in non-controlled businesses – gives us a significant advantage over companies that limit themselves to acquisitions they can operate. Our appetite for *either* operating businesses or passive investments doubles our chances of finding sensible uses for Berkshire's endless gusher of cash.

- I've mentioned in the past that my experience in business helps me as an investor and that my investment experience has made me a better businessman. Each pursuit teaches lessons that are applicable to the other. And some truths can only be fully learned through experience. (In Fred Schwed's wonderful book, *Where Are the Customers' Yachts?*, a Peter Arno cartoon depicts a puzzled Adam looking at an eager Eve, while a caption says, “There are certain things that cannot be adequately explained to a virgin either by words or pictures.” If you haven't read Schwed's book, buy a copy at our annual meeting. Its wisdom and humor are truly priceless.)

Among Arno's "certain things," I would include two separate skills, the evaluation of investments and the management of businesses. I therefore think it's worthwhile for Todd Combs and Ted Weschler, our two investment managers, to each have oversight of at least one of our businesses. A sensible opportunity for them to do so opened up a few months ago when we agreed to purchase two companies that, though smaller than we would normally acquire, have excellent economic characteristics. Combined, the two earn \$100 million annually on about \$125 million of net tangible assets.

I've asked Todd and Ted to each take on one as Chairman, in which role they will function in the very limited way that I do with our larger subsidiaries. This arrangement will save me a minor amount of work and, more important, make the two of them even better investors than they already are (which is to say among the best).

* * * * *

Late in 2009, amidst the gloom of the Great Recession, we agreed to buy BNSF, the largest purchase in Berkshire's history. At the time, I called the transaction an "all-in wager on the economic future of the United States."

That kind of commitment was nothing new for us. We've been making similar wagers ever since Buffett Partnership Ltd. acquired control of Berkshire in 1965. For good reason, too: Charlie and I have always considered a "bet" on ever-rising U.S. prosperity to be very close to a sure thing.

Indeed, who has ever benefited during the past 238 years by betting *against* America? If you compare our country's present condition to that existing in 1776, you have to rub your eyes in wonder. In my lifetime alone, *real* per-capita U.S. output has *sexupled*. My parents could not have dreamed in 1930 of the world their son would see. Though the preachers of pessimism prattle endlessly about America's problems, I've never seen one who wishes to emigrate (though I can think of a few for whom I would happily buy a one-way ticket).

The dynamism embedded in our market economy will continue to work its magic. Gains won't come in a smooth or uninterrupted manner; they never have. And we will regularly grumble about our government. But, most assuredly, America's best days lie ahead.

With this tailwind working for us, Charlie and I hope to build Berkshire's per-share intrinsic value by (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. We will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Those building blocks rest on a rock-solid foundation. A century hence, BNSF and Berkshire Hathaway Energy will still be playing vital roles in our economy. Homes and autos will remain central to the lives of most families. Insurance will continue to be essential for both businesses and individuals. Looking ahead, Charlie and I see a world made to order for Berkshire. We feel fortunate to be entrusted with its management.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (nor, in fact, for any other stock). In our 2010 annual report, however, we laid out the three elements – one of them qualitative – that we believe are the keys to a sensible estimate of Berkshire's intrinsic value. That discussion is reproduced in full on pages 123-124.

Here is an update of the two quantitative factors: In 2014 our per-share investments increased 8.4% to \$140,123, and our earnings from businesses other than insurance and investments increased 19% to \$10,847 per share.

Since 1970, our per-share investments have increased at a rate of 19% compounded annually, and our earnings figure has grown at a 20.6% clip. It is no coincidence that the price of Berkshire stock over the ensuing 44 years has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both sectors, but our main focus is to build operating earnings. That's why we were pleased to exchange our Phillips 66 and Graham Holdings stock for operating businesses last year and to contract with Procter and Gamble to acquire Duracell by means of a similar exchange set to close in 2015.

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Now, let's examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. So we'll present them as four separate businesses, which is how Charlie and I view them (though there are important and *enduring* advantages to having them all under one roof). Our goal is to provide you with the information we would wish to have if our positions were reversed, with you being the reporting manager and we the absentee shareholders. (But don't get any ideas!)

Insurance

Let's look first at insurance, Berkshire's core operation. That industry has been the engine that has propelled our expansion since 1967, when we acquired National Indemnity and its sister company, National Fire & Marine, for \$8.6 million. Though that purchase had monumental consequences for Berkshire, its execution was simplicity itself.

Jack Ringwalt, a friend of mine who was the controlling shareholder of the two companies, came to my office saying he would like to sell. Fifteen minutes later, we had a deal. Neither of Jack's companies had ever had an audit by a public accounting firm, and I didn't ask for one. My reasoning: (1) Jack was honest and (2) He was also a bit quirky and likely to walk away if the deal became at all complicated.

On pages 128-129, we reproduce the 1½-page purchase agreement we used to finalize the transaction. That contract was homemade: Neither side used a lawyer. Per page, this has to be Berkshire's best deal: National Indemnity today has GAAP (generally accepted accounting principles) net worth of \$111 billion, which exceeds that of any other insurer in the world.

One reason we were attracted to the property-casualty business was its financial characteristics: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over many decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

<i>Year</i>	<i>Float (in \$ millions)</i>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2014	83,921

Further gains in float will be tough to achieve. On the plus side, GEICO and our new commercial insurance operation are almost certain to grow at a good clip. National Indemnity's reinsurance division, however, is party to a number of run-off contracts whose float drifts downward. If we do in time experience a decline in float, it will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate demands for sums that are large compared to our cash resources. This strength is a key pillar in Berkshire's economic fortress.

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it frequently causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses. The prolonged period of low interest rates our country is now dealing with causes earnings on float to decrease, thereby exacerbating the profit problems of the industry.

As noted in the first section of this report, Berkshire has now operated at an underwriting profit for twelve consecutive years, our pre-tax gain for the period having totaled \$24 billion. Looking ahead, I believe we will continue to underwrite profitably in most years. Doing so is the daily focus of *all* of our insurance managers, who know that while float is valuable, its benefits can be drowned by poor underwriting results. That message is given at least lip service by all insurers; at Berkshire it is a religion.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a *liability*, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as strictly a liability is incorrect; it should instead be viewed as a revolving fund. Daily, we pay old claims and related expenses – a huge \$22.7 billion to more than six million claimants in 2014 – and that reduces float. Just as surely, we each day write new business and thereby generate new claims that add to float.

If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability. Owing \$1 that in effect will never leave the premises – because new business is almost certain to deliver a substitute – is worlds different from owing \$1 that will go out the door tomorrow and not be replaced. The two types of liabilities are treated as equals, however, under GAAP.

A partial offset to this overstated liability is a \$15.5 billion “goodwill” asset that we incurred in buying our insurance companies and that increases book value. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, *any* goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay for float of *similar quality* were we to purchase an insurance operation possessing it – to be *far* in excess of its historic carrying value. Under present accounting rules (with which we agree) this excess value will *never* be entered on our books. But I can assure you that it's real. That's one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

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Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that possess hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources.

Indeed, we are *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a \$250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because of its many streams of earnings. We would also remain awash in cash and be looking for large opportunities in a market that might well have gone into shock. Meanwhile, other major insurers and reinsurers would be far in the red, if not facing insolvency.

Ajit's underwriting skills are unmatched. His mind, moreover, is an idea factory that is always looking for more lines of business he can add to his current assortment. Last year I told you about his formation of Berkshire Hathaway Specialty Insurance ("BHSI"). This initiative took us into commercial insurance, where we were instantly welcomed by both major insurance brokers and corporate risk managers throughout America. Previously, we had written only a few specialized lines of commercial insurance.

BHSI is led by Peter Eastwood, an experienced underwriter who is widely respected in the insurance world. During 2014, Peter expanded his talented group, moving into both international business and new lines of insurance. We repeat last year's prediction that BHSI will be a major asset for Berkshire, one that will generate volume in the billions within a few years.

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We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been considerably better than cost-free under his leadership, and we expect that, on average, to continue. We are particularly enthusiastic about General Re's international life reinsurance business, which has grown consistently and profitably since we acquired the company in 1998.

It can be remembered that soon after we purchased General Re, it was beset by problems that caused commentators – and me as well, briefly – to believe I had made a huge mistake. That day is long gone. General Re is now a gem.

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Finally, there is GEICO, the insurer on which I cut my teeth 64 years ago. GEICO is managed by Tony Nicely, who joined the company at 18 and completed 53 years of service in 2014. Tony became CEO in 1993, and since then the company has been flying. There is *no* better manager than Tony.

When I was first introduced to GEICO in January 1951, I was blown away by the huge cost advantage the company enjoyed compared to the expenses borne by the giants of the industry. It was clear to me that GEICO would succeed because it *deserved* to succeed. No one *likes* to buy auto insurance. Almost everyone, though, likes to drive. The insurance consequently needed is a major expenditure for most families. Savings matter to them – and *only* a low-cost operation can deliver these. Indeed, at least 40% of the people reading this letter can save money by insuring with GEICO. So stop reading and go to geico.com or call 800-368-2734.

GEICO's cost advantage is the factor that has enabled the company to gobble up market share year after year. (We ended 2014 at 10.8% compared to 2.5% in 1995, when Berkshire acquired control of GEICO.) The company's low costs create a moat – an *enduring* one – that competitors are unable to cross. Our gecko never tires of telling Americans how GEICO can save them important money. The gecko, I should add, has one particularly endearing quality – he works without pay. Unlike a human spokesperson, he never gets a swelled head from his fame nor does he have an agent to constantly remind us how valuable he is. I love the little guy.

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In addition to our three major insurance operations, we own a group of smaller companies, most of them plying their trade in odd corners of the insurance world. In aggregate, these companies are a growing operation that consistently delivers an underwriting profit. Indeed, over the past decade, they have earned \$2.95 billion from underwriting while growing their float from \$1.7 billion to \$8.6 billion. Charlie and I treasure these companies and their managers.

<u>Insurance Operations</u>	<u>Underwriting Profit</u> <i>(in millions)</i>		<u>Yearend Float</u>	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
BH Reinsurance	\$ 606	\$1,294	\$42,454	\$37,231
General Re	277	283	19,280	20,013
GEICO	1,159	1,127	13,569	12,566
Other Primary	626	385	8,618	7,430
	<u>\$2,668</u>	<u>\$3,089</u>	<u>\$83,921</u>	<u>\$77,240</u>

* * * * *

Simply put, insurance is the sale of promises. The “customer” pays money now; the insurer promises to pay money in the future should certain unwanted events occur.

Sometimes, the promise will not be tested for decades. (Think of life insurance bought by people in their 20s.) Therefore, both the ability and willingness of the insurer to pay, even if economic chaos prevails when payment time arrives, is all-important.

Berkshire's promises have no equal, a fact affirmed in recent years by certain of the world's largest and most sophisticated P/C insurers, who wished to shed themselves of huge and exceptionally long-lived liabilities. That is, these insurers wished to “cede” these liabilities – most of them potential losses from asbestos claims – to a reinsurer. They needed the right one, though: If a reinsurer fails to pay a loss, the original insurer is still on the hook for it. Choosing a reinsurer, therefore, that down the road proves to be financially strapped or a bad actor threatens the original insurer with getting huge liabilities right back in its lap.

Last year, our premier position in reinsurance was reaffirmed by our writing a policy carrying a \$3 billion single premium. I believe that the policy's size has only been exceeded by our 2007 transaction with Lloyd's, in which the premium was \$7.1 billion.

In fact, I know of only eight P/C policies in history that had a single premium exceeding \$1 billion. And, yes, all eight were written by Berkshire. Certain of these contracts will require us to make substantial payments 50 years or more from now. When major insurers have needed an unquestionable promise that payments of this type will be made, Berkshire has been the party – the *only* party – to call.

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Berkshire's great managers, premier financial strength and a variety of business models protected by wide moats amount to something unique in the insurance world. This assemblage of strengths is a huge asset for Berkshire shareholders that will only get more valuable with time.

Regulated, Capital-Intensive Businesses

We have two major operations, BNSF and Berkshire Hathaway Energy (“BHE”), that share important characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions will far exceed its interest requirements. Last year, for example, BNSF’s interest coverage was more than 8:1. (Our definition of coverage is pre-tax earnings/interest, *not* EBITDA/interest, a commonly used measure we view as seriously flawed.)

At BHE, meanwhile, two factors ensure the company’s ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies offering an essential service on an exclusive basis. The second is enjoyed by few other utilities: a great diversity of earnings streams, which shield us from being seriously harmed by any single regulatory body. Recently, we have further broadened that base through our \$3 billion (Canadian) acquisition of AltaLink, an electric transmission system serving 85% of Alberta’s population. This multitude of profit streams, supplemented by the inherent advantage of being owned by a strong parent, has enabled BHE and its utility subsidiaries to significantly lower their cost of debt. This economic fact benefits both us *and* our customers.

Every day, our two subsidiaries power the American economy in major ways:

- BNSF carries about 15% (measured by ton-miles) of *all* inter-city freight, whether it is transported by truck, rail, water, air, or pipeline. Indeed, we move more ton-miles of goods than *anyone* else, a fact establishing BNSF as the most important artery in our economy’s circulatory system.

BNSF, like all railroads, also moves its cargo in an extraordinarily fuel-efficient and environmentally friendly way, carrying a ton of freight about 500 miles on a single gallon of diesel fuel. Trucks taking on the same job guzzle about four times as much fuel.

- BHE’s utilities serve regulated retail customers in eleven states. No utility company stretches further. In addition, we are a leader in renewables: From a standing start ten years ago, BHE now accounts for 6% of the country’s wind generation capacity and 7% of its solar generation capacity. Beyond these businesses, BHE owns two large pipelines that deliver 8% of our country’s natural gas consumption; the recently-purchased electric transmission operation in Canada; and major electric businesses in the U.K. and Philippines. And the beat goes on: We will continue to buy and build utility operations throughout the world for decades to come.

BHE can make these investments because it retains *all* of its earnings. In fact, last year the company retained more dollars of earnings – by far – than any other American electric utility. We and our regulators see this 100% retention policy as an important advantage – one almost certain to distinguish BHE from other utilities for many years to come.

When BHE completes certain renewables projects that are underway, the company’s renewables portfolio will have cost \$15 billion. In addition, we have conventional projects in the works that will also cost many billions. We relish making such commitments as long as they promise reasonable returns – and, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need massive investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is concomitantly in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Last year we fully met this objective at BHE, just as we have in every year of our ownership. Our rates remain low, our customer satisfaction is high and our record for employee safety is among the best in the industry.

The story at BNSF, however – as I noted earlier – was not good in 2014, a year in which the railroad disappointed many of its customers. This problem occurred despite the record capital expenditures that BNSF has made in recent years, with those having far exceeded the outlays made by Union Pacific, our principal competitor.

The two railroads are of roughly equal size measured by revenues, though we carry considerably more freight (measured either by carloads or ton-miles). But our service problems exceeded Union Pacific's last year, and we lost market share as a result. Moreover, U.P.'s earnings beat ours by a record amount. Clearly, we have a lot of work to do.

We are wasting no time: As I also mentioned earlier, we will spend \$6 billion in 2015 on improving our railroad's operation. That will amount to about 26% of estimated revenues (a calculation that serves as the industry's yardstick). Outlays of this magnitude are largely unheard of among railroads. For us, this percentage compares to our average of 18% in 2009-2013 and to U.P.'s projection for the near future of 16-17%. Our huge investments will soon lead to a system with greater capacity and much better service. Improved profits should follow.

Here are the key figures for Berkshire Hathaway Energy and BNSF:

<i>Berkshire Hathaway Energy (89.9% owned)</i>	<i>Earnings (in millions)</i>		
	<i>2014</i>	<i>2013</i>	<i>2012</i>
U.K. utilities	\$ 527	\$ 362	\$ 429
Iowa utility	298	230	236
Nevada utilities	549	—	—
PaciCorp (primarily Oregon and Utah)	1,010	982	737
Gas Pipelines (Northern Natural and Kern River)	379	385	383
HomeServices	139	139	82
Other (net)	236	4	91
Operating earnings before corporate interest and taxes	3,138	2,102	1,958
Interest	427	296	314
Income taxes	616	170	172
Net earnings	<u>\$ 2,095</u>	<u>\$ 1,636</u>	<u>\$ 1,472</u>
Earnings applicable to Berkshire	<u>\$ 1,882</u>	<u>\$ 1,470</u>	<u>\$ 1,323</u>

<i>BNSF</i>	<i>Earnings (in millions)</i>		
	<i>2014</i>	<i>2013</i>	<i>2012</i>
Revenues	\$23,239	\$22,014	\$20,835
Operating expenses	16,237	15,357	14,835
Operating earnings before interest and taxes	7,002	6,657	6,000
Interest (net)	833	729	623
Income taxes	2,300	2,135	2,005
Net earnings	<u>\$ 3,869</u>	<u>\$ 3,793</u>	<u>\$ 3,372</u>

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/14 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 5,765	Notes payable	\$ 965
Accounts and notes receivable	8,264	Other current liabilities	<u>9,734</u>
Inventory	10,236	Total current liabilities	10,699
Other current assets	<u>1,117</u>		
Total current assets	25,382		
Goodwill and other intangibles	28,107	Deferred taxes	3,801
Fixed assets	13,806	Term debt and other liabilities	4,269
Other assets	<u>3,793</u>	Non-controlling interests	492
	<u>\$71,088</u>	Berkshire equity	<u>51,827</u>
			<u>\$71,088</u>

Earnings Statement (in millions)

	2014	2013*	2012*
Revenues	\$97,689	\$93,472	\$81,432
Operating expenses	90,788	87,208	75,734
Interest expense	<u>109</u>	<u>104</u>	<u>112</u>
Pre-tax earnings	6,792	6,160	5,586
Income taxes and non-controlling interests	<u>2,324</u>	<u>2,283</u>	<u>2,229</u>
Net earnings	<u>\$ 4,468</u>	<u>\$ 3,877</u>	<u>\$ 3,357</u>

*Earnings for 2012 and 2013 have been restated to exclude Marmon's leasing operations, which are now included in the Finance and Financial Products section.

Our income and expense data conforming to GAAP is on page 49. In contrast, the operating expense figures above are non-GAAP and exclude some purchase-accounting items (primarily the amortization of certain intangible assets). We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the true economic expenses and profits of the businesses aggregated in the table than do GAAP figures.

I won't explain all of the adjustments – some are tiny and arcane – but serious investors should understand the disparate nature of intangible assets. Some truly deplete over time, while others *in no way* lose value. For software, as a big example, amortization charges are very real expenses. The concept of making charges against other intangibles, such as the amortization of customer relationships, however, arises through purchase-accounting rules and clearly does not reflect reality. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when earnings are calculated – even though from an investor's viewpoint they could not be more different.

In the GAAP-compliant figures we show on page 49, amortization charges of \$1.15 billion have been deducted as expenses. We would call about 20% of these “real,” the rest not. The “non-real” charges, once non-existent at Berkshire, have become significant because of the many acquisitions we have made. Non-real amortization charges will almost certainly rise further as we acquire more companies.

The GAAP-compliant table on page 67 gives you the current status of our intangible assets. We now have \$7.4 billion left to amortize, of which \$4.1 billion will be charged over the next five years. Eventually, of course, every dollar of non-real costs becomes entirely charged off. When that happens, reported earnings increase even if true earnings are flat.

Depreciation charges, we want to emphasize, are different: Every dime of depreciation expense we report is a real cost. That’s true, moreover, at most other companies. When CEOs tout EBITDA as a valuation guide, wire them up for a polygraph test.

Our public reports of earnings will, of course, continue to conform to GAAP. To embrace reality, however, you should remember to add back most of the amortization charges we report.

* * * * *

To get back to our many manufacturing, service and retailing operations, they sell products ranging from lollipops to jet airplanes. Some of this sector’s businesses, measured by earnings on unleveraged net *tangible* assets, enjoy terrific economics, producing profits that run from 25% after-tax to far more than 100%. Others generate good returns in the area of 12% to 20%. A few, however, have very poor returns, the result of some serious mistakes I made in my job of capital allocation. I was not misled: I simply was wrong in my evaluation of the economic dynamics of the company or the industry in which it operates.

Fortunately, my blunders normally involved relatively small acquisitions. Our large buys have generally worked out well and, in a few cases, more than well. I have not, nonetheless, made my last mistake in purchasing either businesses or stocks. Not everything works out as planned.

Viewed as a single entity, the companies in this group are an excellent business. They employed an average of \$24 billion of net tangible assets during 2014 and, despite their holding large quantities of excess cash and using little leverage, earned 18.7% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if it is bought for too high a price. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for goodwill. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Furthermore, the intrinsic value of these businesses, in aggregate, exceeds their carrying value by a good margin, and that premium is likely to widen. Even so, the difference between intrinsic value and carrying value in both the insurance and regulated-industry segments is *far* greater. It is there that the truly big winners reside.

* * * * *

We have far too many companies in this group to comment on them individually. Moreover, their competitors – both current and potential – read this report. In a few of our businesses we might be disadvantaged if others knew our numbers. In some of our operations that are not of a size material to an evaluation of Berkshire, therefore, we only disclose what is required. You can find a good bit of detail about many of our operations, however, on pages 97-100.

Finance and Financial Products

This year we include in this section Marmon's very sizable leasing operations, whose wares are railcars, containers and cranes. We have also restated the previous two years to reflect that change. Why have we made it? At one time there was a large minority ownership at Marmon, and I felt it was more understandable to include all of the company's operations in one place. Today we own virtually 100% of Marmon, which makes me think you will gain more insight into our various businesses if we include Marmon's leasing operations under this heading. (The figures for the many dozens of Marmon's other businesses remain in the previous section.)

Our other leasing and rental operations are conducted by CORT (furniture) and XTRA (semi-trailers). These companies are industry leaders and have substantially increased their earnings as the American economy has gained strength. Both companies have invested more money in new equipment than have many of their competitors, and that's paying off.

Kevin Clayton has again delivered an industry-leading performance at Clayton Homes, the largest home builder in America. Last year, Clayton sold 30,871 homes, about 45% of the manufactured homes bought by Americans. When we purchased Clayton in 2003 for \$1.7 billion, its share was 14%.

Key to Clayton's earnings is the company's \$13 billion mortgage portfolio. During the financial panic of 2008 and 2009, when funding for the industry dried up, Clayton was able to keep lending because of Berkshire's backing. In fact, we continued during that period to finance our competitors' retail sales as well as our own.

Many of Clayton's borrowers have low incomes and mediocre FICO scores. But thanks to the company's sensible lending practices, its portfolio performed well during the recession, meaning a very high percentage of our borrowers kept their homes. Our blue-collar borrowers, in many cases, proved much better credit risks than their higher-income brethren.

At Marmon's railroad-car operation, lease rates have improved substantially over the past few years. The nature of this business, however, is that only 20% or so of our leases expire annually. Consequently, improved pricing only gradually works its way into our revenue stream. The trend, though, is strong. Our 105,000-car fleet consists largely of tank cars, but only 8% of those transport crude oil.

One further fact about our rail operation is important for you to know: Unlike many other lessors, we manufacture our own tank cars, about 6,000 of them in a good year. We do not book *any* profit when we transfer cars from our manufacturing division to our leasing division. Our fleet is consequently placed on our books at a "bargain" price. The difference between that figure and a "retail" price is only slowly reflected in our earnings through smaller annual depreciation charges that we enjoy over the 30-year life of the car. Because of that fact as well as others, Marmon's rail fleet is worth considerably more than the \$5 billion figure at which it is carried on our books.

Here's the earnings recap for this sector:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(in millions)		
Berkadia (our 50% share)	\$ 122	\$ 80	\$ 35
Clayton	558	416	255
CORT	36	40	42
Marmon – Containers and Cranes	238	226	246
Marmon – Railcars	442	353	299
XTRA	147	125	106
Net financial income*	<u>296</u>	<u>324</u>	<u>410</u>
	<u><u>\$ 1,839</u></u>	<u><u>\$ 1,564</u></u>	<u><u>\$ 1,393</u></u>

* Excludes capital gains or losses

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value.

<u>Shares**</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost*</i>	<i>Market</i>
(in millions)				
151,610,700	American Express Company	14.8	\$ 1,287	\$ 14,106
400,000,000	The Coca-Cola Company	9.2	1,299	16,888
18,513,482	DaVita HealthCare Partners Inc.	8.6	843	1,402
15,430,586	Deere & Company	4.5	1,253	1,365
24,617,939	DIRECTV	4.9	1,454	2,134
13,062,594	The Goldman Sachs Group, Inc.	3.0	750	2,532
76,971,817	International Business Machines Corp.	7.8	13,157	12,349
24,669,778	Moody's Corporation	12.1	248	2,364
20,060,390	Munich Re	11.8	2,990	4,023
52,477,678	The Procter & Gamble Company	1.9	336	4,683 ***
22,169,930	Sanofi	1.7	1,721	2,032
96,890,665	U.S. Bancorp	5.4	3,033	4,355
43,387,980	USG Corporation	30.0	836	1,214
67,707,544	Wal-Mart Stores, Inc.	2.1	3,798	5,815
483,470,853	Wells Fargo & Company	9.4	11,871	26,504
	Others		<u>10,180</u>	<u>15,704</u>
	Total Common Stocks Carried at Market		<u>\$55,056</u>	<u>\$ 117,470</u>

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required under GAAP rules.

**Excludes shares held by pension funds of Berkshire subsidiaries.

***Held under contract of sale for this amount.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for \$5 billion. At yearend these shares were worth \$12.5 billion. We are likely to purchase the shares just before expiration of our option. In the meantime, it is important for you to realize that Bank of America is, in effect, our fourth largest equity investment – and one we value highly.

* * * * *

Attentive readers will notice that Tesco, which last year appeared in the list of our largest common stock investments, is now absent. An attentive *investor*, I'm embarrassed to report, would have sold Tesco shares earlier. I made a big mistake with this investment by dawdling.

At the end of 2012 we owned 415 million shares of Tesco, then and now the leading food retailer in the U.K. and an important grocer in other countries as well. Our cost for this investment was \$2.3 billion, and the market value was a similar amount.

In 2013, I soured somewhat on the company's then-management and sold 114 million shares, realizing a profit of \$43 million. My leisurely pace in making sales would prove expensive. Charlie calls this sort of behavior "thumb-sucking." (Considering what my delay cost us, he is being kind.)

During 2014, Tesco's problems worsened by the month. The company's market share fell, its margins contracted and accounting problems surfaced. In the world of business, bad news often surfaces serially: You see a cockroach in your kitchen; as the days go by, you meet his relatives.

We sold Tesco shares throughout the year and are now out of the position. (The company, we should mention, has hired new management, and we wish them well.) Our after-tax loss from this investment was \$444 million, about 1/5 of 1% of Berkshire's net worth. In the past 50 years, we have only once realized an investment loss that at the time of sale cost us 2% of our net worth. Twice, we experienced 1% losses. All three of these losses occurred in the 1974-1975 period, when we sold stocks that were very cheap in order to buy others we believed to be even cheaper.

* * * * *

Our investment results have been helped by a terrific tailwind. During the 1964-2014 period, the S&P 500 rose from 84 to 2,059, which, with reinvested dividends, generated the overall return of 11,196% shown on page 2. Concurrently, the purchasing power of the dollar declined a staggering 87%. That decrease means that it now takes \$1 to buy what could be bought for 13¢ in 1965 (as measured by the Consumer Price Index).

There is an important message for investors in that disparate performance between stocks and dollars. Think back to our 2011 annual report, in which we defined investing as "the transfer to others of purchasing power now with the reasoned expectation of receiving more purchasing power – *after taxes have been paid on nominal gains* – in the future."

The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been *far* safer to invest in a diversified collection of American businesses than to invest in securities – Treasuries, for example – whose values have been tied to American currency. That was also true in the preceding half-century, a period including the Great Depression and two world wars. Investors should heed this history. To one degree or another it is almost certain to be repeated during the next century.

Stock prices will always be far more *volatile* than cash-equivalent holdings. *Over the long term*, however, currency-denominated instruments are *riskier* investments – *far* riskier investments – than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is *far* from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray.

It is true, of course, that owning equities for a day or a week or a year is far riskier (in both nominal and purchasing-power terms) than leaving funds in cash-equivalents. That is relevant to certain investors – say, investment banks – whose viability can be threatened by declines in asset prices and which might be forced to sell securities during depressed markets. Additionally, any party that might have meaningful near-term needs for funds should keep appropriate sums in Treasuries or insured bank deposits.

For the great majority of investors, however, who can – and *should* – invest with a multi-decade horizon, quotational declines are unimportant. Their focus should remain fixed on attaining significant gains in purchasing power over their investing lifetime. For them, a diversified equity portfolio, *bought over time*, will prove far less risky than dollar-based securities.

If the investor, instead, fears price volatility, erroneously viewing it as a measure of risk, he may, ironically, end up doing some very risky things. Recall, if you will, the pundits who six years ago bemoaned falling stock prices and advised investing in “safe” Treasury bills or bank certificates of deposit. People who heeded this sermon are now earning a pittance on sums they had previously expected would finance a pleasant retirement. (The S&P 500 was then below 700; now it is about 2,100.) If not for their fear of meaningless price volatility, these investors could have assured themselves of a good income for life by simply buying a very low-cost index fund whose dividends would trend upward over the years and whose principal would grow as well (with many ups and downs, to be sure).

Investors, of course, can, *by their own behavior*, make stock ownership highly risky. And many do. Active trading, attempts to “time” market movements, inadequate diversification, the payment of high and unnecessary fees to managers and advisors, and the use of borrowed money can destroy the decent returns that a life-long owner of equities would otherwise enjoy. Indeed, borrowed money has *no* place in the investor’s tool kit: *Anything* can happen *anytime* in markets. And no advisor, economist, or TV commentator – and definitely not Charlie nor I – can tell you when chaos will occur. Market forecasters will fill your ear but will never fill your wallet.

The commission of the investment sins listed above is not limited to “the little guy.” Huge institutional investors, viewed as a group, have long underperformed the unsophisticated index-fund investor who simply sits tight for decades. A major reason has been fees: Many institutions pay substantial sums to consultants who, in turn, recommend high-fee managers. And that is a fool’s game.

There are a few investment managers, of course, who are very good – though in the short run, it’s difficult to determine whether a great record is due to luck or talent. Most advisors, however, are far better at generating high fees than they are at generating high returns. In truth, their core competence is salesmanship. Rather than listen to their siren songs, investors – large and small – should instead read Jack Bogle’s *The Little Book of Common Sense Investing*.

Decades ago, Ben Graham pinpointed the blame for investment failure, using a quote from Shakespeare: “The fault, dear Brutus, is not in our stars, but in ourselves.”

The Annual Meeting

The annual meeting will be held on Saturday, May 2nd at the CenturyLink Center. Last year’s attendance of 39,000 set a record, and we expect a further increase this year as we celebrate our Golden Anniversary. Be there when the doors open at 7 a.m.

Berkshire’s talented Carrie Sova will again be in charge. Carrie joined us six years ago at the age of 24 as a secretary. Then, four years ago, I asked her to take charge of the meeting – a huge undertaking, requiring a multitude of skills – and she jumped at the chance. Carrie is unflappable, ingenious and expert at bringing out the best in the hundreds who work with her. She is aided by our entire home office crew who enjoy pitching in to make the weekend fun and informative for our owners.

And, yes, we also try to sell our visiting shareholders our products while they’re here. In fact, this year we will substantially increase the hours available for purchases, opening for business at the CenturyLink on Friday, May 1st, from noon to 5 p.m. as well as the usual 7 a.m. to 4 p.m. on meeting day. So bring a smile to Charlie’s face and do some serious shopping.

Get up early on Saturday morning. At 6:20 a.m., Norman and Jake, two Texas longhorns each weighing about a ton, will proceed down 10th Street to the CenturyLink. Aboard them will be a couple of our Justin Boot executives, who do double duty as cowboys. Following the steers will be four horses pulling a Wells Fargo stagecoach. Berkshire already markets planes, trains and automobiles. Adding steers and stagecoaches to our portfolio should seal our reputation as America’s all-purpose transportation company.

At about 7:30 a.m. on Saturday, we will have our fourth International Newspaper Tossing Challenge. Our target again will be a Clayton Home porch, located precisely 35 feet from the throwing line. When I was a teenager – in my one brief flirtation with honest labor – I tossed about 500,000 papers. So I think I’m pretty good. Challenge me! Humiliate me! Knock me down a peg! I’ll buy a Dilly Bar for anyone who lands his or her throw closer to the doorstep than I do. The papers will run 36 to 42 pages, and you must fold them yourself (no rubber bands allowed). I’ll present a special prize to the 12-or-under contestant who makes the best toss. Deb Bosanek will be the judge.

At 8:30 a.m., a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (with a break for lunch at CenturyLink’s stands) will last until 3:30 p.m. After a short recess, Charlie and I will convene the annual meeting at 3:45 p.m. This business session typically lasts only a half hour or so.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of Berkshire subsidiaries will be for sale. If you don’t get your shopping done on Friday, slip out while Charlie’s talking on Saturday and binge on our bargains. Check the terrific BNSF railroad layout also. Even though I’m 84, it still excites me.

Last year you did your part as a shopper, and most of our businesses racked up record sales. In a nine-hour period on Saturday, we sold 1,385 pairs of Justin boots (that’s a pair every 23 seconds), 13,440 pounds of See’s candy, 7,276 pairs of Wells Lamont work gloves and 10,000 bottles of Heinz ketchup. Heinz has a new mustard product, so both mustard and ketchup will be available this year. (Buy both!) Now that we are open for business on Friday as well, we expect new records in every precinct.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them the next day at our third annual “Berkshire 5K,” an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor’s Guide that will be sent to you with your credentials for the meeting. Entrants in the race will find themselves running alongside many of Berkshire’s managers, directors and associates. (Charlie and I, however, will sleep in.)

A GEICO booth in the shopping area will be staffed by a number of the company’s top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, among them a couple of new titles. Last year, many shareholders purchased Max Olson’s compilation of Berkshire letters going back to 1965, and he has produced an updated edition for the meeting. We also expect to be selling an inexpensive book commemorating our fifty years. It’s currently a work in process, but I expect it to contain a wide variety of historical material, including documents from the 19th Century.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money, particularly if you had planned to rent a car in Omaha. The savings for a couple could run to \$1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” discount pricing. Last year in the week surrounding the meeting, the store did a record \$40,481,817 of business. (An average week for NFM’s Omaha store is about \$9 million.)

To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, April 28th and Monday, May 4th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Friday, 10 a.m. to 9:30 p.m. on Saturday and 10 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 1st. The second, the main gala, will be held on Sunday, May 3rd, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. In recent years, our three-day volume has far exceeded our sales in all of December, normally a jeweler's best month.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 27th through Saturday, May 9th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Don't play them for money.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine and even then I was unable to score a point against her. Now, she's a sophomore at Princeton, having already represented the United States in the 2012 Olympics. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates and I will lead off and try to soften her up.

Gorat's and Piccolo's will again be open exclusively for Berkshire shareholders on Sunday, May 3rd. Both will be serving until 10 p.m., with Gorat's opening at 1 p.m. and Piccolo's opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*); for Piccolo's, call 402-346-2865. At Piccolo's, order a giant root beer float for dessert. Only sissies get the small one.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, who retired last year after sixty years at Fortune, but remains *the* expert on business and financial matters, and who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

We will also have a panel of three analysts who follow Berkshire. This year the insurance specialist will be Gary Ransom of Dowling & Partners. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. All told we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. (Last year we had 62 in total.) The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and should also have adequate time to analyze it. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday. We do not talk one-on-one to large institutional investors or analysts, treating them instead as we do all other shareholders.

* * * * *

We get terrific help at meeting time from literally thousands of Omaha residents and businesses who want you to enjoy yourselves. This year, because we expect record attendance, we have worried about a shortage of hotel rooms. To deal with that possible problem, Airbnb is making a special effort to obtain listings for the period around meeting time and is likely to have a wide array of accommodations to offer. Airbnb's services may be especially helpful to shareholders who expect to spend only a single night in Omaha and are aware that last year a few hotels required guests to pay for a minimum of three nights. That gets expensive. Those people on a tight budget should check the Airbnb website.

* * * * *

For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I believe the mindset of our managers also to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 24 men and women who work with me at our corporate office. This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 24,100-page Federal income tax return and oversees the filing of 3,400 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and french fries (smothered in Heinz ketchup, of course) for lunch. No CEO has it better; I truly do feel like tap dancing to work every day.

Last year, for the annual report, we dropped our 48-year-old "no pictures" policy – who says I'm not flexible? – and ran a photo of our remarkable home-office crew that was taken at our Christmas lunch. I didn't warn the gang of the public exposure they were to receive, so they didn't have on their Sunday best. This year was a different story: On the facing page you will see what our group looks like when they think someone will be noticing. However they dress, their performance is mind-boggling.

Come meet them on May 2nd and enjoy our Woodstock for Capitalists.

February 27, 2015

Warren E. Buffett
Chairman of the Board

BERKSHIRE HATHAWAY INC. ACQUISITION CRITERIA

We are eager to hear *from principals or their representatives* about businesses that meet all of the following criteria:

- (1) Large purchases (at least \$75 million of pre-tax earnings unless the business will fit into one of our existing units),
- (2) Demonstrated consistent earning power (future projections are of no interest to us, nor are “turnaround” situations),
- (3) Businesses earning good returns on equity while employing little or no debt,
- (4) Management in place (we can’t supply it),
- (5) Simple businesses (if there’s lots of technology, we won’t understand it),
- (6) An offering price (we don’t want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

The larger the company, the greater will be our interest: We would like to make an acquisition in the \$5-20 billion range. *We are not interested, however, in receiving suggestions about purchases we might make in the general stock market.*

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer – customarily within five minutes – as to whether we’re interested. We prefer to buy for cash, but will consider issuing stock when we receive as much in intrinsic business value as we give. *We don’t participate in auctions.*

Charlie and I frequently get approached about acquisitions that don’t come close to meeting our tests: We’ve found that if you advertise an interest in buying collies, a lot of people will call hoping to sell you their cocker spaniels. A line from a country song expresses our feeling about new ventures, turnarounds, or auction-like sales: “When the phone don’t ring, you’ll know it’s me.”



Berkshire – Past, Present and Future

In the Beginning

On May 6, 1964, Berkshire Hathaway, then run by a man named Seabury Stanton, sent a letter to its shareholders offering to buy 225,000 shares of its stock for \$11.375 per share. I had expected the letter; I was surprised by the price.

Berkshire then had 1,583,680 shares outstanding. About 7% of these were owned by Buffett Partnership Ltd. (“BPL”), an investing entity that I managed and in which I had virtually all of my net worth. Shortly before the tender offer was mailed, Stanton had asked me at what price BPL would sell its holdings. I answered \$11.50, and he said, “Fine, we have a deal.” Then came Berkshire’s letter, offering an eighth of a point less. I bristled at Stanton’s behavior and didn’t tender.

That was a monumentally stupid decision.

Berkshire was then a northern textile manufacturer mired in a terrible business. The industry in which it operated was heading south, both metaphorically and physically. And Berkshire, for a variety of reasons, was unable to change course.

That was true even though the industry’s problems had long been widely understood. Berkshire’s own Board minutes of July 29, 1954, laid out the grim facts: “The textile industry in New England started going out of business forty years ago. During the war years this trend was stopped. The trend must continue until supply and demand have been balanced.”

About a year after that board meeting, Berkshire Fine Spinning Associates and Hathaway Manufacturing – both with roots in the 19th Century – joined forces, taking the name we bear today. With its fourteen plants and 10,000 employees, the merged company became the giant of New England textiles. What the two managements viewed as a merger agreement, however, soon morphed into a suicide pact. During the seven years following the consolidation, Berkshire operated at an overall loss, and its net worth shrunk by 37%.

Meanwhile, the company closed nine plants, sometimes using the liquidation proceeds to repurchase shares. And that pattern caught my attention.

I purchased BPL’s first shares of Berkshire in December 1962, anticipating more closings and more repurchases. The stock was then selling for \$7.50, a wide discount from per-share working capital of \$10.25 and book value of \$20.20. Buying the stock at that price was like picking up a discarded cigar butt that had one puff remaining in it. Though the stub might be ugly and soggy, the puff would be free. Once that momentary pleasure was enjoyed, however, no more could be expected.

Berkshire thereafter stuck to the script: It soon closed another two plants, and in that May 1964 move, set out to repurchase shares with the shutdown proceeds. The price that Stanton offered was 50% above the cost of our original purchases. There it was – my free puff, just waiting for me, after which I could look elsewhere for other discarded butts.

Instead, irritated by Stanton’s chiseling, I ignored his offer and began to aggressively buy more Berkshire shares.

By April 1965, BPL owned 392,633 shares (out of 1,017,547 then outstanding) and at an early-May board meeting we formally took control of the company. Through Seabury's and my childish behavior – after all, what was an eighth of a point to either of us? – he lost his job, and I found myself with more than 25% of BPL's capital invested in a terrible business about which I knew very little. I became the dog who caught the car.

Because of Berkshire's operating losses and share repurchases, its net worth at the end of fiscal 1964 had fallen to \$22 million from \$55 million at the time of the 1955 merger. The full \$22 million was required by the textile operation: The company had no excess cash and owed its bank \$2.5 million. (Berkshire's 1964 annual report is reproduced on pages 130-142.)

For a time I got lucky: Berkshire immediately enjoyed two years of good operating conditions. Better yet, its earnings in those years were free of income tax because it possessed a large loss carry-forward that had arisen from the disastrous results in earlier years.

Then the honeymoon ended. During the 18 years following 1966, we struggled unremittingly with the textile business, all to no avail. But stubbornness – stupidity? – has its limits. In 1985, I finally threw in the towel and closed the operation.

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Undeterred by my first mistake of committing much of BPL's resources to a dying business, I quickly compounded the error. Indeed, my second blunder was far more serious than the first, eventually becoming the most costly in my career.

Early in 1967, I had Berkshire pay \$8.6 million to buy National Indemnity Company ("NICO"), a small but promising Omaha-based insurer. (A tiny sister company was also included in the deal.) Insurance was in my sweet spot: I understood and liked the industry.

Jack Ringwalt, the owner of NICO, was a long-time friend who wanted to sell to me – me, personally. In no way was his offer intended for Berkshire. So why did I purchase NICO for Berkshire rather than for BPL? I've had 48 years to think about that question, and I've yet to come up with a good answer. I simply made a colossal mistake.

If BPL had been the purchaser, my partners and I would have owned 100% of a fine business, destined to form the base for building the company Berkshire has become. Moreover, our growth would not have been impeded for nearly two decades by the unproductive funds imprisoned in the textile operation. Finally, our subsequent acquisitions would have been owned in their entirety by my partners and me rather than being 39%-owned by the legacy shareholders of Berkshire, to whom we had no obligation. Despite these facts staring me in the face, I opted to marry 100% of an excellent business (NICO) to a 61%-owned terrible business (Berkshire Hathaway), a decision that eventually diverted \$100 billion or so from BPL partners to a collection of strangers.

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One more confession and then I'll go on to more pleasant topics: Can you believe that in 1975 I bought Waumbec Mills, another New England textile company? Of course, the purchase price was a "bargain" based on the assets we received and the *projected* synergies with Berkshire's existing textile business. Nevertheless – surprise, surprise – Waumbec was a disaster, with the mill having to be closed down not many years later.

And now some good news: The northern textile industry is finally extinct. You need no longer panic if you hear that I've been spotted wandering around New England.

Charlie Straightens Me Out

My cigar-but strategy worked very well while I was managing small sums. Indeed, the many dozens of free puffs I obtained in the 1950s made that decade by far the best of my life for both relative and absolute investment performance.

Even then, however, I made a few exceptions to cigar butts, the most important being GEICO. Thanks to a 1951 conversation I had with Lorimer Davidson, a wonderful man who later became CEO of the company, I learned that GEICO was a terrific business and promptly put 65% of my \$9,800 net worth into its shares. Most of my gains in those early years, though, came from investments in mediocre companies that traded at bargain prices. Ben Graham had taught me that technique, and it worked.

But a major weakness in this approach gradually became apparent: Cigar-but investing was scalable only to a point. With large sums, it would never work well.

In addition, though marginal businesses purchased at cheap prices may be attractive as short-term investments, they are the wrong foundation on which to build a large and enduring enterprise. Selecting a marriage partner clearly requires more demanding criteria than does dating. (Berkshire, it should be noted, would have been a highly satisfactory “date”: If we had taken Seabury Stanton’s \$11.375 offer for our shares, BPL’s weighted annual return on its Berkshire investment would have been about 40%).

* * * * *

It took Charlie Munger to break my cigar-but habits and set the course for building a business that could combine huge size with satisfactory profits. Charlie had grown up a few hundred feet from where I now live and as a youth had worked, as did I, in my grandfather’s grocery store. Nevertheless, it was 1959 before I met Charlie, long after he had left Omaha to make Los Angeles his home. I was then 28 and he was 35. The Omaha doctor who introduced us predicted that we would hit it off – and we did.

If you’ve attended our annual meetings, you know Charlie has a wide-ranging brilliance, a prodigious memory, and some firm opinions. I’m not exactly wishy-washy myself, and we sometimes don’t agree. In 56 years, however, we’ve never had an argument. When we differ, Charlie usually ends the conversation by saying: “Warren, think it over and you’ll agree with me because you’re smart and I’m right.”

What most of you do *not* know about Charlie is that architecture is among his passions. Though he began his career as a practicing lawyer (with his time billed at \$15 per hour), Charlie made his first real money in his 30s by designing and building five apartment projects near Los Angeles. Concurrently, he designed the house that he lives in today – some 55 years later. (Like me, Charlie can’t be budged if he is happy in his surroundings.) In recent years, Charlie has designed large dorm complexes at Stanford and the University of Michigan and today, at age 91, is working on another major project.

From my perspective, though, Charlie’s most important architectural feat was the design of today’s Berkshire. The blueprint he gave me was simple: Forget what you know about buying fair businesses at wonderful prices; instead, buy wonderful businesses at fair prices.

Altering my behavior is not an easy task (ask my family). I had enjoyed reasonable success without Charlie's input, so why should I listen to a lawyer who had never spent a day in business school (when – ahem – *I* had attended *three*). But Charlie never tired of repeating his maxims about business and investing to me, and his logic was irrefutable. Consequently, Berkshire has been built to Charlie's blueprint. My role has been that of general contractor, with the CEOs of Berkshire's subsidiaries doing the real work as sub-contractors.

The year 1972 was a turning point for Berkshire (though not without occasional backsliding on my part – remember my 1975 purchase of Waumbec). We had the opportunity then to buy See's Candy for Blue Chip Stamps, a company in which Charlie, I and Berkshire had major stakes, and which was later merged into Berkshire.

See's was a legendary West Coast manufacturer and retailer of boxed chocolates, then annually earning about \$4 million pre-tax while utilizing only \$8 million of net tangible assets. Moreover, the company had a huge asset that did not appear on its balance sheet: a broad and durable competitive advantage that gave it significant pricing power. That strength was virtually certain to give See's major gains in earnings over time. Better yet, these would materialize with only minor amounts of incremental investment. In other words, See's could be expected to gush cash for decades to come.

The family controlling See's wanted \$30 million for the business, and Charlie rightly said it was worth that much. But I didn't want to pay more than \$25 million and wasn't all that enthusiastic even at that figure. (A price that was three times net tangible assets made me gulp.) My misguided caution could have scuttled a terrific purchase. But, luckily, the sellers decided to take our \$25 million bid.

To date, See's has earned \$1.9 billion pre-tax, with its growth having required added investment of only \$40 million. See's has thus been able to distribute huge sums that have helped Berkshire buy other businesses that, in turn, have themselves produced large distributable profits. (Envision rabbits breeding.) Additionally, through watching See's in action, I gained a business education about the value of powerful brands that opened my eyes to many other profitable investments.

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Even with Charlie's blueprint, I have made plenty of mistakes since Waumbec. The most gruesome was Dexter Shoe. When we purchased the company in 1993, it had a terrific record and in no way looked to me like a cigar butt. Its competitive strengths, however, were soon to evaporate because of foreign competition. And I simply didn't see that coming.

Consequently, Berkshire paid \$433 million for Dexter and, rather promptly, its value went to zero. GAAP accounting, however, doesn't come close to recording the magnitude of my error. The fact is that I gave Berkshire stock to the sellers of Dexter rather than cash, and the shares I used for the purchase are now worth about \$5.7 billion. As a financial disaster, this one deserves a spot in the Guinness Book of World Records.

Several of my subsequent errors also involved the use of Berkshire shares to purchase businesses whose earnings were destined to simply limp along. Mistakes of that kind are deadly. Trading shares of a wonderful business – which Berkshire most certainly is – for ownership of a so-so business irreparably destroys value.

We've also suffered financially when this mistake has been committed by companies whose shares Berkshire has owned (with the errors sometimes occurring while I was serving as a director). Too often CEOs seem blind to an elementary reality: The intrinsic value of the shares you give in an acquisition must not be greater than the intrinsic value of the business you receive.

I've yet to see an investment banker quantify this all-important math when he is presenting a stock-for-stock deal to the board of a potential acquirer. Instead, the banker's focus will be on describing "customary" premiums-to-market-price that are currently being paid for acquisitions – an absolutely asinine way to evaluate the attractiveness of an acquisition – or whether the deal will increase the acquirer's earnings-per-share (which in itself should be far from determinative). In striving to achieve the desired per-share number, a panting CEO and his "helpers" will often conjure up fanciful "synergies." (As a director of 19 companies over the years, I've never heard "dis-synergies" mentioned, though I've witnessed plenty of these once deals have closed.) Post mortems of acquisitions, in which reality is honestly compared to the original projections, are rare in American boardrooms. They should instead be standard practice.

I can promise you that long after I'm gone, Berkshire's CEO and Board will carefully make intrinsic value calculations before issuing shares in any acquisitions. You can't get rich trading a hundred-dollar bill for eight tens (even if your advisor has handed you an expensive "fairness" opinion endorsing that swap).

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Overall, Berkshire's acquisitions have worked out well – and *very* well in the case of a few large ones. So, too, have our investments in marketable securities. The latter are always valued on our balance sheet at their market prices so any gains – including those unrealized – are immediately reflected in our net worth. But the businesses we buy outright are never revalued upward on our balance sheet, even when we could sell them for many billions of dollars more than their carrying value. The unrecorded gains in the value of Berkshire's subsidiaries have become huge, with these growing at a particularly fast pace in the last decade.

Listening to Charlie has paid off.

Berkshire Today

Berkshire is now a sprawling conglomerate, constantly trying to sprawl further.

Conglomerates, it should be acknowledged, have a terrible reputation with investors. And they richly deserve it. Let me first explain why they are in the doghouse, and then I will go on to describe why the conglomerate form brings huge and enduring advantages to Berkshire.

Since I entered the business world, conglomerates have enjoyed several periods of extreme popularity, the silliest of which occurred in the late 1960s. The drill for conglomerate CEOs then was simple: By personality, promotion or dubious accounting – and often by all three – these managers drove a fledgling conglomerate’s stock to, say, 20 times earnings and then issued shares as fast as possible to acquire another business selling at ten-or-so times earnings. They immediately applied “pooling” accounting to the acquisition, which – with not a dime’s worth of change in the underlying businesses – automatically increased per-share earnings, and used the rise as proof of managerial genius. They next explained to investors that this sort of talent justified the maintenance, or even the enhancement, of the acquirer’s p/e multiple. And, finally, they promised to endlessly repeat this procedure and thereby create ever-increasing per-share earnings.

Wall Street’s love affair with this hocus-pocus intensified as the 1960s rolled by. The Street’s denizens are always ready to suspend disbelief when dubious maneuvers are used to manufacture rising per-share earnings, particularly if these acrobatics produce mergers that generate huge fees for investment bankers. Auditors willingly sprinkled their holy water on the conglomerates’ accounting and sometimes even made suggestions as to how to further juice the numbers. For many, gushers of easy money washed away ethical sensitivities.

Since the per-share earnings gains of an expanding conglomerate came from exploiting p/e differences, its CEO had to search for businesses selling at low multiples of earnings. These, of course, were characteristically mediocre businesses with poor long-term prospects. This incentive to bottom-fish usually led to a conglomerate’s collection of underlying businesses becoming more and more junky. That mattered little to investors: It was deal velocity and pooling accounting they looked to for increased earnings.

The resulting firestorm of merger activity was fanned by an adoring press. Companies such as ITT, Litton Industries, Gulf & Western, and LTV were lionized, and their CEOs became celebrities. (These once-famous conglomerates are now long gone. As Yogi Berra said, “Every Napoleon meets his Watergate.”)

Back then, accounting shenanigans of all sorts – many of them ridiculously transparent – were excused or overlooked. Indeed, having an accounting wizard at the helm of an expanding conglomerate was viewed as a huge plus: Shareholders in those instances could be sure that *reported* earnings would never disappoint, no matter how bad the operating realities of the business might become.

In the late 1960s, I attended a meeting at which an acquisitive CEO bragged of his “bold, imaginative accounting.” Most of the analysts listening responded with approving nods, seeing themselves as having found a manager whose forecasts were certain to be met, whatever the business results might be.

Eventually, however, the clock struck twelve, and everything turned to pumpkins and mice. Once again, it became evident that business models based on the serial issuances of overpriced shares – just like chain-letter models – most assuredly redistribute wealth, but in no way create it. Both phenomena, nevertheless, periodically blossom in our country – they are every promoter’s dream – though often they appear in a carefully-crafted disguise. The ending is always the same: Money flows from the gullible to the fraudster. And with stocks, unlike chain letters, the sums hijacked can be staggering.

At both BPL and Berkshire, we have *never* invested in companies that are hell-bent on issuing shares. That behavior is one of the surest indicators of a promotion-minded management, weak accounting, a stock that is overpriced and – all too often – outright dishonesty.

So what do Charlie and I find so attractive about Berkshire’s conglomerate structure? To put the case simply: If the conglomerate form is used judiciously, it is an ideal structure for maximizing long-term capital growth.

One of the heralded virtues of capitalism is that it efficiently allocates funds. The argument is that markets will direct investment to promising businesses and deny it to those destined to wither. That is true: With all its excesses, market-driven allocation of capital is usually far superior to any alternative.

Nevertheless, there are often obstacles to the rational movement of capital. As those 1954 Berkshire minutes made clear, capital withdrawals within the textile industry that should have been obvious were delayed for decades because of the vain hopes and self-interest of managements. Indeed, I myself delayed abandoning our obsolete textile mills for far too long.

A CEO with capital employed in a declining operation seldom elects to massively redeploy that capital into unrelated activities. A move of that kind would usually require that long-time associates be fired and mistakes be admitted. Moreover, it’s unlikely *that* CEO would be the manager you would wish to handle the redeployment job even if he or she was inclined to undertake it.

At the shareholder level, taxes and frictional costs weigh heavily on individual investors when they attempt to reallocate capital among businesses and industries. Even tax-free institutional investors face major costs as they move capital because they usually need intermediaries to do this job. A lot of mouths with expensive tastes then clamor to be fed – among them investment bankers, accountants, consultants, lawyers and such capital-reallocators as leveraged buyout operators. Money-shufflers don’t come cheap.

In contrast, a conglomerate such as Berkshire is perfectly positioned to allocate capital rationally and at minimal cost. Of course, form itself is no guarantee of success: We have made plenty of mistakes, and we will make more. Our structural advantages, however, are formidable.

At Berkshire, we can – without incurring taxes or much in the way of other costs – move huge sums from businesses that have limited opportunities for incremental investment to other sectors with greater promise. Moreover, we are free of historical biases created by lifelong association with a given industry and are not subject to pressures from colleagues having a vested interest in maintaining the status quo. That’s important: If horses had controlled investment decisions, there would have been no auto industry.

Another major advantage we possess is the ability to buy *pieces* of wonderful businesses – a.k.a. common stocks. That's not a course of action open to most managements. Over our history, this strategic alternative has proved to be very helpful; a broad range of options always sharpens decision-making. The businesses we are offered by the stock market every day – in small pieces, to be sure – are often far more attractive than the businesses we are concurrently being offered in their entirety. Additionally, the gains we've realized from marketable securities have helped us make certain large acquisitions that would otherwise have been beyond our financial capabilities.

In effect, the world is Berkshire's oyster – a world offering us a range of opportunities far beyond those realistically open to most companies. We are limited, of course, to businesses whose economic prospects we can evaluate. And that's a serious limitation: Charlie and I have no idea what a great many companies will look like ten years from now. But that limitation is much smaller than that borne by an executive whose experience has been confined to a single industry. On top of that, we can profitably scale to a *far* larger size than the many businesses that are constrained by the limited potential of the single industry in which they operate.

I mentioned earlier that See's Candy had produced huge earnings compared to its modest capital requirements. We would have loved, of course, to intelligently use those funds to expand our candy operation. But our many attempts to do so were largely futile. So, without incurring tax inefficiencies or frictional costs, we have used the excess funds generated by See's to help purchase other businesses. If See's had remained a stand-alone company, its earnings would have had to be distributed to investors to redeploy, sometimes after being heavily depleted by large taxes and, almost always, by significant frictional and agency costs.

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Berkshire has one further advantage that has become increasingly important over the years: We are now the home of choice for the owners and managers of many outstanding businesses.

Families that own successful businesses have multiple options when they contemplate sale. Frequently, the best decision is to do nothing. There are worse things in life than having a prosperous business that one understands well. But sitting tight is seldom recommended by Wall Street. (Don't ask the barber whether you need a haircut.)

When one part of a family wishes to sell while others wish to continue, a public offering often makes sense. But, when owners wish to cash out entirely, they usually consider one of two paths.

The first is sale to a competitor who is salivating at the possibility of wringing "synergies" from the combining of the two companies. This buyer invariably contemplates getting rid of large numbers of the seller's associates, the very people who have helped the owner build his business. A caring owner, however – and there are plenty of them – usually does not want to leave his long-time associates sadly singing the old country song: "*She got the goldmine, I got the shaft.*"

The second choice for sellers is the Wall Street buyer. For some years, these purchasers accurately called themselves "leveraged buyout firms." When that term got a bad name in the early 1990s – remember RJR and *Barbarians at the Gate?* – these buyers hastily relabeled themselves "private-equity."

The name may have changed but that was all: Equity is dramatically *reduced* and debt is piled on in virtually all private-equity purchases. Indeed, the amount that a private-equity purchaser offers to the seller is in part determined by the buyer assessing the *maximum* amount of debt that can be placed on the acquired company.

Later, if things go well and equity begins to build, leveraged buy-out shops will often seek to re-leverage with new borrowings. They then typically use part of the proceeds to pay a huge dividend that drives equity sharply downward, sometimes even to a negative figure.

In truth, “equity” is a dirty word for many private-equity buyers; what they love is debt. And, because debt is currently so inexpensive, these buyers can frequently pay top dollar. Later, the business will be resold, often to another leveraged buyer. In effect, the business becomes a piece of merchandise.

Berkshire offers a third choice to the business owner who wishes to sell: a permanent home, in which the company’s people and culture will be retained (though, occasionally, management changes will be needed). Beyond that, any business we acquire dramatically increases its financial strength and ability to grow. Its days of dealing with banks and Wall Street analysts are also forever ended.

Some sellers don’t care about these matters. But, when sellers do, Berkshire does not have a lot of competition.

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Sometimes pundits propose that Berkshire spin-off certain of its businesses. These suggestions make no sense. Our companies are worth more as part of Berkshire than as separate entities. One reason is our ability to move funds between businesses or into new ventures instantly and without tax. In addition, certain costs duplicate themselves, in full or part, if operations are separated. Here’s the most obvious example: Berkshire incurs nominal costs for its single board of directors; were our dozens of subsidiaries to be split off, the overall cost for directors would soar. So, too, would regulatory and administration expenditures.

Finally, there are sometimes important tax efficiencies for Subsidiary A because we own Subsidiary B. For example, certain tax credits that are available to our utilities are currently realizable only because we generate huge amounts of taxable income at other Berkshire operations. That gives Berkshire Hathaway Energy a major advantage over most public-utility companies in developing wind and solar projects.

Investment bankers, being paid as they are for action, constantly urge acquirers to pay 20% to 50% premiums over market price for publicly-held businesses. The bankers tell the buyer that the premium is justified for “control value” and for the wonderful things that are going to happen once the acquirer’s CEO takes charge. (What acquisition-hungry manager will challenge *that* assertion?)

A few years later, bankers – bearing straight faces – again appear and just as earnestly urge spinning off the earlier acquisition in order to “unlock shareholder value.” Spin-offs, of course, strip the owning company of its purported “control value” without any compensating payment. The bankers explain that the spun-off company will flourish because its management will be more entrepreneurial, having been freed from the smothering bureaucracy of the parent company. (So much for that talented CEO we met earlier.)

If the divesting company later wishes to reacquire the spun-off operation, it presumably would again be urged by its bankers to pay a hefty “control” premium for the privilege. (Mental “flexibility” of this sort by the banking fraternity has prompted the saying that fees too often lead to transactions rather than transactions leading to fees.)

It’s possible, of course, that someday a spin-off or sale at Berkshire would be required by regulators. Berkshire carried out such a spin-off in 1979, when new regulations for bank holding companies forced us to divest a bank we owned in Rockford, Illinois.

Voluntary spin-offs, though, make no sense for us: We would lose control value, capital-allocation flexibility and, in some cases, important tax advantages. The CEOs who brilliantly run our subsidiaries now would have difficulty in being as effective if running a spun-off operation, given the operating and financial advantages derived from Berkshire's ownership. Moreover, the parent and the spun-off operations, once separated, would likely incur moderately greater costs than existed when they were combined.

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Before I depart the subject of spin-offs, let's look at a lesson to be learned from a conglomerate mentioned earlier: LTV. I'll summarize here, but those who enjoy a good financial story should read the piece about Jimmy Ling that ran in the October 1982 issue of *D Magazine*. Look it up on the Internet.

Through a lot of corporate razzle-dazzle, Ling had taken LTV from sales of only \$36 million in 1965 to number 14 on the Fortune 500 list just two years later. Ling, it should be noted, had never displayed any managerial skills. But Charlie told me long ago to never underestimate the man who overestimates himself. And Ling had no peer in that respect.

Ling's strategy, which he labeled "project redeployment," was to buy a large company and then partially spin off its various divisions. In LTV's 1966 annual report, he explained the magic that would follow: "Most importantly, acquisitions must meet the test of the 2 plus 2 equals 5 (or 6) formula." The press, the public and Wall Street loved this sort of talk.

In 1967 Ling bought Wilson & Co., a huge meatpacker that also had interests in golf equipment and pharmaceuticals. Soon after, he split the parent into three businesses, Wilson & Co. (meatpacking), Wilson Sporting Goods and Wilson Pharmaceuticals, each of which was to be partially spun off. These companies quickly became known on Wall Street as Meatball, Golf Ball and Goof Ball.

Soon thereafter, it became clear that, like Icarus, Ling had flown too close to the sun. By the early 1970s, Ling's empire was melting, and he himself had been spun off from LTV . . . that is, *fired*.

Periodically, financial markets will become divorced from reality – you can count on that. More Jimmy Lings will appear. They will look and sound authoritative. The press will hang on their every word. Bankers will fight for their business. What they are saying will recently have "worked." Their early followers will be feeling very clever. Our suggestion: Whatever their line, never forget that 2+2 will always equal 4. And when someone tells you how old-fashioned that math is --- zip up your wallet, take a vacation and come back in a few years to buy stocks at cheap prices.

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Today Berkshire possesses (1) an unmatched collection of businesses, most of them now enjoying favorable economic prospects; (2) a cadre of outstanding managers who, with few exceptions, are unusually devoted to both the subsidiary they operate *and* to Berkshire; (3) an extraordinary diversity of earnings, premier financial strength and oceans of liquidity that we will maintain under *all* circumstances; (4) a first-choice ranking among many owners and managers who are contemplating sale of their businesses and (5) in a point related to the preceding item, a culture, distinctive in many ways from that of most large companies, that we have worked 50 years to develop and that is now rock-solid.

These strengths provide us a wonderful foundation on which to build.

The Next 50 Years at Berkshire

Now let's take a look at the road ahead. Bear in mind that if I had attempted 50 years ago to gauge what was coming, certain of my predictions would have been far off the mark. With that warning, I will tell you what I would say to my family today if they asked me about Berkshire's future.

- First and definitely foremost, I believe that the chance of permanent capital loss for patient Berkshire shareholders is as low as can be found among single-company investments. That's because our per-share *intrinsic business value* is almost certain to advance over time.

This cheery prediction comes, however, with an important caution: If an investor's entry point into Berkshire stock is unusually high – at a price, say, approaching double book value, which Berkshire shares have occasionally reached – it may well be many years before the investor can realize a profit. In other words, a sound investment can morph into a rash speculation if it is bought at an elevated price. Berkshire is not exempt from this truth.

Purchases of Berkshire that investors make at a price modestly above the level at which the company would repurchase its shares, however, should produce gains within a reasonable period of time. Berkshire's directors will only authorize repurchases at a price they believe to be *well below* intrinsic value. (In our view, that is an essential criterion for repurchases that is often ignored by other managements.)

For those investors who plan to sell within a year or two after their purchase, I can offer *no* assurances, whatever the entry price. Movements of the general stock market during such abbreviated periods will likely be far more important in determining your results than the concomitant change in the intrinsic value of your Berkshire shares. As Ben Graham said many decades ago: "In the short-term the market is a voting machine; in the long-run it acts as a weighing machine." Occasionally, the voting decisions of investors – amateurs and professionals alike – border on lunacy.

Since I know of no way to reliably predict market movements, I recommend that you purchase Berkshire shares *only* if you expect to hold them for at least five years. Those who seek short-term profits should look elsewhere.

Another warning: Berkshire shares should not be purchased with borrowed money. There have been three times since 1965 when our stock has fallen about 50% from its high point. Someday, something close to this kind of drop will happen again, and no one knows when. Berkshire will almost certainly be a satisfactory holding for *investors*. But it could well be a disastrous choice for speculators employing leverage.

- I believe the chance of any event causing Berkshire to experience financial problems is essentially zero. We will always be prepared for the thousand-year flood; in fact, if it occurs we will be selling life jackets to the unprepared. Berkshire played an important role as a "first responder" during the 2008-2009 meltdown, and we have since more than doubled the strength of our balance sheet and our earnings potential. Your company is the Gibraltar of American business and will remain so.

Financial staying power requires a company to maintain three strengths under *all* circumstances: (1) a large and reliable stream of earnings; (2) massive liquid assets and (3) *no* significant near-term cash requirements. Ignoring that last necessity is what usually leads companies to experience unexpected problems: Too often, CEOs of profitable companies feel they will always be able to refund maturing obligations, however large these are. In 2008-2009, many managements learned how perilous that mindset can be.

Here's how we will *always* stand on the three essentials. First, our earnings stream is huge and comes from a vast array of businesses. Our shareholders now own many large companies that have durable competitive advantages, and we will acquire more of those in the future. Our diversification assures Berkshire's continued profitability, even if a catastrophe causes insurance losses that far exceed any previously experienced.

Next up is cash. At a healthy business, cash is sometimes thought of as something to be minimized – as an unproductive asset that acts as a drag on such markers as return on equity. Cash, though, is to a business as oxygen is to an individual: never thought about when it is present, the only thing in mind when it is absent.

American business provided a case study of that in 2008. In September of that year, many long-prosperous companies suddenly wondered whether their checks would bounce in the days ahead. Overnight, their financial oxygen disappeared.

At Berkshire, our “breathing” went uninterrupted. Indeed, in a three-week period spanning late September and early October, we supplied \$15.6 billion of fresh money to American businesses.

We could do that because we always maintain at least \$20 billion – and usually far more – in cash equivalents. And by that we mean U.S. Treasury bills, not other substitutes for cash that are claimed to deliver liquidity and actually do so, *except* when it is truly needed. When bills come due, only cash is legal tender. Don’t leave home without it.

Finally – getting to our third point – we will never engage in operating or investment practices that can result in sudden demands for large sums. That means we will not expose Berkshire to short-term debt maturities of size nor enter into derivative contracts or other business arrangements that could require large collateral calls.

Some years ago, we became a party to certain derivative contracts that we believed were significantly mispriced and that had only minor collateral requirements. These have proved to be quite profitable. Recently, however, newly-written derivative contracts have required full collateralization. And that ended our interest in derivatives, regardless of what profit potential they might offer. We have not, for some years, written these contracts, except for a few needed for operational purposes at our utility businesses.

Moreover, we will not write insurance contracts that give policyholders the right to cash out at their option. Many *life* insurance products contain redemption features that make them susceptible to a “run” in times of extreme panic. Contracts of that sort, however, do not exist in the property-casualty world that we inhabit. If our premium volume should shrink, our float would decline – but only at a very slow pace.

The reason for our conservatism, which may impress some people as extreme, is that it is entirely predictable that people will occasionally panic, but not at all predictable when this will happen. Though practically all days are relatively uneventful, tomorrow is *always* uncertain. (I felt no special apprehension on December 6, 1941 or September 10, 2001.) And if you can’t predict what tomorrow will bring, you must be prepared for whatever it does.

A CEO who is 64 and plans to retire at 65 may have his own special calculus in evaluating risks that have only a tiny chance of happening in a given year. He may, in fact, be “right” 99% of the time. Those odds, however, hold no appeal for us. We will never play financial Russian roulette with the funds you’ve entrusted to us, even if the metaphorical gun has 100 chambers and only one bullet. In our view, it is madness to risk losing what you *need* in pursuing what you simply *desire*.

- Despite our conservatism, I think we will be able *every* year to build the underlying per-share earning power of Berkshire. That does *not* mean operating earnings will increase each year – far from it. The U.S. economy will ebb and flow – though mostly flow – and, when it weakens, so will our current earnings. But we will continue to achieve organic gains, make bolt-on acquisitions and enter new fields. I believe, therefore, that Berkshire will annually add to its *underlying* earning power.

In some years the gains will be substantial, and at other times they will be minor. Markets, competition, and chance will determine when opportunities come our way. Through it all, Berkshire will keep moving forward, powered by the array of solid businesses we now possess and the new companies we will purchase. In most years, moreover, our country’s economy will provide a strong tailwind for business. We are blessed to have the United States as our home field.

- The bad news is that Berkshire's long-term gains – measured by percentages, not by dollars – cannot be dramatic and *will not come close* to those achieved in the past 50 years. The numbers have become too big. I think Berkshire will outperform the average American company, but our advantage, if any, won't be great.

Eventually – probably between ten and twenty years from now – Berkshire's earnings and capital resources will reach a level that will not allow management to intelligently reinvest all of the company's earnings. At that time our directors will need to determine whether the best method to distribute the excess earnings is through dividends, share repurchases or both. If Berkshire shares are selling below intrinsic business value, massive repurchases will almost certainly be the best choice. You can be comfortable that your directors will make the right decision.

- No company will be more shareholder-minded than Berkshire. For more than 30 years, we have annually reaffirmed our Shareholder Principles (see page 117), always leading off with: "Although our form is corporate, our attitude is partnership." This covenant with you is etched in stone.

We have an extraordinarily knowledgeable and business-oriented board of directors ready to carry out that promise of partnership. None took the job for the money: In an arrangement almost non-existent elsewhere, our directors are paid only token fees. They receive their rewards instead through ownership of Berkshire shares and the satisfaction that comes from being good stewards of an important enterprise.

The shares that they and their families own – which, in many cases, are worth very substantial sums – were *purchased* in the market (rather than their materializing through options or grants). In addition, unlike almost all other sizable public companies, we carry no directors and officers liability insurance. At Berkshire, directors walk in your shoes.

To further ensure continuation of our culture, I have suggested that my son, Howard, succeed me as a *non-executive* Chairman. My only reason for this wish is to make change easier if the wrong CEO should ever be employed and there occurs a need for the Chairman to move forcefully. I can assure you that this problem has a *very* low probability of arising at Berkshire – likely as low as at any public company. In my service on the boards of nineteen public companies, however, I've seen how hard it is to replace a mediocre CEO if that person is also Chairman. (The deed usually gets done, but almost always very late.)

If elected, Howard will receive no pay and will spend no time at the job other than that required of all directors. He will simply be a safety valve to whom any director can go if he or she has concerns about the CEO and wishes to learn if other directors are expressing doubts as well. Should multiple directors be apprehensive, Howard's chairmanship will allow the matter to be promptly and properly addressed.

- Choosing the right CEO is all-important and is a subject that commands much time at Berkshire board meetings. Managing Berkshire is primarily a job of capital allocation, coupled with the selection and retention of outstanding managers to captain our operating subsidiaries. Obviously, the job also requires the replacement of a subsidiary's CEO when that is called for. These duties require Berkshire's CEO to be a rational, calm and decisive individual who has a broad understanding of business and good insights into human behavior. It's important as well that he knows his limits. (As Tom Watson, Sr. of IBM said, "I'm no genius, but I'm smart in spots and I stay around those spots.")

Character is crucial: A Berkshire CEO must be "all in" for the company, not for himself. (I'm using male pronouns to avoid awkward wording, but gender should never decide who becomes CEO.) He can't help but earn money far in excess of any possible need for it. But it's important that neither ego nor avarice motivate him to reach for pay matching his most lavishly-compensated peers, even if his achievements far exceed theirs. A CEO's behavior has a huge impact on managers down the line: If it's clear to them that shareholders' interests are paramount to him, they will, with few exceptions, also embrace that way of thinking.

My successor will need one other particular strength: the ability to fight off the ABCs of business decay, which are arrogance, bureaucracy and complacency. When these corporate cancers metastasize, even the strongest of companies can falter. The examples available to prove the point are legion, but to maintain friendships I will exhume only cases from the distant past.

In their glory days, General Motors, IBM, Sears Roebuck and U.S. Steel sat atop huge industries. Their strengths seemed unassailable. But the destructive behavior I deplored above eventually led each of them to fall to depths that their CEOs and directors had not long before thought impossible. Their one-time financial strength and their historical earning power proved no defense.

Only a vigilant and determined CEO can ward off such debilitating forces as Berkshire grows ever larger. He must never forget Charlie's plea: "Tell me where I'm going to die, so I'll never go there." If our non-economic values were to be lost, much of Berkshire's economic value would collapse as well. "Tone at the top" will be key to maintaining Berkshire's special culture.

Fortunately, the structure our future CEOs will need to be successful is firmly in place. The extraordinary delegation of authority now existing at Berkshire is the ideal antidote to bureaucracy. In an operating sense, Berkshire is not a giant company but rather a collection of large companies. At headquarters, we have never had a committee nor have we ever required our subsidiaries to submit budgets (though many use them as an important internal tool). We don't have a legal office nor departments that other companies take for granted: human relations, public relations, investor relations, strategy, acquisitions, you name it.

We do, of course, have an active audit function; no sense being a damned fool. To an unusual degree, however, we trust our managers to run their operations with a keen sense of stewardship. After all, they were doing exactly that before we acquired their businesses. With only occasional exceptions, furthermore, our trust produces better results than would be achieved by streams of directives, endless reviews and layers of bureaucracy. Charlie and I try to interact with our managers in a manner consistent with what we would wish for, if the positions were reversed.

- Our directors believe that our future CEOs should come from internal candidates whom the Berkshire board has grown to know well. Our directors also believe that an incoming CEO should be relatively young, so that he or she can have a long run in the job. Berkshire will operate best if its CEOs average well over ten years at the helm. (It's hard to teach a new dog old tricks.) And they are not likely to retire at 65 either (or have you noticed?).

In both Berkshire's business acquisitions and large, tailored investment moves, it is important that our counterparties be both familiar with and feel comfortable with Berkshire's CEO. Developing confidence of that sort and cementing relationships takes time. The payoff, though, can be huge.

Both the board and I believe we now have the right person to succeed me as CEO – a successor ready to assume the job the day after I die or step down. In certain important respects, this person will do a better job than I am doing.

- Investments will always be of great importance to Berkshire and will be handled by several specialists. They will report to the CEO because their investment decisions, in a broad way, will need to be coordinated with Berkshire's operating and acquisition programs. Overall, though, our investment managers will enjoy great autonomy. In this area, too, we are in fine shape for decades to come. Todd Combs and Ted Weschler, each of whom has spent several years on Berkshire's investment team, are first-rate in all respects and can be of particular help to the CEO in evaluating acquisitions.

All told, Berkshire is ideally positioned for life after Charlie and I leave the scene. We have the right people in place – the right directors, managers and prospective successors to those managers. Our culture, furthermore, is embedded throughout their ranks. Our system is also regenerative. To a large degree, both good and bad cultures self-select to perpetuate themselves. For very good reasons, business owners and operating managers with values similar to ours will continue to be attracted to Berkshire as a one-of-a-kind and *permanent* home.

- I would be remiss if I didn't salute another key constituency that makes Berkshire special: our shareholders. Berkshire truly has an owner base unlike that of any other giant corporation. That fact was demonstrated in spades at last year's annual meeting, where the shareholders were offered a proxy resolution:

RESOLVED: Whereas the corporation has more money than it needs and since the owners unlike Warren are not multi billionaires, the board shall consider paying a meaningful annual dividend on the shares.

The sponsoring shareholder of that resolution never showed up at the meeting, so his motion was not officially proposed. Nevertheless, the proxy votes had been tallied, and they were enlightening.

Not surprisingly, the A shares – owned by relatively few shareholders, each with a large economic interest – voted “no” on the dividend question by a margin of 89 to 1.

The remarkable vote was that of our B shareholders. They number in the hundreds of thousands – perhaps even totaling one million – and they voted 660,759,855 “no” and 13,927,026 “yes,” a ratio of about 47 to 1.

Our directors recommended a “no” vote but the company did not otherwise attempt to influence shareholders. Nevertheless, 98% of the shares voting said, in effect, “Don’t send us a dividend but instead reinvest all of the earnings.” To have our fellow owners – large and small – be so in sync with our managerial philosophy is both remarkable and rewarding.

I am a lucky fellow to have you as partners.

Warren E. Buffett

Vice Chairman's Thoughts – Past and Future

To the shareholders of Berkshire Hathaway Inc.:

I closely watched the 50-year history of Berkshire's uncommon success under Warren Buffett. And it now seems appropriate that I independently supplement whatever celebratory comment comes from him. I will try to do five things.

- (1) Describe the management system and policies that caused a small and unfixably-doomed commodity textile business to morph into the mighty Berkshire that now exists,
- (2) Explain how the management system and policies came into being,
- (3) Explain, to some extent, why Berkshire did so well,
- (4) Predict whether abnormally good results would continue if Buffett were soon to depart, and
- (5) Consider whether Berkshire's great results over the last 50 years have implications that may prove useful elsewhere.

The management system and policies of Berkshire under Buffett (herein together called "the Berkshire system") were fixed early and are described below:

- (1) Berkshire would be a diffuse conglomerate, averse only to activities about which it could not make useful predictions.
- (2) Its top company would do almost all business through separately incorporated subsidiaries whose CEOs would operate with very extreme autonomy.
- (3) There would be almost nothing at conglomerate headquarters except a tiny office suite containing a Chairman, a CFO, and a few assistants who mostly helped the CFO with auditing, internal control, etc.
- (4) Berkshire subsidiaries would always prominently include casualty insurers. Those insurers as a group would be expected to produce, in due course, dependable underwriting gains while also producing substantial "float" (from unpaid insurance liabilities) for investment.
- (5) There would be no significant system-wide personnel system, stock option system, other incentive system, retirement system, or the like, because the subsidiaries would have their own systems, often different.
- (6) Berkshire's Chairman would reserve only a few activities for himself.
 - (i) He would manage almost all security investments, with these normally residing in Berkshire's casualty insurers.
 - (ii) He would choose all CEOs of important subsidiaries, and he would fix their compensation and obtain from each a private recommendation for a successor in case one was suddenly needed.
 - (iii) He would deploy most cash not needed in subsidiaries after they had increased their competitive advantage, with the ideal deployment being the use of that cash to acquire new subsidiaries.
 - (iv) He would make himself promptly available for almost any contact wanted by any subsidiary's CEO, and he would require almost no additional contact.
 - (v) He would write a long, logical, and useful letter for inclusion in his annual report, designed as he would wish it to be if he were only a passive shareholder, and he would be available for hours of answering questions at annual shareholders' meetings.
 - (vi) He would try to be an exemplar in a culture that would work well for customers, shareholders, and other incumbents for a long time, both before and after his departure.
 - (vii) His first priority would be reservation of much time for quiet reading and thinking, particularly that which might advance his determined learning, no matter how old he became; and

- (viii) He would also spend much time in enthusiastically admiring what others were accomplishing.
- (7) New subsidiaries would usually be bought with cash, not newly issued stock.
- (8) Berkshire would not pay dividends so long as more than one dollar of market value for shareholders was being created by each dollar of retained earnings.
- (9) In buying a new subsidiary, Berkshire would seek to pay a fair price for a good business that the Chairman could pretty well understand. Berkshire would also want a good CEO in place, one expected to remain for a long time and to manage well without need for help from headquarters.
- (10) In choosing CEOs of subsidiaries, Berkshire would try to secure trustworthiness, skill, energy, and love for the business and circumstances the CEO was in.
- (11) As an important matter of preferred conduct, Berkshire would almost never sell a subsidiary.
- (12) Berkshire would almost never transfer a subsidiary's CEO to another unrelated subsidiary.
- (13) Berkshire would never force the CEO of a subsidiary to retire on account of mere age.
- (14) Berkshire would have little debt outstanding as it tried to maintain (i) virtually perfect creditworthiness under all conditions and (ii) easy availability of cash and credit for deployment in times presenting unusual opportunities.
- (15) Berkshire would always be user-friendly to a prospective seller of a large business. An offer of such a business would get prompt attention. No one but the Chairman and one or two others at Berkshire would ever know about the offer if it did not lead to a transaction. And they would never tell outsiders about it.

Both the elements of the Berkshire system and their collected size are quite unusual. No other large corporation I know of has half of such elements in place.

How did Berkshire happen to get a corporate personality so different from the norm?

Well, Buffett, even when only 34 years old, controlled about 45% of Berkshire's shares and was completely trusted by all the other big shareholders. He could install whatever system he wanted. And he did so, creating the Berkshire system.

Almost every element was chosen because Buffett believed that, under him, it would help maximize Berkshire's achievement. He was not trying to create a one-type-fits-all system for other corporations. Indeed, Berkshire's subsidiaries were not required to use the Berkshire system in their own operations. And some flourished while using different systems.

What was Buffett aiming at as he designed the Berkshire system?

Well, over the years I diagnosed several important themes:

- (1) He particularly wanted continuous maximization of the rationality, skills, and devotion of the most important people in the system, starting with himself.
- (2) He wanted win/win results everywhere--in gaining loyalty by giving it, for instance.
- (3) He wanted decisions that maximized long-term results, seeking these from decision makers who usually stayed long enough in place to bear the consequences of decisions.
- (4) He wanted to minimize the bad effects that would almost inevitably come from a large bureaucracy at headquarters.
- (5) He wanted to personally contribute, like Professor Ben Graham, to the spread of wisdom attained.

When Buffett developed the Berkshire system, did he foresee all the benefits that followed? No. Buffett stumbled into some benefits through practice evolution. But, when he saw useful consequences, he strengthened their causes.

Why did Berkshire under Buffett do so well?

Only four large factors occur to me:

- (1) The constructive peculiarities of Buffett,
- (2) The constructive peculiarities of the Berkshire system,
- (3) Good luck, and
- (4) The weirdly intense, contagious devotion of some shareholders and other admirers, including some in the press.

I believe all four factors were present and helpful. But the heavy freight was carried by the constructive peculiarities, the weird devotion, and their interactions.

In particular, Buffett's decision to limit his activities to a few kinds and to maximize his attention to them, and to keep doing so for 50 years, was a lollapalooza. Buffett succeeded for the same reason Roger Federer became good at tennis.

Buffett was, in effect, using the winning method of the famous basketball coach, John Wooden, who won most regularly after he had learned to assign virtually all playing time to his seven best players. That way, opponents always faced his best players, instead of his second best. And, with the extra playing time, the best players improved more than was normal.

And Buffett much out-Woodened Wooden, because in his case the exercise of skill was concentrated in one person, not seven, and his skill improved and improved as he got older and older during 50 years, instead of deteriorating like the skill of a basketball player does.

Moreover, by concentrating so much power and authority in the often-long-serving CEOs of important subsidiaries, Buffett was also creating strong Wooden-type effects there. And such effects enhanced the skills of the CEOs and the achievements of the subsidiaries.

Then, as the Berkshire system bestowed much-desired autonomy on many subsidiaries and their CEOs, and Berkshire became successful and well known, these outcomes attracted both more and better subsidiaries into Berkshire, and better CEOs as well.

And the better subsidiaries and CEOs then required less attention from headquarters, creating what is often called a "virtuous circle."

How well did it work out for Berkshire to always include casualty insurers as important subsidiaries?

Marvelously well. Berkshire's ambitions were unreasonably extreme and, even so, it got what it wanted.

Casualty insurers often invest in common stocks with a value amounting roughly to their shareholders' equity, as did Berkshire's insurance subsidiaries. And the S&P 500 Index produced about 10% per annum, pre-tax, during the last 50 years, creating a significant tailwind.

And, in the early decades of the Buffett era, common stocks within Berkshire's insurance subsidiaries greatly outperformed the index, exactly as Buffett expected. And, later, when both the large size of Berkshire's stockholdings and income tax considerations caused the index-beating part of returns to fade to insignificance (perhaps not forever), other and better advantage came. Ajit Jain created out of nothing an immense reinsurance business that produced both a huge "float" and a large underwriting gain. And all of GEICO came into Berkshire, followed by a quadrupling of GEICO's market share. And the rest of Berkshire's insurance operations hugely improved, largely by dint of reputational advantage, underwriting discipline, finding and staying within good niches, and recruiting and holding outstanding people.

Then, later, as Berkshire's nearly unique and quite dependable corporate personality and large size became well known, its insurance subsidiaries got and seized many attractive opportunities, not available to others, to buy privately issued securities. Most of these securities had fixed maturities and produced outstanding results.

Berkshire's marvelous outcome in insurance was not a natural result. Ordinarily, a casualty insurance business is a producer of mediocre results, even when very well managed. And such results are of little use. Berkshire's better outcome was so astoundingly large that I believe that Buffett would now fail to recreate it if he returned to a small base while retaining his smarts and regaining his youth.

Did Berkshire suffer from being a diffuse conglomerate? No, its opportunities were usefully enlarged by a widened area for operation. And bad effects, common elsewhere, were prevented by Buffett's skills.

Why did Berkshire prefer to buy companies with cash, instead of its own stock? Well, it was hard to get anything in exchange for Berkshire stock that was as valuable as what was given up.

Why did Berkshire's acquisition of companies outside the insurance business work out so well for Berkshire shareholders when the normal result in such acquisitions is bad for shareholders of the acquirer?

Well, Berkshire, by design, had methodological advantages to supplement its better opportunities. It never had the equivalent of a "department of acquisitions" under pressure to buy. And it never relied on advice from "helpers" sure to be prejudiced in favor of transactions. And Buffett held self-delusion at bay as he underclaimed expertise while he knew better than most corporate executives what worked and what didn't in business, aided by his long experience as a passive investor. And, finally, even when Berkshire was getting much better opportunities than most others, Buffett often displayed almost inhuman patience and seldom bought. For instance, during his first ten years in control of Berkshire, Buffett saw one business (textiles) move close to death and two new businesses come in, for a net gain of one.

What were the big mistakes made by Berkshire under Buffett? Well, while mistakes of commission were common, almost all huge errors were in not making a purchase, including not purchasing Walmart stock when that was sure to work out enormously well. The errors of omission were of much importance. Berkshire's net worth would now be at least \$50 billion higher if it had seized several opportunities it was not quite smart enough to recognize as virtually sure things.

The next to last task on my list was: Predict whether abnormally good results would continue at Berkshire if Buffett were soon to depart.

The answer is yes. Berkshire has in place in its subsidiaries much business momentum grounded in much durable competitive advantage.

Moreover, its railroad and utility subsidiaries now provide much desirable opportunity to invest large sums in new fixed assets. And many subsidiaries are now engaged in making wise "bolt-on" acquisitions.

Provided that most of the Berkshire system remains in place, the combined momentum and opportunity now present is so great that Berkshire would almost surely remain a better-than-normal company for a very long time even if (1) Buffett left tomorrow, (2) his successors were persons of only moderate ability, and (3) Berkshire never again purchased a large business.

But, under this Buffett-soon-leaves assumption, his successors would not be "of only moderate ability." For instance, Ajit Jain and Greg Abel are proven performers who would probably be under-described as "world-class." "World-leading" would be the description I would choose. In some important ways, each is a better business executive than Buffett.

And I believe neither Jain nor Abel would (1) leave Berkshire, no matter what someone else offered or (2) desire much change in the Berkshire system.

Nor do I think that desirable purchases of new businesses would end with Buffett's departure. With Berkshire now so large and the age of activism upon us, I think some desirable acquisition opportunities will come and that Berkshire's \$60 billion in cash will constructively decrease.

My final task was to consider whether Berkshire's great results over the last 50 years have implications that may prove useful elsewhere.

The answer is plainly yes. In its early Buffett years, Berkshire had a big task ahead: turning a tiny stash into a large and useful company. And it solved that problem by avoiding bureaucracy and relying much on one thoughtful leader for a long, long time as he kept improving and brought in more people like himself.

Compare this to a typical big-corporation system with much bureaucracy at headquarters and a long succession of CEOs who come in at about age 59, pause little thereafter for quiet thought, and are soon forced out by a fixed retirement age.

I believe that versions of the Berkshire system should be tried more often elsewhere and that the worst attributes of bureaucracy should much more often be treated like the cancers they so much resemble. A good example of bureaucracy fixing was created by George Marshall when he helped win World War II by getting from Congress the right to ignore seniority in choosing generals.

Sincerely,

Charles T. Munger

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
Compounded Annual Gain – 1965-2015	19.2%	20.8%	9.7%
Overall Gain – 1964-2015	798,981%	1,598,284%	11,355%

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2015 was \$15.4 billion, which increased the per-share book value of both our Class A and Class B stock by 6.4%. Over the last 51 years (that is, since present management took over), per-share book value has grown from \$19 to \$155,501, a rate of 19.2% compounded annually.*

During the first half of those years, Berkshire's net worth was roughly equal to the number that really counts: the intrinsic value of the business. The similarity of the two figures existed then because most of our resources were deployed in marketable securities that were regularly revalued to their quoted prices (less the tax that would be incurred if they were to be sold). In Wall Street parlance, our balance sheet was then in very large part "marked to market."

By the early 1990s, however, our focus had changed to the outright ownership of businesses, a shift that diminished the relevance of balance-sheet figures. That disconnect occurred because the accounting rules that apply to controlled companies are materially different from those used in valuing marketable securities. The carrying value of the "losers" we own is written down, but "winners" are *never* revalued upwards.

We've had experience with both outcomes: I've made some dumb purchases, and the amount I paid for the economic goodwill of those companies was later written off, a move that reduced Berkshire's book value. We've also had some winners – a few of them very big – but have not written those up by a penny.

Over time, this asymmetrical accounting treatment (with which we agree) necessarily widens the gap between intrinsic value and book value. Today, the large – and growing – unrecorded gains at our "winners" make it clear that Berkshire's intrinsic value *far* exceeds its book value. That's why we would be delighted to repurchase our shares should they sell as low as 120% of book value. At that level, purchases would instantly and meaningfully increase per-share intrinsic value for Berkshire's continuing shareholders.

The unrecorded increase in the value of our owned businesses explains why Berkshire's aggregate market-value gain – tabulated on the facing page – materially exceeds our book-value gain. The two indicators vary erratically over short periods. Last year, for example, book-value performance was superior. Over time, however, market-value gains should continue their historical tendency to exceed gains in book value.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

The Year at Berkshire

Charlie Munger, Berkshire Vice Chairman and my partner, and I expect Berkshire's *normalized* earning power to increase every year. (*Actual* year-to-year earnings, of course, will sometimes decline because of weakness in the U.S. economy or, possibly, because of insurance mega-catastrophes.) In some years the normalized gains will be small; at other times they will be material. Last year was a good one. Here are the highlights:

- The most important development at Berkshire during 2015 was not financial, though it led to better earnings. After a poor performance in 2014, our BNSF railroad dramatically improved its service to customers last year. To attain that result, we invested about \$5.8 billion during the year in capital expenditures, a sum far and away the record for any American railroad and nearly three times our annual depreciation charge. It was money well spent.

BNSF moves about 17% of America's intercity freight (measured by revenue ton-miles), whether transported by rail, truck, air, water or pipeline. In that respect, we are a strong number one among the seven large American railroads (two of which are Canadian-based), carrying 45% more ton-miles of freight than our closest competitor. Consequently, our maintaining first-class service is not only vital to our shippers' welfare but also important to the smooth functioning of the U.S. economy.

For most American railroads, 2015 was a disappointing year. Aggregate ton-miles fell, and earnings weakened as well. BNSF, however, maintained volume, and pre-tax income rose to a record \$6.8 billion* (a gain of \$606 million from 2014). Matt Rose and Carl Ice, the managers of BNSF, have my thanks and deserve yours.

- BNSF is the largest of our "Powerhouse Five," a group that also includes Berkshire Hathaway Energy, Marmon, Lubrizol and IMC. Combined, these companies – our five most profitable non-insurance businesses – earned \$13.1 billion in 2015, an increase of \$650 million over 2014.

Of the five, only Berkshire Hathaway Energy, then earning \$393 million, was owned by us in 2003. Subsequently, we purchased three of the other four on an all-cash basis. In acquiring BNSF, however, we paid about 70% of the cost in cash and, for the remainder, issued Berkshire shares that increased the number outstanding by 6.1%. In other words, the \$12.7 billion gain in annual earnings delivered Berkshire by the five companies over the twelve-year span has been accompanied by only minor dilution. That satisfies our goal of not simply increasing earnings, but making sure we also increase *per-share* results.

- Next year, I will be discussing the "Powerhouse Six." The newcomer will be Precision Castparts Corp. ("PCC"), a business that we purchased a month ago for more than \$32 billion of cash. PCC fits perfectly into the Berkshire model and will substantially increase our *normalized* per-share earning power.

Under CEO Mark Donegan, PCC has become the world's premier supplier of aerospace components (most of them destined to be original equipment, though spares are important to the company as well). Mark's accomplishments remind me of the magic regularly performed by Jacob Harpaz at IMC, our remarkable Israeli manufacturer of cutting tools. The two men transform very ordinary raw materials into extraordinary products that are used by major manufacturers worldwide. Each is the da Vinci of his craft.

PCC's products, often delivered under multi-year contracts, are key components in most large aircraft. Other industries are served as well by the company's 30,466 employees, who work out of 162 plants in 13 countries. In building his business, Mark has made many acquisitions and will make more. We look forward to having him deploy Berkshire's capital.

* Throughout this letter, all earnings are stated on a pre-tax basis unless otherwise designated.

A personal thank-you: The PCC acquisition would not have happened without the input and assistance of our own Todd Combs, who brought the company to my attention a few years ago and went on to educate me about both the business and Mark. Though Todd and Ted Weschler are primarily investment managers – they each handle about \$9 billion for us – both of them cheerfully and ably add major value to Berkshire in other ways as well. Hiring these two was one of my best moves.

- With the PCC acquisition, Berkshire will own 10 ¼ companies that would populate the Fortune 500 if they were stand-alone businesses. (Our 27% holding of Kraft Heinz is the ¼.) That leaves just under 98% of America's business giants that have yet to call us. Operators are standing by.
- Our many dozens of smaller non-insurance businesses earned \$5.7 billion last year, up from \$5.1 billion in 2014. Within this group, we have one company that last year earned more than \$700 million, two that earned between \$400 million and \$700 million, seven that earned between \$250 million and \$400 million, six that earned between \$100 million and \$250 million, and eleven that earned between \$50 million and \$100 million. We love them all: This collection of businesses will expand both in number and earnings as the years go by.
- When you hear talk about America's crumbling infrastructure, rest assured that they're not talking about Berkshire. We invested \$16 billion in property, plant and equipment last year, a full 86% of it deployed in the United States.

I told you earlier about BNSF's record capital expenditures in 2015. At the end of *every* year, our railroad's physical facilities will be improved from those existing twelve months earlier.

Berkshire Hathaway Energy ("BHE") is a similar story. That company has invested \$16 billion in renewables and now owns 7% of the country's wind generation and 6% of its solar generation. Indeed, the 4,423 megawatts of wind generation owned and operated by our regulated utilities is *six* times the generation of the runner-up utility.

We're not done. Last year, BHE made major commitments to the future development of renewables in support of the Paris Climate Change Conference. Our fulfilling those promises will make great sense, both for the environment and for Berkshire's economics.

- Berkshire's huge and growing insurance operation again operated at an underwriting profit in 2015 – that makes 13 years in a row – and increased its float. During those years, our float – money that doesn't belong to us but that we can invest for Berkshire's benefit – grew from \$41 billion to \$88 billion. Though neither that gain nor the size of our float is reflected in Berkshire's earnings, float generates significant investment income because of the assets it allows us to hold.

Meanwhile, our underwriting profit totaled \$26 billion during the 13-year period, including \$1.8 billion earned in 2015. Without a doubt, Berkshire's largest unrecorded wealth lies in its insurance business. We've spent 48 years building this multi-faceted operation, and it can't be replicated.

- While Charlie and I search for new businesses to buy, our many subsidiaries are regularly making bolt-on acquisitions. Last year we contracted for 29 bolt-ons, scheduled to cost \$634 million in aggregate. The cost of these purchases ranged from \$300,000 to \$143 million.

Charlie and I encourage bolt-ons, *if* they are sensibly-priced. (Most deals offered us most definitely aren't.) These purchases deploy capital in operations that fit with our existing businesses and that will be managed by our corps of expert managers. That means no additional work for us, yet more earnings for Berkshire, a combination we find highly appealing. We will make many dozens of bolt-on deals in future years.

- Our Heinz partnership with Jorge Paulo Lemann, Alex Behring and Bernardo Hees more than doubled its size last year by merging with Kraft. Before this transaction, we owned about 53% of Heinz at a cost of \$4.25 billion. Now we own 325.4 million shares of Kraft Heinz (about 27%) that cost us \$9.8 billion. The new company has annual sales of \$27 billion and can supply you Heinz ketchup or mustard to go with your Oscar Mayer hot dogs that come from the Kraft side. Add a Coke, and you will be enjoying my favorite meal. (We will have the Oscar Mayer Wienermobile at the annual meeting – bring your kids.)

Though we sold no Kraft Heinz shares, “GAAP” (Generally Accepted Accounting Principles) required us to record a \$6.8 billion write-up of our investment upon completion of the merger. That leaves us with our Kraft Heinz holding carried on our balance sheet at a value many billions above our cost and many billions below its market value, an outcome only an accountant could love.

Berkshire also owns Kraft Heinz preferred shares that pay us \$720 million annually and are carried at \$7.7 billion on our balance sheet. That holding will almost certainly be redeemed for \$8.32 billion in June (the earliest date allowed under the preferred’s terms). That will be good news for Kraft Heinz and bad news for Berkshire.

Jorge Paulo and his associates could not be better partners. We share with them a passion to buy, build and *hold* large businesses that satisfy basic needs and desires. We follow different paths, however, in pursuing this goal.

Their method, at which they have been extraordinarily successful, is to buy companies that offer an opportunity for eliminating many unnecessary costs and then – *very promptly* – to make the moves that will get the job done. Their actions significantly boost productivity, the all-important factor in America’s economic growth over the past 240 years. Without more output of desired goods and services per working hour – that’s the measure of productivity gains – an economy inevitably stagnates. At much of corporate America, truly major gains in productivity are possible, a fact offering opportunities to Jorge Paulo and his associates.

At Berkshire, we, too, crave efficiency and detest bureaucracy. To achieve our goals, however, we follow an approach emphasizing *avoidance* of bloat, buying businesses such as PCC that have long been run by cost-conscious and efficient managers. After the purchase, *our* role is simply to create an environment in which these CEOs – and their eventual successors, who typically are like-minded – can maximize both their managerial effectiveness and the pleasure they derive from their jobs. (With this hands-off style, I am heeding a well-known Mungerism: “If you want to guarantee yourself a lifetime of misery, be sure to marry someone with the intent of changing their behavior.”)

We will continue to operate with extreme – indeed, almost unheard of – decentralization at Berkshire. But we will also look for opportunities to partner with Jorge Paulo, either as a financing partner, as was the case when his group purchased Tim Horton’s, or as a combined equity-and-financing partner, as at Heinz. We also may occasionally partner with others, as we have successfully done at Berkadia.

Berkshire, however, will join only with partners making friendly acquisitions. To be sure, certain hostile offers are justified: Some CEOs forget that it is shareholders for whom they should be working, while other managers are woefully inept. In either case, directors may be blind to the problem or simply reluctant to make the change required. That’s when new faces are needed. We, though, will leave these “opportunities” for others. At Berkshire, we go only where we are welcome.

- Berkshire increased its ownership interest last year in each of its “Big Four” investments – American Express, Coca-Cola, IBM and Wells Fargo. We purchased additional shares of IBM (increasing our ownership to 8.4% versus 7.8% at yearend 2014) and Wells Fargo (going to 9.8% from 9.4%). At the other two companies, Coca-Cola and American Express, stock repurchases raised our percentage ownership. Our equity in Coca-Cola grew from 9.2% to 9.3%, and our interest in American Express increased from 14.8% to 15.6%. In case you think these seemingly small changes aren’t important, consider this math: For the four companies in aggregate, each increase of one percentage point in our ownership raises Berkshire’s portion of their annual earnings by about \$500 million.

These four investees possess excellent businesses and are run by managers who are both talented and shareholder-oriented. Their returns on tangible equity range from excellent to staggering. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business. It’s better to have a partial interest in the Hope Diamond than to own all of a rhinestone.

If Berkshire’s yearend holdings are used as the marker, our portion of the “Big Four’s” 2015 earnings amounted to \$4.7 billion. In the earnings we report to you, however, we include only the dividends they pay us – about \$1.8 billion last year. But make no mistake: The nearly \$3 billion of these companies’ earnings we don’t report are every bit as valuable to us as the portion Berkshire records.

The earnings our investees retain are often used for repurchases of their own stock – a move that increases Berkshire’s share of future earnings without requiring us to lay out a dime. The retained earnings of these companies also fund business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees, in aggregate, will grow substantially over time. If gains do indeed materialize, dividends to Berkshire will increase and so, too, will our unrealized capital gains.

Our flexibility in capital allocation – our willingness to invest large sums passively in non-controlled businesses – gives us a significant edge over companies that limit themselves to acquisitions they will operate. Woody Allen once explained that the advantage of being bi-sexual is that it doubles your chance of finding a date on Saturday night. In like manner – well, not exactly like manner – our appetite for either operating businesses or passive investments doubles *our* chances of finding sensible uses for Berkshire’s endless gusher of cash. Beyond that, having a huge portfolio of marketable securities gives us a stockpile of funds that can be tapped when an elephant-sized acquisition is offered to us.

* * * * *

It’s an election year, and candidates can’t stop speaking about our country’s problems (which, of course, only *they* can solve). As a result of this negative drumbeat, many Americans now believe that their children will not live as well as they themselves do.

That view is dead wrong: The babies being born in America today are the luckiest crop in history.

American GDP per capita is now about \$56,000. As I mentioned last year that – *in real terms* – is a staggering six times the amount in 1930, the year I was born, a leap far beyond the wildest dreams of my parents or their contemporaries. U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more. This all-powerful trend is certain to continue: America’s economic magic remains alive and well.

Some commentators bemoan our current 2% per year growth in real GDP – and, yes, we would all like to see a higher rate. But let’s do some simple math using the much-lamented 2% figure. That rate, we will see, delivers astounding gains.

America's population is growing about .8% per year (.5% from births minus deaths and .3% from net migration). Thus 2% of *overall* growth produces about 1.2% of *per capita* growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in *real GDP per capita*. (Compounding's effects produce the excess over the percentage that would result by simply multiplying 25 x 1.2%.) In turn, that 34.4% gain will produce a staggering \$19,000 increase in *real GDP per capita* for the next generation. Were that to be distributed equally, the gain would be \$76,000 annually for a family of four. Today's politicians need not shed tears for tomorrow's children.

Indeed, most of *today's* children are doing well. *All* families in my upper middle-class neighborhood regularly enjoy a living standard better than that achieved by John D. Rockefeller Sr. at the time of my birth. His unparalleled fortune couldn't buy what we now take for granted, whether the field is – to name just a few – transportation, entertainment, communication or medical services. Rockefeller certainly had power and fame; he could not, however, live as well as my neighbors now do.

Though the pie to be shared by the next generation will be *far* larger than today's, how it will be divided will remain fiercely contentious. Just as is now the case, there will be struggles for the increased output of goods and services between those people in their productive years and retirees, between the healthy and the infirm, between the inheritors and the Horatio Algers, between investors and workers and, in particular, between those with talents that are valued highly by the marketplace and the equally decent hard-working Americans who lack the skills the market prizes. Clashes of that sort have forever been with us – and will forever continue. Congress will be the battlefield; money and votes will be the weapons. Lobbying will remain a growth industry.

The good news, however, is that even members of the “losing” sides will almost certainly enjoy – *as they should* – far more goods and services in the future than they have in the past. The quality of their increased bounty will also dramatically improve. Nothing rivals the market system in producing what people want – nor, even more so, in delivering what people don't yet know they want. My parents, when young, could not envision a television set, nor did I, in my 50s, think I needed a personal computer. Both products, once people saw what they could do, quickly revolutionized their lives. I now spend ten hours a week playing bridge online. And, as I write this letter, “search” is invaluable to me. (I'm not ready for Tinder, however.)

For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did.

* * * * *

Considering this favorable tailwind, Berkshire (and, to be sure, a great many other businesses) will almost certainly prosper. The managers who succeed Charlie and me will build Berkshire's per-share intrinsic value by following our simple blueprint of: (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. Management will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (nor, in fact, for any other stock). It is possible, however, to make a sensible estimate. In our 2010 annual report we laid out the three elements – one of them qualitative – that we believe are the keys to an estimation of Berkshire’s intrinsic value. That discussion is reproduced in full on pages 113-114.

Here is an update of the two quantitative factors: In 2015 our per-share cash and investments increased 8.3% to \$159,794 (with our Kraft Heinz shares stated at market value), and earnings from our many businesses – *including insurance underwriting income* – increased 2.1% to \$12,304 per share. We exclude in the second factor the dividends and interest from the investments we hold because including them would produce a double-counting of value. In arriving at our earnings figure, we deduct all corporate overhead, interest, depreciation, amortization and minority interests. Income taxes, though, are not deducted. That is, the earnings are pre-tax.

I used the italics in the paragraph above because we are for the first time including insurance underwriting income in business earnings. We did not do that when we initially introduced Berkshire’s two quantitative pillars of valuation because our insurance results were then heavily influenced by catastrophe coverages. If the wind didn’t blow and the earth didn’t shake, we made large profits. But a mega-catastrophe would produce red ink. In order to be conservative then in stating our business earnings, we consistently assumed that underwriting would break even over time and ignored any of its gains or losses in our annual calculation of the second factor of value.

Today, our insurance results are likely to be more stable than was the case a decade or two ago because we have deemphasized catastrophe coverages and greatly expanded our bread-and-butter lines of business. Last year, our underwriting income contributed \$1,118 per share to the \$12,304 per share of earnings referenced in the second paragraph of this section. Over the past decade, annual underwriting income has averaged \$1,434 per share, and we anticipate being profitable in most years. You should recognize, however, that underwriting in any given year could well be unprofitable, perhaps substantially so.

Since 1970, our per-share investments have increased at a rate of 18.9% compounded annually, and our earnings (*including* the underwriting results in both the initial and terminal year) have grown at a 23.7% clip. It is no coincidence that the price of Berkshire stock over the ensuing 45 years has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both sectors, but our main goal is to build operating earnings.

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Now, let’s examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. So we’ll present them as four separate businesses, which is how Charlie and I view them (though there are important and *enduring* economic advantages to having them all under one roof). Our intent is to provide you with the information we would wish to have if our positions were reversed, with you being the reporting manager and we the absentee shareholders. (Don’t get excited; this is not a switch we are considering.)

Insurance

Let’s look first at insurance. The property-casualty (“P/C”) branch of that industry has been the engine that has propelled our expansion since 1967, when we acquired National Indemnity and its sister company, National Fire & Marine, for \$8.6 million. Today, National Indemnity is the largest property-casualty company in the world, as measured by net worth. Moreover, its intrinsic value is *far* in excess of the value at which it is carried on our books.

One reason we were attracted to the P/C business was its financial characteristics: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over many decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call “float” – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

<i>Year</i>	<i>Float (in millions)</i>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2015	87,722

Further gains in float will be tough to achieve. On the plus side, GEICO and several of our specialized operations are almost certain to grow at a good clip. National Indemnity's reinsurance division, however, is party to a number of run-off contracts whose float drifts downward. If we do in time experience a decline in float, it will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. This structure is by design and is a key component in the strength of Berkshire's economic fortress. It will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it sometimes causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses. The prolonged period of low interest rates the world is now dealing with also virtually guarantees that earnings on float will steadily decrease for many years to come, thereby exacerbating the profit problems of insurers. It's a good bet that industry results over the next ten years will fall short of those recorded in the past decade, particularly for those companies that specialize in reinsurance.

As noted early in this report, Berkshire has now operated at an underwriting profit for 13 consecutive years, our pre-tax gain for the period having totaled \$26.2 billion. That's no accident: Disciplined risk evaluation is the daily focus of *all* of our insurance managers, who know that while float is valuable, its benefits can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a *liability*, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as strictly a liability is incorrect. It should instead be viewed as a revolving fund. Daily, we pay old claims and related expenses – a huge \$24.5 billion to more than six million claimants in 2015 – and that reduces float. Just as surely, we each day write new business that will soon generate its own claims, adding to float.

If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability. Owing \$1 that in effect will never leave the premises – because new business is almost certain to deliver a substitute – is worlds different from owing \$1 that will go out the door tomorrow and not be replaced. The two types of liabilities, however, are treated as equals under GAAP.

A partial offset to this overstated liability is a \$15.5 billion “goodwill” asset that we incurred in buying our insurance companies and that increases book value. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, *any* goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay for float of *similar quality* were we to purchase an insurance operation possessing it – to be *far* in excess of its historic carrying value. Indeed, almost the entire \$15.5 billion we carry for goodwill in our insurance business was already on our books in 2000. Yet we subsequently *tripled* our float. Its value today is one reason – a huge reason – why we believe Berkshire’s intrinsic business value substantially exceeds its book value.

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Berkshire’s attractive insurance economics exist only because we have some terrific managers running disciplined operations that possess hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources.

Indeed, Berkshire is *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a \$250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because of its many streams of earnings. We would also remain awash in cash and be looking for large opportunities to write business in an insurance market that might well be in disarray. Meanwhile, other major insurers and reinsurers would be swimming in red ink, if not facing insolvency.

When Ajit entered Berkshire’s office on a Saturday in 1986, he did not have a day’s experience in the insurance business. Nevertheless, Mike Goldberg, then our manager of insurance, handed him the keys to our reinsurance business. With that move, Mike achieved sainthood: Since then, Ajit has created tens of billions of value for Berkshire shareholders.

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We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can’t be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been considerably better than cost-free under his leadership, and we expect that, on average, to continue. We are particularly enthusiastic about General Re's international life reinsurance business, which has grown consistently and profitably since we acquired the company in 1998.

It can be remembered that soon after we purchased General Re, it was beset by problems that caused commentators – and me as well, briefly – to believe I had made a huge mistake. That day is long gone. General Re is now a gem.

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Finally, there is GEICO, the insurer on which I cut my teeth 65 years ago. GEICO is managed by Tony Nicely, who joined the company at 18 and completed 54 years of service in 2015. Tony became CEO in 1993, and since then the company has been flying. There is *no* better manager than Tony. In the 40 years that I've known him, his every action has made great sense.

When I was first introduced to GEICO in January 1951, I was blown away by the huge cost advantage the company enjoyed compared to the expenses borne by the giants of the industry. It was clear to me that GEICO would succeed because it *deserved* to succeed.

No one *likes* to buy auto insurance. Almost everyone, though, likes to drive. The insurance consequently needed is a major expenditure for most families. Savings matter to them – and *only* a low-cost operation can deliver these. Indeed, at least 40% of the people reading this letter can save money by insuring with GEICO. So stop reading – right now! – and go to geico.com or call 800-368-2734.

GEICO's cost advantage is the factor that has enabled the company to gobble up market share year after year. (We ended 2015 with 11.4% of the market compared to 2.5% in 1995, when Berkshire acquired control of GEICO.) The company's low costs create a moat – an *enduring* one – that competitors are unable to cross.

All the while, our gecko never tires of telling Americans how GEICO can save them important money. I love hearing the little guy deliver his message: "15 minutes could save you 15% or more on car insurance." (Of course, there's always a grouch in the crowd. One of my friends says he is glad that only a few animals can talk, since the ones that do speak seem unable to discuss any subject but insurance.)

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In addition to our three major insurance operations, we own a group of smaller companies that primarily write commercial coverages. In aggregate, these companies are a large, growing and valuable operation that consistently delivers an underwriting profit, usually much better than that reported by their competitors. Indeed, over the past 13 years, this group has earned \$4 billion from underwriting – about 13% of its premium volume – while increasing its float from \$943 million to \$9.9 billion.

Less than three years ago, we formed Berkshire Hathaway Specialty Insurance ("BHSI"), which we include in this group. Our first decision was to put Peter Eastwood in charge. That move was a home run: BHSI has already developed \$1 billion of annual premium volume and, under Peter's direction, is destined to become one of the world's leading P/C insurers.

Here's a recap of underwriting earnings and float by division:

<i>Insurance Operations</i>	<i>Underwriting Profit</i> <i>(in millions)</i>		<i>Yearend Float</i>	
	<i>2015</i>	<i>2014</i>	<i>2015</i>	<i>2014</i>
BH Reinsurance	\$ 421	\$ 606	\$ 44,108	\$ 42,454
General Re	132	277	18,560	19,280
GEICO	460	1,159	15,148	13,569
Other Primary	824	626	9,906	8,618
	<u>\$ 1,837</u>	<u>\$ 2,668</u>	<u>\$ 87,722</u>	<u>\$ 83,921</u>

Berkshire's great managers, premier financial strength and a variety of business models protected by wide moats amount to something unique in the insurance world. This assemblage of strengths is a huge asset for Berkshire shareholders that will only get more valuable with time.

Regulated, Capital-Intensive Businesses

We have two major operations, BNSF and BHE, that share important characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement. Together, they last year accounted for 37% of Berkshire's after-tax operating earnings.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions would far exceed its interest requirements. Last year, for example, in a disappointing year for railroads, BNSF's interest coverage was more than 8:1. (Our definition of coverage is the ratio of earnings before interest and taxes to interest, *not* EBITDA/interest, a commonly used measure we view as seriously flawed.)

At BHE, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies offering an essential service on an exclusive basis. The second is enjoyed by few other utilities: a great and ever-widening diversity of earnings streams, which shield BHE from being seriously harmed by any single regulatory body. These many sources of profit, supplemented by the inherent advantage of being owned by a strong parent, have allowed BHE and its utility subsidiaries to significantly lower their cost of debt. This economic fact benefits both us *and* our customers.

All told, BHE and BNSF invested \$11.6 billion in plant and equipment last year, a massive commitment to key components of America's infrastructure. We relish making such investments as long as they promise reasonable returns – and, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need huge investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is concomitantly in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Low prices are a powerful way to keep these constituencies happy. In Iowa, BHE's average retail rate is 6.8¢ per KWH. Alliant, the other major electric utility in the state, averages 9.5¢. Here are the comparable industry figures for adjacent states: Nebraska 9.0¢, Missouri 9.3¢, Illinois 9.3¢, Minnesota 9.7¢. The national average is 10.4¢. Our rock-bottom prices add up to real money for paycheck-strapped customers.

At BNSF, price comparisons between major railroads are far more difficult to make because of significant differences in both their mix of cargo and the average distance it is carried. To supply a *very* crude measure, however, our revenue per ton-mile was just under 3¢ last year, while shipping costs for customers of the other four major U.S.-based railroads were at least 40% higher, ranging from 4.2¢ to 5.3¢.

Both BHE and BNSF have been leaders in pursuing planet-friendly technology. In wind generation, no state comes close to Iowa, where last year megawatt-hours we generated from wind equaled 47% of all megawatt-hours sold to our retail customers. (Additional wind projects to which we are committed will take that figure to 58% in 2017.)

BNSF, like other Class I railroads, uses only a single gallon of diesel fuel to move a ton of freight almost 500 miles. That makes the railroads four times as fuel-efficient as trucks! Furthermore, railroads alleviate highway congestion – and the taxpayer-funded maintenance expenditures that come with heavier traffic – in a major way.

Here are the key figures for BHE and BNSF:

<i>Berkshire Hathaway Energy (89.9% owned)</i>	<i>Earnings (in millions)</i>		
	<i>2015</i>	<i>2014</i>	<i>2013</i>
U.K. utilities	\$ 460	\$ 527	\$ 362
Iowa utility	314	298	230
Nevada utilities	586	549	(58)
PacifiCorp (primarily Oregon and Utah)	1,026	1,010	982
Gas pipelines (Northern Natural and Kern River)	401	379	385
Canadian transmission utility	170	16	—
Renewable projects	175	194	50
HomeServices	191	139	139
Other (net)	27	26	12
Operating earnings before corporate interest and taxes	3,350	3,138	2,102
Interest	499	427	296
Income taxes	481	616	170
Net earnings	<u>\$ 2,370</u>	<u>\$ 2,095</u>	<u>\$ 1,636</u>
Earnings applicable to Berkshire	<u>\$ 2,132</u>	<u>\$ 1,882</u>	<u>\$ 1,470</u>

<i>BNSF</i>	<i>Earnings (in millions)</i>		
	<i>2015</i>	<i>2014</i>	<i>2013</i>
Revenues	\$ 21,967	\$ 23,239	\$ 22,014
Operating expenses	14,264	16,237	15,357
Operating earnings before interest and taxes	7,703	7,002	6,657
Interest (net)	928	833	729
Income taxes	2,527	2,300	2,135
Net earnings	<u>\$ 4,248</u>	<u>\$ 3,869</u>	<u>\$ 3,793</u>

I currently expect increased after-tax earnings at BHE in 2016, but lower earnings at BNSF.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/15 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 6,807	Notes payable	\$ 2,135
Accounts and notes receivable	8,886	Other current liabilities	10,565
Inventory	11,916	Total current liabilities	12,700
Other current assets	<u>970</u>		
Total current assets	28,579		
Goodwill and other intangibles	30,289	Deferred taxes	3,649
Fixed assets	15,161	Term debt and other liabilities	4,767
Other assets	<u>4,445</u>	Non-controlling interests	521
		Berkshire equity	56,837
	<u>\$ 78,474</u>		<u>\$ 78,474</u>

Earnings Statement (in millions)

	<u>2015</u>	<u>2014</u>	<u>2013*</u>
Revenues	\$107,825	\$ 97,689	\$ 93,472
Operating expenses	100,607	90,788	87,208
Interest expense	<u>103</u>	<u>109</u>	<u>104</u>
Pre-tax earnings	7,115	6,792	6,160
Income taxes and non-controlling interests	<u>2,432</u>	<u>2,324</u>	<u>2,283</u>
Net earnings	<u>\$ 4,683</u>	<u>\$ 4,468</u>	<u>\$ 3,877</u>

* Earnings for 2013 have been restated to exclude Marmon's leasing operations, which are now included in the Finance and Financial Products results.

Our income and expense data conforming to GAAP is on page 38. In contrast, the operating expense figures above are non-GAAP because they exclude some purchase-accounting items (primarily the amortization of certain intangible assets). We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the true economic expenses and profits of the businesses aggregated in the table than do GAAP figures.

I won't explain all of the adjustments – some are tiny and arcane – but serious investors should understand the disparate nature of intangible assets. Some truly deplete in value over time, while others *in no way* lose value. For software, as a big example, amortization charges are very real expenses. Conversely, the concept of recording charges against other intangibles, such as customer relationships, arises from purchase-accounting rules and clearly does not reflect economic reality. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when earnings are calculated – even though, from an investor's viewpoint, they could not differ more.

In the GAAP-compliant figures we show on page 38, amortization charges of \$1.1 billion have been deducted as expenses. We would call about 20% of these “real,” the rest not. The “non-real” charges, once nonexistent at Berkshire, have become significant because of the many acquisitions we have made. Non-real amortization charges are likely to climb further as we acquire more companies.

The table on page 55 gives you the current status of our intangible assets as calculated by GAAP. We now have \$6.8 billion left of amortizable intangibles, of which \$4.1 billion will be expensed over the next five years. Eventually, of course, every dollar of these “assets” will be charged off. When that happens, reported earnings increase even if true earnings are flat. (My gift to my successor.)

I suggest that you ignore a portion of GAAP amortization costs. But it is with some trepidation that I do that, knowing that it has become common for managers to tell their owners to ignore certain expense items that are all too real. “Stock-based compensation” is the most egregious example. The very name says it all: “compensation.” If compensation isn’t an expense, what is it? And, if real and recurring expenses don’t belong in the calculation of earnings, where in the world do they belong?

Wall Street analysts often play their part in this charade, too, parroting the phony, compensation-ignoring “earnings” figures fed them by managements. Maybe the offending analysts don’t know any better. Or maybe they fear losing “access” to management. Or maybe they are cynical, telling themselves that since everyone else is playing the game, why shouldn’t they go along with it. Whatever their reasoning, these analysts are guilty of propagating misleading numbers that can deceive investors.

Depreciation charges are a more complicated subject but are almost always true costs. Certainly they are at Berkshire. I wish we could keep our businesses competitive while spending less than our depreciation charge, but in 51 years I’ve yet to figure out how to do so. Indeed, the depreciation charge we record in our railroad business falls far short of the capital outlays needed to merely keep the railroad running properly, a mismatch that leads to GAAP earnings that are higher than true economic earnings. (This overstatement of earnings exists at all railroads.) When CEOs or investment bankers tout pre-depreciation figures such as EBITDA as a valuation guide, watch their noses lengthen while they speak.

Our public reports of earnings will, of course, continue to conform to GAAP. To embrace reality, however, you should remember to add back most of the amortization charges we report. You should also subtract something to reflect BNSF’s inadequate depreciation charge.

* * * * *

Let’s get back to our many manufacturing, service and retailing operations, which sell products ranging from lollipops to jet airplanes. Some of this sector’s businesses, measured by earnings on unleveraged net *tangible* assets, enjoy terrific economics, producing profits that run from 25% after-tax to far more than 100%. Others generate good returns in the area of 12% to 20%.

A few, however – these are serious mistakes I made in my job of capital allocation – have very poor returns. In most of these cases, I was wrong in my evaluation of the economic dynamics of the company or the industry in which it operates, and we are now paying the price for my misjudgments. At other times, I stumbled in evaluating either the fidelity or the ability of incumbent managers or ones I later appointed. I will commit more errors; you can count on that. If we luck out, they will occur at our smaller operations.

Viewed as a single entity, the companies in this group are an excellent business. They employed an average of \$25.6 billion of net tangible assets during 2015 and, despite their holding large quantities of excess cash and using only token amounts of leverage, earned 18.4% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if it is bought at too high a price. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for goodwill and other intangibles. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Earnings from the group should grow substantially in 2016 as Duracell and Precision Castparts enter the fold.

* * * * *

We have far too many companies in this group to comment on them individually. Moreover, their competitors – both current and potential – read this report. In a few of our businesses we might be disadvantaged if others knew our numbers. In some of our operations that are not of a size material to an evaluation of Berkshire, therefore, we only disclose what is required. You can nevertheless find a good bit of detail about many of our operations on pages 88-91.

Finance and Financial Products

Our three leasing and rental operations are conducted by CORT (furniture), XTRA (semi-trailers), and Marmon (primarily tank cars but also freight cars, intermodal tank containers and cranes). These companies are industry leaders and have substantially increased their earnings as the American economy has gained strength. At each of the three, we have invested more money in new equipment than have many of our competitors, and that's paid off. Dealing from strength is one of Berkshire's enduring advantages.

Kevin Clayton has again delivered an industry-leading performance at Clayton Homes, the second-largest home builder in America. Last year, the company sold 34,397 homes, about 45% of the manufactured homes bought by Americans. In contrast, the company was number three in the field, with a 14% share, when Berkshire purchased it in 2003.

Manufactured homes allow the American dream of home ownership to be achieved by lower-income citizens: Around 70% of new homes costing \$150,000 or less come from our industry. About 46% of Clayton's homes are sold through the 331 stores we ourselves own and operate. Most of Clayton's remaining sales are made to 1,395 independent retailers.

Key to Clayton's operation is its \$12.8 billion mortgage portfolio. We originate about 35% of *all* mortgages on manufactured homes. About 37% of our mortgage portfolio emanates from our retail operation, with the balance primarily originated by independent retailers, some of which sell our homes while others market only the homes of our competitors.

Lenders other than Clayton have come and gone. With Berkshire's backing, however, Clayton steadfastly financed home buyers throughout the panic days of 2008-2009. Indeed, during that period, Clayton used precious capital to finance dealers who did *not* sell our homes. The funds we supplied to Goldman Sachs and General Electric at that time produced headlines; the funds Berkshire quietly delivered to Clayton both made home ownership possible for thousands of families and kept many non-Clayton dealers alive.

Our retail outlets, employing simple language and large type, consistently inform home buyers of alternative sources for financing – most of it coming from local banks – and always secure acknowledgments from customers that this information has been received and read. (The form we use is reproduced in its actual size on page 119.)

Mortgage-origination practices are of great importance to both the borrower and to society. There is no question that reckless practices in home lending played a major role in bringing on the financial panic of 2008, which in turn led to the Great Recession. In the years preceding the meltdown, a destructive and often corrupt pattern of mortgage creation flourished whereby (1) an originator in, say, California would make loans and (2) promptly sell them to an investment or commercial bank in, say, New York, which would package many mortgages to serve as collateral for a dizzyingly complicated array of mortgage-backed securities to be (3) sold to unwitting institutions around the world.

As if these sins weren't sufficient to create an unholy mess, imaginative investment bankers sometimes concocted a second layer of sliced-up financing whose value depended on the junkier portions of primary offerings. (When Wall Street gets "innovative," watch out!) While that was going on, I described this "doubling-up" practice as requiring an investor to read tens of thousands of pages of mind-numbing prose to evaluate a single security being offered.

Both the originator and the packager of these financings had no skin in the game and were driven by volume and mark-ups. Many housing borrowers joined the party as well, blatantly lying on their loan applications while mortgage originators looked the other way. Naturally, the gamiest credits generated the most profits. Smooth Wall Street salesmen garnered millions annually by manufacturing products that their customers were unable to understand. (It's also questionable as to whether the major rating agencies were capable of evaluating the more complex structures. But rate them they did.)

Barney Frank, perhaps the most financially-savvy member of Congress during the panic, recently assessed the 2010 Dodd-Frank Act, saying, "The one major weakness that I've seen in the implementation was this decision by the regulators not to impose risk retention on all residential mortgages." Today, some legislators and commentators continue to advocate a 1%-to-5% retention by the originator as a way to align its interests with that of the ultimate lender or mortgage guarantor.

At Clayton, our risk retention was, and is, 100%. When we originate a mortgage we keep it (leaving aside the few that qualify for a government guarantee). When we make mistakes in granting credit, we therefore pay a price – a hefty price that dwarfs any profit we realized upon the original sale of the home. Last year we had to foreclose on 8,444 manufactured-housing mortgages at a cost to us of \$157 million.

The average loan we made in 2015 was only \$59,942, small potatoes for traditional mortgage lenders, but a daunting commitment for our many lower-income borrowers. Our buyer acquires a decent home – take a look at the home we will have on display at our annual meeting – requiring monthly principal-and-interest payments that average \$522.

Some borrowers, of course, will lose their jobs, and there will be divorces and deaths. Others will get overextended on credit cards and mishandle their finances. We will lose money then, and our borrower will lose his down payment (though his mortgage payments during his time of occupancy may have been well under rental rates for comparable quarters). Nevertheless, despite the low FICO scores and income of our borrowers, their payment behavior during the Great Recession was *far* better than that prevailing in many mortgage pools populated by people earning multiples of our typical borrower's income.

The strong desire of our borrowers to have a home of their own is one reason we've done well with our mortgage portfolio. Equally important, we have financed much of the portfolio with floating-rate debt or with short-term fixed-rate debt. Consequently, the incredibly low short-term rates of recent years have provided us a constantly-widening spread between our interest costs and the income we derive from our mortgage portfolio, which bears fixed rates. (Incidentally, we would have enjoyed similar margins had we simply bought long-term bonds and financed the position in some short-term manner.)

Normally, it is risky business to lend long at fixed rates and borrow short as we have been doing at Clayton. Over the years, some important financial institutions have gone broke doing that. At Berkshire, however, we possess a natural offset in that our businesses always maintain at least \$20 billion in cash-equivalents that *earn* short-term rates. More often, our short-term investments are in the \$40 billion to \$60 billion range. If we have, say, \$60 billion invested at 1/4% or less, a sharp move to higher short-term rates would bring benefits to us far exceeding the higher financing costs we would incur in funding Clayton's \$13 billion mortgage portfolio. In banking terms, Berkshire is – and always will be – heavily asset-sensitive and will consequently benefit from rising interest rates.

Let me talk about one subject of which I am particularly proud, that having to do with regulation. The Great Recession caused mortgage originators, servicers and packagers to come under intense scrutiny and to be assessed many billions of dollars in fines and penalties.

The scrutiny has certainly extended to Clayton, whose mortgage practices have been continuously reviewed and examined in respect to such items as originations, servicing, collections, advertising, compliance, and internal controls. At the federal level, we answer to the Federal Trade Commission, the Department of Housing and Urban Development and the Consumer Financial Protection Bureau. Dozens of states regulate us as well. During the past two years, indeed, various federal and state authorities (from 25 states) examined and reviewed Clayton and its mortgages on 65 occasions. The result? Our total fines during this period were \$38,200 and our refunds to customers \$704,678. Furthermore, though we had to foreclose on 2.64% of our manufactured-home mortgages last year, 95.4% of our borrowers were current on their payments at yearend, as they moved toward owning a debt-free home.

* * * * *

Marmon's rail fleet expanded to 133,220 units by yearend, a number significantly increased by the company's purchase of 25,085 cars from General Electric on September 30. If our fleet was connected to form a single train, the engine would be in Omaha and the caboose in Portland, Maine.

At yearend, 97% of our railcars were leased, with about 15-17% of the fleet coming up for renewal each year. Though "tank cars" sound like vessels carrying crude oil, only about 7% of our fleet carries that product; chemicals and refined petroleum products are the lead items we transport. When trains roll by, look for the UTLX or Procor markings that identify our tank cars. When you spot the brand, puff out your chest; you own a portion of that car.

Here's the earnings recap for this sector:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
	<u>(in millions)</u>		
Berkadia (our 50% share)	\$ 74	\$ 122	\$ 80
Clayton	706	558	416
CORT	55	49	42
Marmon – Containers and Cranes	192	238	226
Marmon – Railcars	546	442	353
XTRA	172	147	125
Net financial income*	<u>341</u>	<u>283</u>	<u>322</u>
	<u>\$ 2,086</u>	<u>\$ 1,839</u>	<u>\$ 1,564</u>

* Excludes capital gains or losses

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding because we are part of a control group and account for it on the “equity” method.

<u>Shares**</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost*</i>	<i>Market</i>
(in millions)				
151,610,700	American Express Company	15.6	\$ 1,287	\$ 10,545
46,577,138	AT&T	0.8	1,283	1,603
7,463,157	Charter Communications, Inc.	6.6	1,202	1,367
400,000,000	The Coca-Cola Company	9.3	1,299	17,184
18,513,482	DaVita HealthCare Partners Inc.	8.8	843	1,291
22,164,450	Deere & Company	7.0	1,773	1,690
11,390,582	The Goldman Sachs Group, Inc.	2.7	654	2,053
81,033,450	International Business Machines Corp.	8.4	13,791	11,152
24,669,778	Moody's Corporation	12.6	248	2,475
55,384,926	Phillips 66	10.5	4,357	4,530
52,477,678	The Procter & Gamble Company	1.9	336	4,683 ***
22,169,930	Sanofi	1.7	1,701	1,896
101,859,335	U.S. Bancorp	5.8	3,239	4,346
63,507,544	Wal-Mart Stores, Inc.	2.0	3,593	3,893
500,000,000	Wells Fargo & Company	9.8	12,730	27,180
	Others		10,276	16,450
	Total Common Stocks Carried at Market		<u>\$ 58,612</u>	<u>\$ 112,338</u>

* This is our actual purchase price and also our tax basis; GAAP “cost” differs in a few cases because of write-ups or write-downs that have been required under GAAP rules.

** Excludes shares held by pension funds of Berkshire subsidiaries.

*** Held under contract of sale for this amount.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for \$5 billion. At yearend these shares were worth \$11.8 billion. We are likely to purchase them just before expiration of our option and, if we wish, we can use our \$5 billion of Bank of America 6% preferred to fund the purchase. In the meantime, it is important for you to realize that Bank of America is, in effect, our fourth largest equity investment – and one we value highly.

Productivity and Prosperity

Earlier, I told you how our partners at Kraft Heinz root out inefficiencies, thereby increasing output per hour of employment. That kind of improvement has been the secret sauce of America's remarkable gains in living standards since the nation's founding in 1776. Unfortunately, the label of "secret" is appropriate: Too few Americans fully grasp the linkage between productivity and prosperity. To see that connection, let's look first at the country's most dramatic example – farming – and later examine three Berkshire-specific areas.

In 1900, America's civilian work force numbered 28 million. Of these, 11 million, a staggering 40% of the total, worked in farming. The leading crop then, as now, was corn. About 90 million acres were devoted to its production and the yield per acre was 30 bushels, for a total output of 2.7 billion bushels annually.

Then came the tractor and one innovation after another that revolutionized such keys to farm productivity as planting, harvesting, irrigation, fertilization and seed quality. Today, we devote about 85 million acres to corn. Productivity, however, has improved yields to more than 150 bushels per acre, for an annual output of 13-14 billion bushels. Farmers have made similar gains with other products.

Increased yields, though, are only half the story: The huge increases in physical output have been accompanied by a dramatic reduction in the number of farm laborers ("human input"). Today about three million people work on farms, a tiny 2% of our 158-million-person work force. Thus, improved farming methods have allowed tens of millions of present-day workers to utilize their time and talents in other endeavors, a reallocation of human resources that enables Americans of today to enjoy huge quantities of *non-farm* goods and services they would otherwise lack.

It's easy to look back over the 115-year span and realize how extraordinarily beneficial agricultural innovations have been – not just for farmers but, more broadly, for our entire society. We would not have anything close to the America we now know had we stifled those improvements in productivity. (It was fortunate that horses couldn't vote.) On a day-to-day basis, however, talk of the "greater good" must have rung hollow to farm hands who lost their jobs to machines that performed routine tasks far more efficiently than humans ever could. We will examine this flip-side to productivity gains later in this section.

For the moment, however, let's move on to three stories of efficiencies that have had major consequences for Berkshire subsidiaries. Similar transformations have been commonplace throughout American business.

- In 1947, shortly after the end of World War II, the American workforce totaled 44 million. About 1.35 million workers were employed in the railroad industry. The revenue ton-miles of freight moved by Class I railroads that year totaled 655 billion.

By 2014, Class I railroads carried 1.85 trillion ton-miles, an increase of 182%, while employing only 187,000 workers, a reduction of 86% since 1947. (Some of this change involved passenger-related employees, but most of the workforce reduction came on the freight side.) As a result of this staggering improvement in productivity, the inflation-adjusted price for moving a ton-mile of freight has fallen by 55% since 1947, a drop saving shippers about \$90 billion *annually* in current dollars.

Another startling statistic: If it took as many people now to move freight as it did in 1947, we would need well over three million railroad workers to handle present volumes. (Of course, that level of employment would raise freight charges by a lot; consequently, nothing close to today's volume would actually move.)

Our own BNSF was formed in 1995 by a merger between Burlington Northern and Santa Fe. In 1996, the merged company's first full year of operation, 411 million ton-miles of freight were transported by 45,000 employees. Last year the comparable figures were 702 million ton-miles (plus 71%) and 47,000 employees (plus only 4%). That dramatic gain in productivity benefits both owners and shippers. Safety at BNSF has improved as well: Reportable injuries were 2.04 per 200,000 man-hours in 1996 and have since fallen more than 50% to 0.95.

- A bit more than a century ago, the auto was invented, and around it formed an industry that insures cars and their drivers. Initially, this business was written through traditional insurance agencies – the kind dealing in fire insurance. This agency-centric approach included high commissions and other underwriting expenses that consumed about 40¢ of the premium dollar. Strong local agencies were then in the driver's seat because they represented multiple insurers and could play one company off against another when commissions were being negotiated. Cartel-like pricing prevailed, and all involved were doing fine – except for the consumer.

And then some American ingenuity came into play: G. J. Mecherle, a farmer from Merna, Illinois, came up with the idea of a captive sales force that would sell the insurance products of only a single company. His baby was christened State Farm Mutual. The company cut commissions and expenses – moves that permitted lower prices – and soon became a powerhouse. For many decades, State Farm has been the runaway volume leader in both auto and homeowner's insurance. Allstate, which also operated with a direct distribution model, was long the runner-up. Both State Farm and Allstate have had underwriting expenses of about 25%.

In the early 1930s, another contender, United Services Auto Association ("USAA"), a mutual-like company, was writing auto insurance for military officers on a direct-to-the-customer basis. This marketing innovation rose from a need that military personnel had to buy insurance that would stay with them as they moved from base to base. That was business of little interest to local insurance agencies, which wanted the steady renewals that came from permanent residents.

The direct distribution method of USAA, as it happened, incurred lower costs than those enjoyed by State Farm and Allstate and therefore delivered an even greater bargain to customers. That made Leo and Lillian Goodwin, employees of USAA, dream of broadening the target market for its direct distribution model beyond military officers. In 1936, starting with \$100,000 of capital, they incorporated Government Employees Insurance Co. (later compressing this mouthful to GEICO).

Their fledgling did \$238,000 of auto insurance business in 1937, its first full year. Last year GEICO did \$22.6 billion, more than double the volume of USAA. (Though the early bird gets the worm, the second mouse gets the cheese.) GEICO's underwriting expenses in 2015 were 14.7% of premiums, with USAA being the only large company to achieve a lower percentage. (GEICO is fully as efficient as USAA but spends considerably more on advertising aimed at promoting growth.)

With the price advantage GEICO's low costs allow, it's not surprising that several years ago the company seized the number two spot in auto insurance from Allstate. GEICO is also gaining ground on State Farm, though it is still far ahead of us in volume. On August 30, 2030 – my 100th birthday – I plan to announce that GEICO has taken over the top spot. Mark your calendar.

GEICO employs about 34,000 people to serve its 14 million policyholders. I can only guess at the workforce it would require to serve a similar number of policyholders under the agency system. I believe, however, that the number would be at least 60,000, a combination of what the insurer would need in direct employment and the personnel required at supporting agencies.

- In its electric utility business, our Berkshire Hathaway Energy (“BHE”) operates within a changing economic model. Historically, the survival of a local electric company did not depend on its efficiency. In fact, a “sloppy” operation could do just fine financially.

That’s because utilities were usually the sole supplier of a needed product and were allowed to price at a level that gave them a prescribed return upon the capital they employed. The joke in the industry was that a utility was the only business that would automatically earn more money by redecorating the boss’s office. And some CEOs ran things accordingly.

That’s all changing. Today, society has decided that federally-subsidized wind and solar generation is in our country’s long-term interest. Federal tax credits are used to implement this policy, support that makes renewables price-competitive in certain geographies. Those tax credits, or other government-mandated help for renewables, may eventually erode the economics of the incumbent utility, particularly if it is a high-cost operator. BHE’s long-established emphasis on efficiency – even when the company didn’t need it to attain authorized earnings – leaves us particularly competitive in today’s market (and, more important, in tomorrow’s as well).

BHE acquired its Iowa utility in 1999. In the year before, that utility employed 3,700 people and produced 19 million megawatt-hours of electricity. Now we employ 3,500 people and produce 29 million megawatt-hours. That major increase in efficiency allowed us to operate without a rate increase for 16 years, a period during which industry rates increased 44%.

The safety record of our Iowa utility is also outstanding. It had .79 injuries per 100 employees in 2015 compared to the rate of 7.0 experienced by the previous owner in the year before we bought the operation.

In 2006 BHE purchased PacifiCorp, which operated primarily in Oregon and Utah. The year before our purchase PacifiCorp employed 6,750 people and produced 52.6 million megawatt-hours. Last year the numbers were 5,700 employees and 56.3 million megawatt-hours. Here, too, safety improved dramatically, with the accident-rate-per-100-employees falling from 3.4 in 2005 to .85 in 2015. In safety, BHE now ranks in the industry’s top decile.

Those outstanding performances explain why BHE is welcomed by regulators when it proposes to buy a utility in their jurisdiction. The regulators know the company will run an efficient, safe and reliable operation and also arrive with unlimited capital to fund whatever projects make sense. (BHE has never paid a dividend to Berkshire since we assumed ownership. No investor-owned utility in America comes close to matching BHE’s enthusiasm for reinvestment.)

* * * * *

The productivity gains that I’ve just spelled out – and countless others that have been achieved in America – have delivered awesome benefits to society. That’s the reason our citizens, as a whole, have enjoyed – and will continue to enjoy – major gains in the goods and services they receive.

To this thought there are offsets. First, the productivity gains achieved in recent years have largely benefitted the wealthy. Second, productivity gains frequently cause upheaval: Both capital and labor can pay a terrible price when innovation or new efficiencies upend their worlds.

We need shed no tears for the capitalists (whether they be private owners or an army of public shareholders). It’s their job to take care of themselves. When large rewards can flow to investors from good decisions, these parties should not be spared the losses produced by *wrong* choices. Moreover, investors who diversify widely and simply sit tight with their holdings are certain to prosper: In America, gains from winning investments have always *far* more than offset the losses from clunkers. (During the 20th Century, the Dow Jones Industrial Average – an index fund of sorts – soared from 66 to 11,497, with its component companies all the while paying ever-increasing dividends.)

A long-employed worker faces a different equation. When innovation and the market system interact to produce efficiencies, many workers may be rendered unnecessary, their talents obsolete. Some can find decent employment elsewhere; for others, that is not an option.

When low-cost competition drove shoe production to Asia, our once-prosperous Dexter operation folded, putting 1,600 employees in a small Maine town out of work. Many were past the point in life at which they could learn another trade. We lost our entire investment, which we could afford, but many workers lost a livelihood they could not replace. The same scenario unfolded in slow-motion at our original New England textile operation, which struggled for 20 years before expiring. Many older workers at our New Bedford plant, as a poignant example, spoke Portuguese and knew little, if any, English. They had no Plan B.

The answer in such disruptions is not the restraining or outlawing of actions that increase productivity. Americans would not be living nearly as well as we do if we had mandated that 11 million people should forever be employed in farming.

The solution, rather, is a variety of safety nets aimed at providing a decent life for those who are willing to work but find their specific talents judged of small value because of market forces. (I personally favor a reformed and expanded Earned Income Tax Credit that would try to make sure America works for those willing to work.) The price of achieving ever-increasing prosperity for the great majority of Americans should not be penury for the unfortunate.

Important Risks

We, like all public companies, are required by the SEC to annually catalog “risk factors” in our 10-K. I can’t remember, however, an instance when reading a 10-K’s “risk” section has helped me in evaluating a business. That’s not because the identified risks aren’t real. The truly important risks, however, are usually well known. Beyond that, a 10-K’s catalog of risks is seldom of aid in assessing: (1) the probability of the threatening event actually occurring; (2) the range of costs if it does occur; and (3) the timing of the possible loss. A threat that will only surface 50 years from now may be a problem for society, but it is not a *financial* problem for today’s investor.

Berkshire operates in more industries than any company I know of. Each of our pursuits has its own array of possible problems and opportunities. Those are easy to list but hard to evaluate: Charlie, I and our various CEOs often differ in a very major way in our calculation of the likelihood, the timing and the cost (or benefit) that may result from these possibilities.

Let me mention just a few examples. To begin with an obvious threat, BNSF, along with other railroads, is *certain* to lose significant coal volume over the next decade. At some point in the future – though not, in my view, for a long time – GEICO’s premium volume *may* shrink because of driverless cars. This development could hurt our auto dealerships as well. Circulation of our print newspapers will continue to fall, a certainty we allowed for when purchasing them. To date, renewables have helped our utility operation but that could change, particularly if storage capabilities for electricity materially improve. Online retailing threatens the business model of our retailers and certain of our consumer brands. These potentialities are just a few of the negative possibilities facing us – but even the most casual follower of business news has long been aware of them.

None of these problems, however, is crucial to Berkshire’s long-term well-being. When we took over the company in 1965, its risks could have been encapsulated in a single sentence: “The northern textile business in which all of our capital resides is destined for recurring losses and will eventually disappear.” That development, however, was no death knell. We simply adapted. And we will continue to do so.

Every day Berkshire managers are thinking about how they can better compete in an always-changing world. Just as vigorously, Charlie and I focus on where a steady stream of funds should be deployed. In that respect, we possess a major advantage over one-industry companies, whose options are far more limited. I firmly believe that Berkshire has the money, talent and culture to plow through the sort of adversities I've itemized above – and many more – and to emerge with ever-greater earning power.

There is, however, one clear, present and enduring danger to Berkshire against which Charlie and I are powerless. That threat to Berkshire is also the major threat our citizenry faces: a “successful” (as defined by the aggressor) cyber, biological, nuclear or chemical attack on the United States. That is a risk Berkshire shares with *all* of American business.

The probability of such mass destruction in any given year is likely very small. It's been more than 70 years since I delivered a Washington Post newspaper headlining the fact that the United States had dropped the first atomic bomb. Subsequently, we've had a few close calls but avoided catastrophic destruction. We can thank our government – and luck! – for this result.

Nevertheless, what's a small probability in a short period approaches certainty in the longer run. (If there is only one chance in thirty of an event occurring in a given year, the likelihood of it occurring at least once in a century is 96.6%.) The added bad news is that there will forever be people and organizations and perhaps even nations that would like to inflict maximum damage on our country. Their means of doing so have increased exponentially during my lifetime. “Innovation” has its dark side.

There is no way for American corporations or their investors to shed this risk. If an event occurs in the U.S. that leads to mass devastation, the value of all equity investments will almost certainly be decimated.

No one knows what “the day after” will look like. I think, however, that Einstein's 1949 appraisal remains apt: “I know not with what weapons World War III will be fought, but World War IV will be fought with sticks and stones.”

* * * * *

I am writing this section because we have a proxy proposal regarding climate change to consider at this year's annual meeting. The sponsor would like us to provide a report on the dangers that this change might present to our insurance operation and explain how we are responding to these threats.

It seems highly likely to me that climate change poses a major problem for the planet. I say “highly likely” rather than “certain” because I have no scientific aptitude and remember well the dire predictions of most “experts” about Y2K. It would be foolish, however, for me or anyone to demand 100% proof of huge forthcoming damage to the world if that outcome seemed at all possible and if prompt action had even a small chance of thwarting the danger.

This issue bears a similarity to Pascal's Wager on the Existence of God. Pascal, it may be recalled, argued that if there were only a tiny probability that God truly existed, it made sense to behave as if He did because the rewards could be infinite whereas the lack of belief risked eternal misery. Likewise, if there is only a 1% chance the planet is heading toward a truly major disaster and delay means passing a point of no return, inaction now is foolhardy. Call this Noah's Law: If an ark may be essential for *survival*, begin building it today, no matter how cloudless the skies appear.

It's understandable that the sponsor of the proxy proposal believes Berkshire is especially threatened by climate change because we are a huge insurer, covering all sorts of risks. The sponsor may worry that property losses will skyrocket because of weather changes. And such worries might, in fact, be warranted if we wrote ten- or twenty-year policies at fixed prices. But insurance policies are customarily written for one year and repriced annually to reflect changing exposures. Increased possibilities of loss translate promptly into increased premiums.

Think back to 1951 when I first became enthused about GEICO. The company's average loss-per-policy was then about \$30 annually. Imagine your reaction if I had predicted then that in 2015 the loss costs would increase to about \$1,000 per policy. Wouldn't such skyrocketing losses prove disastrous, you might ask? Well, no.

Over the years, inflation has caused a huge increase in the cost of repairing both the cars and the humans involved in accidents. But these increased costs have been promptly matched by increased premiums. So, paradoxically, the upward march in loss costs has made insurance companies far more *valuable*. If costs had remained unchanged, Berkshire would now own an auto insurer doing \$600 million of business annually rather than one doing \$23 billion.

Up to now, climate change has *not* produced more frequent nor more costly hurricanes nor other weather-related events covered by insurance. As a consequence, U.S. super-cat rates have *fallen* steadily in recent years, which is why we have backed away from that business. If super-cats become costlier and more frequent, the likely – though far from certain – effect on Berkshire's insurance business would be to make it larger and more profitable.

As a citizen, you may understandably find climate change keeping you up nights. As a homeowner in a low-lying area, you may wish to consider moving. But when you are thinking only as a shareholder of a major insurer, climate change should not be on your list of worries.

The Annual Meeting

Charlie and I have finally decided to enter the 21st Century. Our annual meeting this year will be webcast worldwide in its entirety. To view the meeting, simply go to <https://finance.yahoo.com/brklivestream> at 9 a.m. Central Daylight Time on Saturday, April 30th. The Yahoo! webcast will begin with a half hour of interviews with managers, directors and shareholders. Then, at 9:30, Charlie and I will commence answering questions.

This new arrangement will serve two purposes. First, it may level off or modestly decrease attendance at the meeting. Last year's record of more than 40,000 attendees strained our capacity. In addition to quickly filling the CenturyLink Center's main arena, we packed its overflow rooms and then spilled into two large meeting rooms at the adjoining Omaha Hilton. All major hotels were sold out notwithstanding Airbnb's stepped-up presence. Airbnb was especially helpful for those visitors on limited budgets.

Our second reason for initiating a webcast is more important. Charlie is 92, and I am 85. If we were partners with you in a small business, and were charged with running the place, you would want to look in occasionally to make sure we hadn't drifted off into la-la land. Shareholders, in contrast, should not need to come to Omaha to monitor how we look and sound. (In making your evaluation, be kind: Allow for the fact that we didn't look that impressive when we were at our best.)

Viewers can also observe our life-prolonging diet. During the meeting, Charlie and I will each consume enough Coke, See's fudge and See's peanut brittle to satisfy the weekly caloric needs of an NFL lineman. Long ago we discovered a fundamental truth: There's nothing like eating carrots and broccoli when you're *really* hungry – and want to stay that way.

Shareholders planning to attend the meeting should come at 7 a.m. when the doors open at CenturyLink Center and *start shopping*. Carrie Sova will again be in charge of the festivities. She had her second child late last month, but that did not slow her down. Carrie is unflappable, ingenious and expert at bringing out the best in those who work with her. She is aided by hundreds of Berkshire employees from around the country and by our entire home office crew as well, all of them pitching in to make the weekend fun and informative for our owners.

Last year we increased the number of hours available for shopping at the CenturyLink. Sales skyrocketed – so, naturally, we will stay with the new schedule. On Friday, April 29th you can shop between noon and 5 p.m., and on Saturday exhibits and stores will be open from 7 a.m. until 4:30 p.m.

On Saturday morning, we will have our fifth International Newspaper Tossing Challenge. Our target will again be a Clayton Home porch, located precisely 35 feet from the throwing line. When I was a teenager – in my one brief flirtation with honest labor – I delivered about 500,000 papers. So I think I'm pretty good at this game. Challenge me! Humiliate me! Knock me down a peg! The papers will run 36 to 42 pages, and you must fold them yourself (no rubber bands allowed).

The competition begins at 7:15, when contestants will make preliminary tosses. The eight throws judged most accurate – four made by contestants 12 or under, and four made by the older set – will compete against me at 7:45. The young challengers will each receive a prize. But the older ones will have to beat me to take anything home.

And be sure to check out the Clayton home itself. It can be purchased for \$78,900, fully installed on land you provide. In past years, we've made many sales on the meeting day. Kevin Clayton will be on hand with his order book.

At 8:30 a.m., a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (including a break for lunch at CenturyLink's stands) will last until 3:30 p.m. After a short recess, Charlie and I will convene the annual meeting at 3:45 p.m. This business session typically lasts only a half hour or so and can safely be skipped by those craving a little last-minute shopping.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of Berkshire subsidiaries will be for sale. Say hello to the many Berkshire managers who will be captaining their exhibits. And be sure to view the terrific BNSF railroad layout that salutes all of our subsidiaries. Your children (and you!) will be enchanted with it.

We will have a new and very special exhibit in the hall this year: a full-size model of the world's largest aircraft engine, for which Precision Castparts makes many key components. The real engines weigh about 20,000 pounds and are ten feet in diameter and 22 feet in length. The bisected model at the meeting will give you a good look at many PCC components that help power your flights.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them on Sunday at our fourth annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that will be sent to you with your meeting credentials. Entrants in the race will find themselves running alongside many of Berkshire's managers, directors and associates. (Charlie and I, however, will sleep in; the fudge and peanut brittle take their toll.) Participation in the 5K grows every year. Help us set another record.

A GEICO booth in the shopping area will be staffed by a number of the company's top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money. Spend the savings on our other products.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, among them a couple of new titles. Andy Kilpatrick will introduce (and be glad to sign) the latest edition of his all-encompassing coverage of Berkshire. It's 1,304 pages and weighs 9.8 pounds. (My blurb for the book: "Ridiculously skimpy.") Check out Peter Bevelin's new book as well. Peter has long been a keen observer of Berkshire.

We will also have a new, 20-page-longer edition of Berkshire's 50-year commemorative book that at last year's meeting sold 12,000 copies. Since then, Carrie and I have uncovered additional material that we find fascinating, such as some very personal letters sent by Grover Cleveland to Edward Butler, his friend and the then-publisher of *The Buffalo News*. Nothing from the original edition has been changed or eliminated, and the price remains \$20. Charlie and I will jointly sign 100 copies that will be randomly placed among the 5,000 available for sale at the meeting.

My friend, Phil Beuth, has written *Limping on Water*, an autobiography that chronicles his life at Capital Cities Communications and tells you a lot about its leaders, Tom Murphy and Dan Burke. These two were the best managerial duo – both in *what* they accomplished and *how* they did it – that Charlie and I ever witnessed. Much of what you become in life depends on whom you choose to admire and copy. Start with Tom Murphy, and you'll never need a second exemplar.

Finally, Jeremy Miller has written *Warren Buffett's Ground Rules*, a book that will debut at the annual meeting. Mr. Miller has done a superb job of researching and dissecting the operation of Buffett Partnership Ltd. and of explaining how Berkshire's culture has evolved from its BPL origin. If you are fascinated by investment theory and practice, you will enjoy this book.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money, particularly if you had planned to rent a car in Omaha. The savings for a couple could run to \$1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. Last year in the week encompassing the meeting, the store did a record \$44,239,493 of business. If you repeat that figure to a retailer, he is not going to believe you. (An average week for NFM's Omaha store – the highest-volume home furnishings store in the United States except for our new Dallas store – is about \$9 million.)

To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, April 26th and Monday, May 2nd inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. During "Berkshire Weekend" NFM will be open from 10 a.m. to 9 p.m. Monday through Friday, 10 a.m. to 9:30 p.m. on Saturday and 10 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is hosting a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, April 29th. The second, the main gala, will be held on Sunday, May 1st, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. During last year's Friday-Sunday stretch, the store wrote a sales ticket every 15 seconds that it was open.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 25th through Saturday, May 7th. During that period, please identify yourself as a shareholder either by presenting your meeting credential or a brokerage statement showing you own our stock.

On Sunday, in the mall outside of Borsheims, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. On the upper level, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon. I will join them and hope to have Ajit and Charlie there also.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine and even then I was unable to score a point against her. Now, she's a junior at Princeton, having already represented the United States in the 2012 Olympics. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates and I will lead off and try to soften her up.

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 1st, serving from 1 p.m. until 10 p.m. To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*). As for my other favorite restaurant, Piccolo's, I'm sad to report it closed.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, the preeminent business journalist of her time, who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

An accompanying set of questions will be asked by three analysts who follow Berkshire. This year the insurance specialist will be Cliff Gallant of Nomura Securities. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. Multi-part questions aren't allowed; we want to give as many questioners as possible a shot at us.

All told we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. (Last year we had 64 in total.) The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and, if possible, should also have adequate time to digest and analyze it before any trading takes place. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday. We do not follow the common practice of talking one-on-one with large institutional investors or analysts, treating them instead as we do all other shareholders. There is no one more important to us than the shareholder of limited means who trusts us with a substantial portion of his savings.

* * * * *

For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I also believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 24 men and women who work with me at our corporate office. This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 30,400-page Federal income tax return – that's up 6,000 pages from the prior year! – oversees the filing of 3,530 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities, fact-checks this letter – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year, for example, they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and french fries (smothered in Heinz ketchup, of course) for lunch. No CEO has it better; I truly do feel like tap dancing to work every day. In fact, my job becomes more fun every year.

In 2015, Berkshire's revenues increased by \$16 billion. Look carefully, however, at the two pictures on the facing page. The top one is from last year's report and shows the entire Berkshire home-office crew at our Christmas lunch. Below that photo is this year's Christmas photo portraying the *same* 25 people identically positioned. In 2015, no one joined us, no one left. And the odds are good that you will see a photo of the same 25 next year.

Can you imagine another very large company – we employ 361,270 people worldwide – enjoying that kind of employment stability at headquarters? At Berkshire we have hired some wonderful people – and they have stayed with us. Moreover, no one is hired unless he or she is truly needed. That's why you've never read about "restructuring" charges at Berkshire.

On April 30th, come to Omaha – the cradle of capitalism – and meet my gang. They are the best.

February 27, 2016

Warren E. Buffett
Chairman of the Board



Front Row – Becki Amick, Sharon Heck, Melissa Hawk, Jalayna Busse, Warren Buffett, Angie Wells, Alisa Krueger, Deb Ray, Carrie Sova, Ellen Schmidt **Back Row** – Tracy Britt Cool, Jennifer Tselentis, Ted Weschler, Joanne Manhart, Bob Reeson, Todd Combs, Dan Jaksich, Debbie Bosanek, Mark Sisley, Marc Hamburg, Kerby Ham, Mark Millard, Allyson Ballard, Stacy Gottschalk, Tiffany Vokt



Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
2016	10.7	23.4	12.0
Compounded Annual Gain – 1965-2016	19.0%	20.8%	9.7%
Overall Gain – 1964-2016	884,319%	1,972,595%	12,717%

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2016 was \$27.5 billion, which increased the per-share book value of both our Class A and Class B stock by 10.7%. Over the last 52 years (that is, since present management took over), per-share book value has grown from \$19 to \$172,108, a rate of 19% compounded annually.*

During the first half of those years, Berkshire's net worth was roughly equal to the number that really counts: the intrinsic value of the business. The similarity of the two figures existed then because most of our resources were deployed in marketable securities that were regularly revalued to their quoted prices (less the tax that would be incurred if they were to be sold). In Wall Street parlance, our balance sheet was then in very large part "marked to market."

By the early 1990s, however, our focus was changing to the outright ownership of businesses, a shift that materially diminished the relevance of balance sheet figures. That disconnect occurred because the accounting rules (commonly referred to as "GAAP") that apply to companies we control differ in important ways from those used to value marketable securities. Specifically, the accounting for *businesses* we own requires that the carrying value of "losers" be written down when their failures become apparent. "Winners," conversely, are *never* revalued upwards.

We've experienced both outcomes: As is the case in marriage, business acquisitions often deliver surprises *after* the "I do's." I've made some dumb purchases, paying far too much for the economic goodwill of companies we acquired. That later led to goodwill write-offs and to consequent reductions in Berkshire's book value. We've also had some winners among the businesses we've purchased – a few of the winners very big – but have not written those up by a penny.

We have no quarrel with the asymmetrical accounting that applies here. But, over time, it necessarily widens the gap between Berkshire's intrinsic value and its book value. Today, the large – and growing – unrecorded gains at our winners produce an intrinsic value for Berkshire's shares that *far* exceeds their book value. The overage is truly huge in our property/casualty insurance business and significant also in many other operations.

Over time, stock prices gravitate toward intrinsic value. That's what has happened at Berkshire, a fact explaining why the company's 52-year market-price gain – shown on the facing page – materially exceeds its book-value gain.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

What We Hope to Accomplish

Charlie Munger, Berkshire's Vice Chairman and my partner, and I expect Berkshire's *normalized* earning power per share to increase every year. *Actual* earnings, of course, will sometimes decline because of periodic weakness in the U.S. economy. In addition, insurance mega-catastrophes or other industry-specific events may occasionally reduce earnings at Berkshire, even when most American businesses are doing well.

It's our job, though, to over time deliver significant growth, bumpy or not. After all, as stewards of *your* capital, Berkshire directors have opted to retain all earnings. Indeed, in both 2015 and 2016 Berkshire ranked first among American businesses in the dollar volume of earnings retained, in each year reinvesting many billions of dollars more than did the runner-up. Those reinvested dollars must earn their keep.

Some years, the gains in underlying earning power we achieve will be minor; very occasionally, the cash register will ring loud. Charlie and I have no magic plan to add earnings except to dream big and to be prepared mentally and financially to act fast when opportunities present themselves. Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons. And that we will do.

I earlier described our gradual shift from a company obtaining most of its gains from investment activities to one that grows in value by owning businesses. Launching that transition, we took baby steps – making small acquisitions whose impact on Berkshire's profits was dwarfed by our gains from marketable securities. Despite that cautious approach, I made one particularly egregious error, acquiring Dexter Shoe for \$434 million in 1993. Dexter's value promptly went to zero. The story gets worse: I used stock for the purchase, giving the sellers 25,203 shares of Berkshire that at yearend 2016 were worth more than \$6 billion.

That wreck was followed by three key happenings – two positive, one negative – that set us firmly on our present course. At the beginning of 1996, we acquired the half of GEICO we didn't already own, a cash transaction that changed our holding from a portfolio investment into a wholly-owned operating business. GEICO, with its almost unlimited potential, quickly became the centerpiece around which we built what I believe is now the world's premier property/casualty business.

Unfortunately, I followed the GEICO purchase by foolishly using Berkshire stock – a *boatload* of stock – to buy General Reinsurance in late 1998. After some early problems, General Re has become a fine insurance operation that we prize. It was, nevertheless, a terrible mistake on my part to issue 272,200 shares of Berkshire in buying General Re, an act that increased our outstanding shares by a whopping 21.8%. My error caused Berkshire shareholders to give far more than they received (a practice that – despite the Biblical endorsement – is far from blessed when you are buying businesses).

Early in 2000, I atoned for that folly by buying 76% (since grown to 90%) of MidAmerican Energy, a brilliantly-managed utility business that has delivered us many large opportunities to make profitable and socially-useful investments. The MidAmerican *cash* purchase – I was learning – firmly launched us on our present course of (1) continuing to build our insurance operation; (2) energetically acquiring large and diversified non-insurance businesses and (3) largely making our deals from internally-generated cash. (Today, I would rather prep for a colonoscopy than issue Berkshire shares.)

Our portfolio of bonds and stocks, de-emphasized though it is, has continued in the post-1998 period to grow and to deliver us hefty capital gains, interest, and dividends. Those portfolio earnings have provided us major help in financing the purchase of businesses. Though unconventional, Berkshire's two-pronged approach to capital allocation gives us a real edge.

Here's our financial record since 1999, when the redirection of our business began in earnest. During the 18-year period covered, Berkshire's outstanding shares grew by only 8.3%, with most of the increase occurring when we purchased BNSF. That, I'm happy to say, was one issuance of stock that made good sense.

After-Tax Earnings
(in billions of dollars)

Year	Capital		Year	Capital	
	Operations (1)	Gains (2)		Operations (1)	Gains (2)
1999	0.67	0.89	2008	9.64	(4.65)
2000	0.94	2.39	2009	7.57	0.49
2001	(0.13)	0.92	2010	11.09	1.87
2002	3.72	0.57	2011	10.78	(0.52)
2003	5.42	2.73	2012	12.60	2.23
2004	5.05	2.26	2013	15.14	4.34
2005	5.00	3.53	2014	16.55	3.32
2006	9.31	1.71	2015	17.36	6.73
2007	9.63	3.58	2016	17.57	6.50

- (1) Including interest and dividends from investments, but *excluding* capital gains or losses.
- (2) In very large part, this tabulation includes only *realized* capital gains or losses. Unrealized gains and losses are also included, however, when GAAP requires that treatment.

Our expectation is that investment gains will continue to be substantial – though totally random as to timing – and that these will supply significant funds for business purchases. Concurrently, Berkshire's superb corps of operating CEOs will focus on increasing earnings at the individual businesses they manage, sometimes helping them to grow by making bolt-on acquisitions. By our avoiding the issuance of Berkshire stock, any improvement in earnings will translate into equivalent per-share gains.

* * * * *

Our efforts to materially increase the normalized earnings of Berkshire will be aided – as they have been throughout our managerial tenure – by America's economic dynamism. One word sums up our country's achievements: miraculous. From a standing start 240 years ago – a span of time less than triple my days on earth – Americans have combined human ingenuity, a market system, a tide of talented and ambitious immigrants, and the rule of law to deliver abundance beyond any dreams of our forefathers.

You need not be an economist to understand how well our system has worked. Just look around you. See the 75 million owner-occupied homes, the bountiful farmland, the 260 million vehicles, the hyper-productive factories, the great medical centers, the talent-filled universities, you name it – they all represent a net gain for Americans from the barren lands, primitive structures and meager output of 1776. Starting from scratch, America has amassed wealth totaling \$90 trillion.

It's true, of course, that American owners of homes, autos and other assets have often borrowed heavily to finance their purchases. If an owner defaults, however, his or her asset does not disappear or lose its usefulness. Rather, ownership customarily passes to an American lending institution that then disposes of it to an American buyer. Our *nation's* wealth remains intact. As Gertrude Stein put it, "Money is always there, but the pockets change."

Above all, it's our market system – an economic traffic cop ably directing capital, brains and labor – that has created America's abundance. This system has also been the primary factor in allocating rewards. Governmental redirection, through federal, state and local taxation, has in addition determined the distribution of a significant portion of the bounty.

America has, for example, decided that those citizens in their productive years should help both the old and the young. Such forms of aid – sometimes enshrined as "entitlements" – are generally thought of as applying to the aged. But don't forget that four million American babies are born each year with an entitlement to a public education. That societal commitment, largely financed at the local level, costs about \$150,000 per baby. The annual cost totals more than \$600 billion, which is about 3 ½% of GDP.

However our wealth may be divided, the mind-boggling amounts you see around you belong almost exclusively to Americans. Foreigners, of course, own or have claims on a modest portion of our wealth. Those holdings, however, are of little importance to our national balance sheet: *Our* citizens own assets abroad that are roughly comparable in value.

Early Americans, we should emphasize, were neither smarter nor more hard working than those people who toiled century after century before them. But those venturesome pioneers crafted a system that unleashed human potential, and their successors built upon it.

This economic creation will deliver increasing wealth to our progeny far into the future. Yes, the build-up of wealth will be interrupted for short periods from time to time. It will not, however, be stopped. I'll repeat what I've both said in the past and expect to say in future years: Babies born in America today are the luckiest crop in history.

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America's economic achievements have led to staggering profits for stockholders. During the 20th century the Dow-Jones Industrials advanced from 66 to 11,497, a 17,320% capital gain that was materially boosted by steadily increasing dividends. The trend continues: By yearend 2016, the index had advanced a further 72%, to 19,763.

American business – and consequently a basket of stocks – is virtually certain to be worth far more in the years ahead. Innovation, productivity gains, entrepreneurial spirit and an abundance of capital will see to that. Ever-present naysayers may prosper by marketing their gloomy forecasts. But heaven help them if they act on the nonsense they peddle.

Many companies, of course, will fall behind, and some will fail. Winnowing of that sort is a product of market dynamism. Moreover, the years ahead will occasionally deliver major market declines – even panics – that will affect virtually all stocks. No one can tell you when these traumas will occur – not me, not Charlie, not economists, not the media. Meg McConnell of the New York Fed aptly described the reality of panics: "We spend a lot of time looking for systemic risk; in truth, however, it tends to find us."

During such scary periods, you should never forget two things: First, widespread fear is your *friend* as an investor, because it serves up bargain purchases. Second, *personal* fear is your enemy. It will also be unwarranted. Investors who avoid high and unnecessary costs and simply sit for an extended period with a collection of large, conservatively-financed American businesses will almost certainly do well.

As for Berkshire, our size precludes a *brilliant* result: Prospective returns fall as assets increase. Nonetheless, Berkshire's collection of good businesses, along with the company's impregnable financial strength and owner-oriented culture, should deliver decent results. We won't be satisfied with less.

Share Repurchases

In the investment world, discussions about share repurchases often become heated. But I'd suggest that participants in this debate take a deep breath: Assessing the desirability of repurchases isn't that complicated.

From the standpoint of exiting shareholders, repurchases are always a plus. Though the day-to-day impact of these purchases is usually minuscule, it's always better for a seller to have an additional buyer in the market.

For continuing shareholders, however, repurchases only make sense if the shares are bought at a price below intrinsic value. When that rule is followed, the remaining shares experience an immediate gain in intrinsic value. Consider a simple analogy: If there are three equal partners in a business worth \$3,000 and one is bought out by the partnership for \$900, each of the remaining partners realizes an immediate gain of \$50. If the exiting partner is paid \$1,100, however, the continuing partners each suffer a loss of \$50. The same math applies with corporations and their shareholders. Ergo, the question of whether a repurchase action is value-enhancing or value-destroying for continuing shareholders is entirely purchase-price dependent.

It is puzzling, therefore, that corporate repurchase announcements almost never refer to a price above which repurchases will be eschewed. That certainly wouldn't be the case if a management was buying an outside business. There, price would always factor into a buy-or-pass decision.

When CEOs or boards are buying a small part of their own company, though, they all too often seem oblivious to price. Would they behave similarly if they were managing a private company with just a few owners and were evaluating the wisdom of buying out one of them? Of course not.

It is important to remember that there are two occasions in which repurchases should not take place, even if the company's shares are underpriced. One is when a business both needs all its available money to protect or expand its own operations and is also uncomfortable adding further debt. Here, the internal need for funds should take priority. This exception assumes, of course, that the business has a decent future awaiting it after the needed expenditures are made.

The second exception, less common, materializes when a business acquisition (or some other investment opportunity) offers far greater value than do the undervalued shares of the potential repurchaser. Long ago, Berkshire itself often had to choose between these alternatives. At our present size, the issue is far less likely to arise.

My suggestion: Before even discussing repurchases, a CEO and his or her Board should stand, join hands and in unison declare, "What is smart at one price is stupid at another."

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To recap Berkshire's own repurchase policy: I am authorized to buy large amounts of Berkshire shares at 120% or less of book value because our Board has concluded that purchases at that level clearly bring an instant and material benefit to continuing shareholders. By our estimate, a 120%-of-book price is a significant discount to Berkshire's intrinsic value, a spread that is appropriate because calculations of intrinsic value can't be precise.

The authorization given me does not mean that we will "prop" our stock's price at the 120% ratio. If that level is reached, we will instead attempt to blend a desire to make meaningful purchases at a value-creating price with a related goal of not over-influencing the market.

To date, repurchasing our shares has proved hard to do. That may well be because we have been clear in describing our repurchase policy and thereby have signaled our view that Berkshire's intrinsic value is significantly higher than 120% of book value. If so, that's fine. Charlie and I prefer to see Berkshire shares sell in a fairly narrow range around intrinsic value, neither wishing them to sell at an unwarranted high price – it's no fun having owners who are disappointed with their purchases – nor one too low. Furthermore, our buying out "partners" at a discount is not a particularly gratifying way of making money. Still, market circumstances could create a situation in which repurchases would benefit both continuing and exiting shareholders. If so, we will be ready to act.

One final observation for this section: As the subject of repurchases has come to a boil, some people have come close to calling them un-American – characterizing them as corporate misdeeds that divert funds needed for productive endeavors. That simply isn’t the case: Both American corporations and private investors are today awash in funds looking to be sensibly deployed. I’m not aware of *any* enticing project that in recent years has died for lack of capital. (Call us if you have a candidate.)

Insurance

Let’s now look at Berkshire’s various businesses, starting with our most important sector, insurance. The property/casualty (“P/C”) branch of that industry has been the engine that has propelled our growth since 1967, the year we acquired National Indemnity and its sister company, National Fire & Marine, for \$8.6 million. Today, National Indemnity is the largest property/casualty company in the world as measured by net worth.

One reason we were attracted to the P/C business was its financial characteristics: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as claims arising from exposure to asbestos, payments can stretch over many decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call “float” – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* it has grown, as the following table shows:

<u>Year</u>	<u>Float (in millions)</u>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2016	91,577

We recently wrote a huge policy that increased float to more than \$100 billion. Beyond that one-time boost, float at GEICO and several of our specialized operations is almost certain to grow at a good clip. National Indemnity’s reinsurance division, however, is party to a number of large run-off contracts whose float is certain to drift downward.

We may in time experience a decline in float. If so, the decline will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. This structure is by design and is a key component in the unequaled financial strength of our insurance companies. It will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, our insurance operation registers an underwriting profit that adds to the investment income the float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it sometimes causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses.

This outcome is made more certain by the dramatically lower interest rates that now exist throughout the world. The investment portfolios of almost all P/C companies – though *not* those of Berkshire – are heavily concentrated in bonds. As these high-yielding legacy investments mature and are replaced by bonds yielding a pittance, earnings from float will steadily fall. For that reason, and others as well, it's a good bet that industry results over the next ten years will fall short of those recorded in the past decade, particularly in the case of companies that specialize in reinsurance.

Nevertheless, I very much like our own prospects. Berkshire's unrivaled financial strength allows us far more flexibility in investing than that generally available to P/C companies. The many alternatives available to us are always an advantage; occasionally, they offer us major opportunities. When others are constrained, our choices expand.

Moreover, our P/C companies have an excellent underwriting record. Berkshire has now operated at an underwriting profit for 14 consecutive years, our pre-tax gain for the period having totaled \$28 billion. That record is no accident: Disciplined risk evaluation is the daily focus of *all* of our insurance managers, who know that while float is valuable, its benefits can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a *liability*, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as a typical liability is a major mistake. It should instead be viewed as a revolving fund. Daily, we pay old claims and related expenses – a huge \$27 billion to more than six million claimants in 2016 – and that reduces float. Just as surely, we each day write new business that will soon generate its own claims, adding to float.

If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability. Owing \$1 that in effect will never leave the premises – because new business is almost certain to deliver a substitute – is worlds different from owing \$1 that will go out the door tomorrow and not be replaced. The two types of liabilities, however, are treated as equals under GAAP.

A partial offset to this overstated liability is a \$15.5 billion “goodwill” asset that we incurred in buying our insurance companies and that is included in our book-value figure. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, *any* goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay for float of *similar quality* were we to purchase an insurance operation possessing it – to be *far* in excess of its historic carrying value. Indeed, almost the entire \$15.5 billion we carry for goodwill in our insurance business was already on our books in 2000 when float was \$28 billion. Yet we have subsequently increased our float by \$64 billion, a gain that in no way is reflected in our book value. This unrecorded asset is one reason – a huge reason – why we believe Berkshire's intrinsic business value far exceeds its book value.

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Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that in most cases possess hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources.

Indeed, Berkshire is *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a \$250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a large profit for the year. Our many streams of non-insurance earnings would see to that. Additionally, we would remain awash in cash and be eager to write business in an insurance market that might well be in disarray. Meanwhile, other major insurers and reinsurers would be swimming in red ink, if not facing insolvency.

When Ajit entered Berkshire's office on a Saturday in 1986, he did not have a day's experience in the insurance business. Nevertheless, Mike Goldberg, then our manager of insurance, handed him the keys to our small and struggling reinsurance business. With that move, Mike achieved sainthood: Since then, Ajit has created tens of billions of value for Berkshire shareholders. If there were ever to be another Ajit and you could swap me for him, *don't hesitate*. Make the trade!

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We have another reinsurance powerhouse in General Re, managed until recently by Tad Montross. After 39 years at General Re, Tad retired in 2016. Tad was a class act in every way and we owe him a ton of thanks. Kara Raiguel, who has worked with Ajit for 16 years, is now CEO of General Re.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance. Tad never listened to that nonsensical excuse for sloppy underwriting, and neither will Kara.

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Finally, there is GEICO, the company that set my heart afire 66 years ago (and for which the flame still burns). GEICO is managed by Tony Nicely, who joined the company at 18 and completed 55 years of service in 2016.

Tony became CEO of GEICO in 1993, and since then the company has been flying. There is *no* better manager than Tony, who brings his combination of brilliance, dedication *and* soundness to the job. (The latter quality is essential to sustained success. As Charlie says, it's great to have a manager with a 160 IQ – unless he thinks it's 180.) Like Ajit, Tony has created tens of billions of value for Berkshire.

On my initial visit to GEICO in 1951, I was blown away by the huge cost advantage the company enjoyed over the giants of the industry. It was clear to me that GEICO would succeed because it *deserved* to succeed. The company's annual sales were then \$8 million; In 2016, GEICO did that much business every three hours of the year.

Auto insurance is a major expenditure for most families. Savings matter to them – and only a low-cost operation can deliver those. In fact, at least 40% of the people reading this letter can save money by insuring with GEICO. So stop reading – right now! – and go to geico.com or call 800-847-7536.

GEICO's low costs create a moat – an *enduring* one – that competitors are unable to cross. As a result, the company gobbles up market share year after year, ending 2016 with about 12% of industry volume. That's up from 2.5% in 1995, the year Berkshire acquired control of GEICO. Employment, meanwhile, grew from 8,575 to 36,085.

GEICO's growth accelerated dramatically during the second half of 2016. Loss costs throughout the auto-insurance industry had been increasing at an unexpected pace and some competitors lost their enthusiasm for taking on new customers. GEICO's reaction to the profit squeeze, however, was to *accelerate* its new-business efforts. We like to make hay while the sun sets, knowing that it will surely rise again.

GEICO continues on a roll as I send you this letter. When insurance prices increase, people shop more. And when they shop, GEICO wins.

Have you called yet? (800-847-7536 or go to geico.com)

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In addition to our three major insurance operations, we own a collection of smaller companies that primarily write commercial coverages. In aggregate, these companies are a large, growing and valuable operation that consistently delivers an underwriting profit, usually one much superior to that reported by their competitors. Over the past 14 years, this group has earned \$4.7 billion from underwriting – about 13% of its premium volume – while increasing its float from \$943 million to \$11.6 billion.

Less than three years ago, we formed Berkshire Hathaway Specialty Insurance ("BHSI"), which is included in this grouping. Our first decision was to put Peter Eastwood in charge, a move that proved to be a home run: We expected significant losses in the early years while Peter built the personnel and infrastructure needed for a world-wide operation. Instead, he and his crew delivered significant underwriting profits throughout the start-up period. BHSI's volume increased 40% in 2016, reaching \$1.3 billion. It's clear to me that the company is destined to become one of the world's leading P/C insurers.

Here's a recap of pre-tax underwriting earnings and float by division:

<i>Insurance Operations</i>	<i><u>Underwriting Profit</u></i>		<i><u>Yearend Float</u></i>	
	<i><u>2016</u></i>	<i><u>2015</u></i>	<i><u>(in millions)</u></i>	<i><u>2016</u></i>
BH Reinsurance	\$ 822	\$ 421	\$ 45,081	\$ 44,108
General Re	190	132	17,699	18,560
GEICO	462	460	17,148	15,148
Other Primary	<u>657</u>	<u>824</u>	<u>11,649</u>	<u>9,906</u>
	<u>\$2,131</u>	<u>\$1,837</u>	<u>\$ 91,577</u>	<u>\$ 87,722</u>

Berkshire's great managers, premier financial strength and a range of business models protected by wide moats amount to something unique in the insurance world. This assemblage of strengths is a huge asset for Berkshire shareholders that time will only make more valuable.

Regulated, Capital-Intensive Businesses

Our BNSF railroad and Berkshire Hathaway Energy ("BHE"), our 90%-owned utility business, share important characteristics that distinguish them from Berkshire's other activities. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement. These two very major companies accounted for 33% of Berkshire's after-tax operating earnings last year.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions would far exceed its interest requirements. Last year, for example, in a disappointing year for railroads, BNSF's interest coverage was more than 6:1. (Our definition of coverage is the ratio of earnings before interest and taxes to interest, *not* EBITDA/interest, a commonly-used measure we view as seriously flawed.)

At BHE, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies offering an essential service for which demand is remarkably steady. The second is enjoyed by few other utilities: an ever-widening diversity of earnings streams, which shield BHE from being seriously harmed by any single regulatory body. These many sources of profit, supplemented by the inherent advantage of the company being owned by a strong parent, have allowed BHE and its utility subsidiaries to significantly lower their cost of debt. That economic fact benefits both us *and* our customers.

All told, BHE and BNSF invested \$8.9 billion in plant and equipment last year, a massive commitment to their segments of America's infrastructure. We relish making such investments as long as they promise reasonable returns – and, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need huge investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is concomitantly in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Low prices are a powerful way to keep these constituencies happy. In Iowa, BHE's average retail rate is 7.1¢ per KWH. Alliant, the other major electric utility in the state, averages 9.9¢. Here are the comparable industry figures for adjacent states: Nebraska 9.0¢, Missouri 9.5¢, Illinois 9.2¢, Minnesota 10.0¢. The national average is 10.3¢. We have promised Iowans that our base rates will not increase until 2029 *at the earliest*. Our rock-bottom prices add up to real money for paycheck-strapped customers.

At BNSF, price comparisons between major railroads are far more difficult to make because of significant differences in both their mix of cargo and the average distance the load is carried. To supply a *very* crude measure, however, our revenue per ton-mile was 3¢ last year, while shipping costs for customers of the other four major U.S.-based railroads ranged from 4¢ to 5¢.

Both BHE and BNSF have been leaders in pursuing planet-friendly technology. In wind generation, no state comes close to rivaling Iowa, where last year the megawatt-hours we generated from wind equaled 55% of all megawatt-hours sold to our Iowa retail customers. New wind projects that are underway will take that figure to 89% by 2020.

Bargain-basement electric rates carry second-order benefits with them. Iowa has attracted large high-tech installations, both because of its low prices for electricity (which data centers use in huge quantities) and because most tech CEOs are enthusiastic about using renewable energy. When it comes to wind energy, Iowa is the Saudi Arabia of America.

BNSF, like other Class I railroads, uses only a single gallon of diesel fuel to move a ton of freight almost 500 miles. Those economics make railroads four times as fuel-efficient as trucks! Furthermore, railroads alleviate highway congestion – and the taxpayer-funded maintenance expenditures that come with heavier traffic – in a major way.

All told, BHE and BNSF own assets that are of major importance to our country as well as to shareholders of Berkshire. Here are the key financial figures for both:

<u>BNSF</u>	<i>Earnings (in millions)</i>		
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenues.....	\$ 19,829	\$ 21,967	\$ 23,239
Operating expenses	<u>13,144</u>	<u>14,264</u>	<u>16,237</u>
Operating earnings before interest and taxes.....	6,685	7,703	7,002
Interest (net)	992	928	833
Income taxes.....	<u>2,124</u>	<u>2,527</u>	<u>2,300</u>
Net earnings.....	<u><u>\$ 3,569</u></u>	<u><u>\$ 4,248</u></u>	<u><u>\$ 3,869</u></u>

<u>Berkshire Hathaway Energy (90% owned)</u>	<i>Earnings (in millions)</i>		
	<u>2016</u>	<u>2015</u>	<u>2014</u>
U.K. utilities	\$ 367	\$ 460	\$ 527
Iowa utility	392	292	270
Nevada utilities	559	586	549
PacifiCorp (primarily Oregon and Utah).....	1,105	1,026	1,010
Gas pipelines (Northern Natural and Kern River)	413	401	379
Canadian transmission utility	147	170	16
Renewable projects	157	175	194
HomeServices	225	191	139
Other (net).....	<u>73</u>	<u>49</u>	<u>54</u>
Operating earnings before corporate interest and taxes	3,438	3,350	3,138
Interest	<u>465</u>	<u>499</u>	<u>427</u>
Income taxes.....	<u>431</u>	<u>481</u>	<u>616</u>
Net earnings.....	<u><u>\$ 2,542</u></u>	<u><u>\$ 2,370</u></u>	<u><u>\$ 2,095</u></u>
Earnings applicable to Berkshire	<u><u>\$ 2,287</u></u>	<u><u>\$ 2,132</u></u>	<u><u>\$ 1,882</u></u>

HomeServices may appear out of place in the above table. But it came with our purchase of MidAmerican (now BHE) in 1999 – and we are lucky that it did.

HomeServices owns 38 realty companies with more than 29,000 agents who operate in 28 states. Last year it purchased four realtors, including Houlihan Lawrence, the leader in New York's Westchester County (in a transaction that closed shortly after yearend).

In real estate parlance, representing either a buyer or a seller is called a “side,” with the representation of both counting as two sides. Last year, our *owned* realtors participated in 244,000 sides, totaling \$86 billion in volume.

HomeServices also *franchises* many operations throughout the country that use our name. We like both aspects of the real estate business and expect to acquire many realtors and franchisees during the next decade.

Manufacturing, Service and Retailing Operations

Our manufacturing, service and retailing operations sell products ranging from lollipops to jet airplanes. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/16 (in millions)

<u>Assets</u>		<u>Liabilities and Equity</u>	
Cash and equivalents	\$ 8,073	Notes payable	\$ 2,054
Accounts and notes receivable	11,183	Other current liabilities	<u>12,464</u>
Inventory	15,727	Total current liabilities.....	14,518
Other current assets.....	<u>1,039</u>		
Total current assets	36,022		
Goodwill and other intangibles	71,473	Deferred taxes.....	12,044
Fixed assets	18,915	Term debt and other liabilities.....	10,943
Other assets	<u>3,183</u>	Non-controlling interests.....	579
	<u>\$129,593</u>	Berkshire equity	<u>91,509</u>
			<u>\$129,593</u>

Earnings Statement (in millions)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenues	\$120,059	\$107,825	\$97,689
Operating expenses	111,383	100,607	90,788
Interest expense.....	<u>214</u>	<u>103</u>	<u>109</u>
Pre-tax earnings	8,462	7,115	6,792
Income taxes and non-controlling interests	<u>2,831</u>	<u>2,432</u>	<u>2,324</u>
Net earnings	<u>\$ 5,631</u>	<u>\$ 4,683</u>	<u>\$ 4,468</u>

Included in this financial summary are 44 businesses that report directly to headquarters. But some of these companies, in turn, have many individual operations under their umbrella. For example, Marmon has 175 separate business units, serving widely disparate markets, and Berkshire Hathaway Automotive owns 83 dealerships, operating in nine states.

This collection of businesses is truly a motley crew. Some operations, measured by earnings on unleveraged net *tangible* assets, enjoy terrific returns that, in a couple of instances, exceed 100%. Most are solid businesses generating good returns in the area of 12% to 20%.

A few, however – these are serious blunders I made in my job of capital allocation – produce very poor returns. In most cases, I was wrong when I originally sized up the economic characteristics of these companies or the industries in which they operate, and we are now paying the price for my misjudgments. In a couple of instances, I stumbled in assessing either the fidelity or ability of incumbent managers or ones I later put in place. I will commit more errors; you can count on that. Fortunately, Charlie – never bashful – is around to say “no” to my worst ideas.

Viewed as a single entity, the companies in the manufacturing, service and retailing group are an excellent business. They employed an average of \$24 billion of net tangible assets during 2016 and, despite their holding large quantities of excess cash and carrying very little debt, earned 24% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if it is bought at too high a price. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show on our balance sheet for goodwill and other intangibles. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Absent a recession, earnings from the group will likely grow in 2017, in part because Duracell and Precision Castparts (both bought in 2016) will for the first time contribute a full year’s earnings to this group. Additionally, Duracell incurred significant transitional costs in 2016 that will not recur.

We have far too many companies in this group to comment on them individually. Moreover, their competitors – both current and potential – read this report. In a few of our businesses, we might be disadvantaged if outsiders knew our numbers. Therefore, in certain of our operations that are not of a size material to an evaluation of Berkshire, we only disclose what is required. You can nevertheless find a good bit of detail about many of our operations on pages 90 - 94. Be aware, though, that it’s the growth of the Berkshire forest that counts. It would be foolish to focus over-intently on any single tree.

* * * * *

For several years I have told you that the income and expense data shown in this section does not conform to GAAP. I have explained that this divergence occurs primarily because of GAAP-ordered rules regarding purchase-accounting adjustments that require the full amortization of certain intangibles over periods averaging about 19 years. In our opinion, most of those amortization “expenses” are not truly an economic cost. Our goal in diverging from GAAP in this section is to present the figures to you in a manner reflecting the way in which Charlie and I view and analyze them.

On page 54 we itemize \$15.4 billion of intangibles that are yet to be amortized by annual charges to earnings. (More intangibles to be amortized will be created as we make new acquisitions.) On that page, we show that the 2016 amortization charge to GAAP earnings was \$1.5 billion, up \$384 million from 2015. My judgment is that about 20% of the 2016 charge is a “real” cost.

Eventually amortization charges fully write off the related asset. When that happens – most often at the 15-year mark – the GAAP earnings we report will increase without any true improvement in the underlying economics of Berkshire’s business. (My gift to my successor.)

Now that I’ve described a GAAP expense that I believe to be overstated, let me move on to a less pleasant distortion produced by accounting rules. The subject this time is GAAP-prescribed depreciation charges, which are necessarily based on historical cost. Yet in certain cases, those charges materially *understate* true economic costs. Countless words were written about this phenomenon in the 1970s and early 1980s, when inflation was rampant. As inflation subsided – thanks to heroic actions by Paul Volcker – the inadequacy of depreciation charges became less of an issue. But the problem still prevails, *big time*, in the railroad industry, where current costs for many depreciable items far outstrip historical costs. The inevitable result is that reported earnings throughout the railroad industry are considerably higher than true economic earnings.

At BNSF, to get down to particulars, our GAAP depreciation charge last year was \$2.1 billion. But were we to spend that sum and no more annually, our railroad would soon deteriorate and become less competitive. The reality is that – *simply to hold our own* – we need to spend far more than the cost we show for depreciation. Moreover, a wide disparity will prevail for decades.

All that said, Charlie and I love our railroad, which was one of our better purchases.

* * * * *

Too many managements – and the number seems to grow every year – are looking for any means to report, *and indeed feature*, “adjusted earnings” that are higher than their company’s GAAP earnings. There are many ways for practitioners to perform this legerdemain. Two of their favorites are the omission of “restructuring costs” and “stock-based compensation” as expenses.

Charlie and I *want* managements, *in their commentary*, to describe unusual items – good or bad – that affect the GAAP numbers. After all, the reason we look at these numbers of the past is to make estimates of the future. But a management that regularly attempts to wave away very real costs by highlighting “adjusted per-share earnings” makes us nervous. That’s because bad behavior is contagious: CEOs who overtly look for ways to report high numbers tend to foster a culture in which subordinates strive to be “helpful” as well. Goals like that can lead, for example, to insurers underestimating their loss reserves, a practice that has destroyed many industry participants.

Charlie and I cringe when we hear analysts talk admiringly about managements who always “make the numbers.” In truth, business is too unpredictable for the numbers always to be met. Inevitably, surprises occur. When they do, a CEO whose focus is centered on Wall Street will be tempted to *make up* the numbers.

Let’s get back to the two favorites of “don’t-count-this” managers, starting with “restructuring.” Berkshire, I would say, has been restructuring from the first day we took over in 1965. Owning only a northern textile business then gave us no other choice. And today a fair amount of restructuring occurs every year at Berkshire. That’s because there are always things that need to change in our hundreds of businesses. Last year, as I mentioned earlier, we spent significant sums getting Duracell in shape for the decades ahead.

We have never, however, singled out restructuring charges and told you to ignore them in estimating our normal earning power. If there were to be some truly major expenses in a single year, I would, of course, mention it in my commentary. Indeed, when there is a total rebasing of a business, such as occurred when Kraft and Heinz merged, it is imperative that for several years the huge one-time costs of rationalizing the combined operations be explained clearly to owners. That’s precisely what the CEO of Kraft Heinz has done, in a manner approved by the company’s directors (who include me). But, to tell owners year after year, “Don’t count this,” when management is simply making business adjustments that are necessary, is misleading. And too many analysts and journalists fall for this baloney.

To say “stock-based compensation” is not an expense is even more cavalier. CEOs who go down that road are, in effect, saying to shareholders, “If you pay me a bundle in options or restricted stock, don’t worry about its effect on earnings. I’ll ‘adjust’ it away.”

To explore this maneuver further, join me for a moment in a visit to a make-believe accounting laboratory whose sole mission is to juice Berkshire’s *reported* earnings. Imaginative technicians await us, eager to show their stuff.

Listen carefully while I tell these enablers that stock-based compensation usually comprises at least 20% of total compensation for the top three or four executives at most large companies. Pay attention, too, as I explain that Berkshire has several hundred such executives at its subsidiaries and pays them similar amounts, but uses only cash to do so. I further confess that, lacking imagination, I have counted *all* of these payments to Berkshire's executives as an expense.

My accounting minions suppress a giggle and immediately point out that 20% of what is paid these Berkshire managers is tantamount to "cash paid in lieu of stock-based compensation" and is therefore not a "true" expense. So – presto! – Berkshire, too, can have "adjusted" earnings.

Back to reality: If CEOs want to leave out stock-based compensation in reporting earnings, they should be required to affirm *to their owners* one of two propositions: why items of value used to pay employees are not a cost or why a payroll cost should be excluded when calculating earnings.

During the accounting nonsense that flourished during the 1960s, the story was told of a CEO who, as his company revved up to go public, asked prospective auditors, "What is two plus two?" The answer that won the assignment, of course, was, "What number do you have in mind?"

Finance and Financial Products

Our three leasing and rental operations are conducted by CORT (furniture), XTRA (semi-trailers), and Marmon (primarily tank cars but also freight cars, intermodal tank containers and cranes). Each is the leader in its field.

We also include Clayton Homes in this section. This company receives most of its revenue from the sale of manufactured homes, but derives the bulk of its *earnings* from its large mortgage portfolio. Last year, Clayton became America's largest home builder, delivering 42,075 units that accounted for 5% of all new American homes. (In fairness, other large builders do far more *dollar* volume than Clayton because they sell site-built homes that command much higher prices.)

In 2015, Clayton branched out, purchasing its first site-builder. Two similar acquisitions followed in 2016, and more will come. Site-built houses are expected to amount to 3% or so of Clayton's unit sales in 2017 and will likely deliver about 14% of its dollar volume.

Even so, Clayton's focus will always be manufactured homes, which account for about 70% of new American homes costing less than \$150,000. Clayton manufactures close to one-half of the total. That is a far cry from Clayton's position in 2003 when Berkshire purchased the company. It then ranked third in the industry in units sold and employed 6,731 people. Now, when its new acquisitions are included, the employee count is 14,677. And that number will increase in the future.

Clayton's earnings in recent years have materially benefited from extraordinarily low interest rates. The company's mortgage loans to home-buyers are at fixed-rates and for long terms (averaging 25 years at inception). But Clayton's own borrowings are short-term credits that re-price frequently. When rates plunge, Clayton's earnings from its portfolio greatly increase. We normally would shun that kind of lend-long, borrow-short approach, which can cause major problems for financial institutions. As a whole, however, Berkshire is always asset-sensitive, meaning that higher short-term rates will benefit our *consolidated* earnings, even as they hurt at Clayton.

Last year Clayton had to foreclose on 8,304 manufactured-housing mortgages, about 2.5% of its total portfolio. Customer demographics help explain that percentage. Clayton's customers are usually lower-income families with mediocre credit scores; many are supported by jobs that will be at risk in any recession; many, similarly, have financial profiles that will be damaged by divorce or death to an extent that would not be typical for a high-income family. Those risks that our customers face are partly mitigated because almost all have a strong desire to own a home and because they enjoy reasonable monthly payments that average only \$587, *including* the cost of insurance and property taxes.

Clayton also has long had programs that help borrowers through difficulties. The two most popular are loan extensions and payment forgiveness. Last year about 11,000 borrowers received extensions, and 3,800 had \$3.4 million of scheduled payments permanently canceled by Clayton. The company does not earn interest or fees when these loss-mitigation moves are made. Our experience is that 93% of borrowers helped through these programs in the last two years now remain in their homes. Since we lose significant sums on foreclosures – losses last year totaled \$150 million – our assistance programs end up helping Clayton as well as its borrowers.

Clayton and Berkshire have been a wonderful partnership. Kevin Clayton came to us with a best-in-class management group and culture. Berkshire, in turn, provided unmatched staying power when the manufactured-home industry fell apart during the Great Recession. (As other lenders to the industry vanished, Clayton supplied credit not only to its own dealers but also to dealers who sold the products of its competitors.) At Berkshire, we never count on synergies when we acquire companies. Truly important ones, however, surfaced after our purchase of Clayton.

Marmon's railcar business experienced a major slowdown in demand last year, which will cause earnings to decline in 2017. Fleet utilization was 91% in December, down from 97% a year earlier, with the drop particularly severe at the large fleet we purchased from General Electric in 2015. Marmon's crane and container rentals have weakened as well.

Big swings in railcar demand have occurred in the past and they will continue. Nevertheless, we very much like this business and expect decent returns on equity capital over the years. Tank cars are Marmon's specialty. People often associate tank cars with the transportation of crude oil; in fact, they are essential to a great variety of shippers.

Over time, we expect to expand our railcar operation. Meanwhile, Marmon is making a number of bolt-on acquisitions whose results are included in the Manufacturing, Service and Retailing section.

Here's the pre-tax earnings recap for our finance-related companies:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
	<i>(in millions)</i>		
Berkadia (our 50% share)	\$ 91	\$ 74	\$ 122
Clayton	744	706	558
CORT	60	55	49
Marmon – Containers and Cranes	126	192	238
Marmon – Railcars	654	546	442
XTRA	179	172	147
Net financial income*	276	341	283
	<u>\$ 2,130</u>	<u>\$ 2,086</u>	<u>\$ 1,839</u>

* Excludes capital gains or losses

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding because Berkshire is part of a control group and therefore must account for this investment on the “equity” method. The 325,442,152 shares Berkshire owns of Kraft Heinz are carried on our balance sheet at a GAAP figure of \$15.3 billion and had a yearend market value of \$28.4 billion. Our cost basis for the shares is \$9.8 billion.

<u>Shares*</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>12/31/16</u>	<u>Cost**</u>	<u>Market</u>
(in millions)					
151,610,700	American Express Company	16.8	\$ 1,287	\$ 11,231	
61,242,652	Apple Inc.	1.1	6,747		7,093
6,789,054	Charter Communications, Inc.	2.5	1,210		1,955
400,000,000	The Coca-Cola Company	9.3	1,299		16,584
54,934,718	Delta Airlines Inc.	7.5	2,299		2,702
11,390,582	The Goldman Sachs Group, Inc.	2.9	654		2,727
81,232,303	International Business Machines Corp.	8.5	13,815		13,484
24,669,778	Moody's Corporation	12.9	248		2,326
74,587,892	Phillips 66.....	14.4	5,841		6,445
22,169,930	Sanofi	1.7	1,692		1,791
43,203,775	Southwest Airlines Co.	7.0	1,757		2,153
101,859,335	U.S. Bancorp	6.0	3,239		5,233
26,620,184	United Continental Holdings Inc.	8.4	1,477		1,940
43,387,980	USG Corp.	29.7	836		1,253
500,000,000	Wells Fargo & Company	10.0	12,730		27,555
	Others		10,697		17,560
	Total Common Stocks Carried at Market		<u>\$ 65,828</u>		<u>\$ 122,032</u>

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis; GAAP “cost” differs in a few cases because of write-downs that have been required under GAAP rules.

Some of the stocks in the table are the responsibility of either Todd Combs or Ted Weschler, who work with me in managing Berkshire’s investments. Each, *independently*, manages more than \$10 billion; I usually learn about decisions they have made by looking at monthly trade sheets. Included in the \$21 billion that the two manage is about \$7.6 billion of pension trust assets of certain Berkshire subsidiaries. As noted, pension investments are not included in the preceding tabulation of Berkshire holdings.

Excluded from the table – *but important* – is our ownership of \$5 billion of preferred stock issued by Bank of America. This stock, which pays us \$300 million per year, also carries with it a valuable warrant allowing Berkshire to purchase 700 million common shares of Bank of America for \$5 billion at any time before September 2, 2021. At yearend, that privilege would have delivered us a profit of \$10.5 billion. If it wishes, Berkshire can use its preferred shares to satisfy the \$5 billion cost of exercising the warrant.

If the dividend rate on Bank of America common stock – now 30 cents annually – should rise above 44 cents before 2021, we would anticipate making a cashless exchange of our preferred into common. If the common dividend remains below 44 cents, it is highly probable that we will exercise the warrant immediately before it expires.

Many of our investees, including Bank of America, have been repurchasing shares, some quite aggressively. We very much like this behavior because we believe the repurchased shares have in most cases been underpriced. (Undervaluation, after all, is why we own these positions.) When a company grows and outstanding shares shrink, good things happen for shareholders.

* * * * *

It's important for you to understand that 95% of the \$86 billion of "cash and equivalents" (which in my mind includes U.S. Treasury Bills) shown on our balance sheet are held by entities in the United States and, consequently, is not subject to any repatriation tax. Moreover, repatriation of the remaining funds would trigger only minor taxes because much of that money has been earned in countries that themselves impose meaningful corporate taxes. Those payments become an offset to U.S. tax when money is brought home.

These explanations are important because many cash-rich American companies hold a large portion of their funds in jurisdictions imposing very low taxes. Such companies hope – and may well be proved right – that the tax levied for bringing these funds to America will soon be materially reduced. In the meantime, these companies are limited as to how they can use that cash. In other words, off-shore cash is simply not worth as much as cash held at home.

Berkshire has a partial offset to the favorable geographical location of its cash, which is that much of it is held in our insurance subsidiaries. Though we have many alternatives for investing this cash, we do not have the unlimited choices that we would enjoy if the cash were held by the parent company, Berkshire. We *do* have an ability annually to distribute large amounts of cash from our insurers to the parent – though here, too, there are limits. Overall, cash held at our insurers is a very valuable asset, but one slightly less valuable to us than is cash held at the parent level.

* * * * *

Sometimes the comments of shareholders or media imply that we will own certain stocks "forever." It is true that we own some stocks that I have no intention of selling for as far as the eye can see (and we're talking 20/20 vision). But we have made no *commitment* that Berkshire will hold *any* of its marketable securities forever.

Confusion about this point may have resulted from a too-casual reading of Economic Principle 11 on pages 110 - 111, which has been included in our annual reports since 1983. That principle covers *controlled businesses*, not marketable securities. This year I've added a final sentence to #11 to ensure that our owners understand that we regard any marketable security as available for sale, however unlikely such a sale now seems.

* * * * *

Before we leave this investment section, a few educational words about dividends and taxes: Berkshire, like most corporations, nets considerably *more* from a dollar of dividends than it reaps from a dollar of capital gains. That will probably surprise those of our shareholders who are accustomed to thinking of capital gains as the route to tax-favored returns.

But here's the *corporate* math. Every \$1 of capital gains that a corporation realizes carries with it 35 cents of federal income tax (and often state income tax as well). The tax on dividends received from *domestic* corporations, however, is consistently lower, though rates vary depending on the status of the recipient.

For a non-insurance company – which describes Berkshire Hathaway, the parent – the federal tax rate is effectively 10½ cents per \$1 of dividends received. Furthermore, a non-insurance company that owns more than 20% of an investee owes taxes of only 7 cents per \$1 of dividends. That rate applies, for example, to the substantial dividends we receive from our 27% ownership of Kraft Heinz, all of it held by the parent company. (The rationale for the low corporate taxes on dividends is that the dividend-paying investee has already paid its own corporate tax on the earnings being distributed.)

Berkshire's insurance subsidiaries pay a tax rate on dividends that is somewhat higher than that applying to non-insurance companies, though the rate is still well below the 35% hitting capital gains. Property/casualty companies owe about 14% in taxes on most dividends they receive. Their tax rate falls, though, to about 11% if they own more than 20% of a U.S.-based investee.

And that's our tax lesson for today.

"The Bet" (or how your money finds its way to Wall Street)

In this section, you will encounter, early on, the story of an investment bet I made nine years ago and, next, some strong opinions I have about investing. As a starter, though, I want to briefly describe Long Bets, a unique establishment that played a role in the bet.

Long Bets was seeded by Amazon's Jeff Bezos and operates as a non-profit organization that administers just what you'd guess: long-term bets. To participate, "proposers" post a proposition at Longbets.org that will be proved right or wrong at a distant date. They then wait for a contrary-minded party to take the other side of the bet. When a "doubter" steps forward, each side names a charity that will be the beneficiary if its side wins; parks its wager with Long Bets; and posts a short essay defending its position on the Long Bets website. When the bet is concluded, Long Bets pays off the winning charity.

Here are examples of what you will find on Long Bets' very interesting site:

In 2002, entrepreneur Mitch Kapor asserted that "By 2029 no computer – or 'machine intelligence' – will have passed the Turing Test," which deals with whether a computer can successfully impersonate a human being. Inventor Ray Kurzweil took the opposing view. Each backed up his opinion with \$10,000. I don't know who will win this bet, but I will confidently wager that no computer will ever replicate Charlie.

That same year, Craig Mundie of Microsoft asserted that pilotless planes would routinely fly passengers by 2030, while Eric Schmidt of Google argued otherwise. The stakes were \$1,000 each. To ease any heartburn Eric might be experiencing from his outsized exposure, I recently offered to take a piece of his action. He promptly laid off \$500 with me. (I like his assumption that I'll be around in 2030 to contribute my payment, should we lose.)

Now, to my bet and its history. In Berkshire's 2005 annual report, I argued that active investment management by professionals – in aggregate – would over a period of years underperform the returns achieved by rank amateurs who simply sat still. I explained that the massive fees levied by a variety of "helpers" would leave their clients – *again in aggregate* – worse off than if the amateurs simply invested in an unmanaged low-cost index fund. (See pages 114 - 115 for a reprint of the argument as I originally stated it in the 2005 report.)

Subsequently, I publicly offered to wager \$500,000 that no investment pro could select a set of at least five hedge funds – wildly-popular and high-fee investing vehicles – that would over an extended period match the performance of an unmanaged S&P-500 index fund charging only token fees. I suggested a ten-year bet and named a low-cost Vanguard S&P fund as my contender. I then sat back and waited expectantly for a parade of fund managers – who could include their own fund as one of the five – to come forth and defend their occupation. After all, these managers urged *others* to bet billions on their abilities. Why should they fear putting a little of their own money on the line?

What followed was the sound of silence. Though there are thousands of professional investment managers who have amassed staggering fortunes by touting their stock-selecting prowess, only one man – Ted Seides – stepped up to my challenge. Ted was a co-manager of Protégé Partners, an asset manager that had raised money from limited partners to form a fund-of-funds – in other words, a fund that invests in multiple hedge funds.

I hadn't known Ted before our wager, but I like him and admire his willingness to put his money where his mouth was. He has been both straight-forward with me and meticulous in supplying all the data that both he and I have needed to monitor the bet.

For Protégé Partners' side of our ten-year bet, Ted picked five funds-of-funds whose results were to be averaged and compared against my Vanguard S&P index fund. The five he selected had invested their money in more than 100 hedge funds, which meant that the overall performance of the funds-of-funds would not be distorted by the good or poor results of a single manager.

Each fund-of-funds, of course, operated with a layer of fees that sat above the fees charged by the hedge funds in which it had invested. In this doubling-up arrangement, the larger fees were levied by the underlying hedge funds; each of the fund-of-funds imposed an additional fee for its presumed skills in selecting hedge-fund managers.

Here are the results for the first nine years of the bet – figures leaving no doubt that Girls Inc. of Omaha, the charitable beneficiary I designated to get any bet winnings I earned, will be the organization eagerly opening the mail next January.

Year	Fund of Funds A	Fund of Funds B	Fund of Funds C	Fund of Funds D	Fund of Funds E	S&P Index Fund
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-2.9%	1.7%	-1.4%	2.5%	4.4%	11.9%
Gain to Date	8.7%	28.3%	62.8%	2.9%	7.5%	85.4%

Footnote: Under my agreement with Protégé Partners, the names of these funds-of-funds have never been publicly disclosed. I, however, see their annual audits.

The compounded annual increase to date for the index fund is 7.1%, which is a return that could easily prove typical for the stock market over time. That's an important fact: A particularly weak nine years for the market over the lifetime of this bet would have probably helped the relative performance of the hedge funds, because many hold large "short" positions. Conversely, nine years of exceptionally high returns from stocks would have provided a tailwind for index funds.

Instead we operated in what I would call a "neutral" environment. In it, the five funds-of-funds delivered, through 2016, an average of only 2.2%, compounded annually. That means \$1 million invested in those funds would have gained \$220,000. The index fund would meanwhile have gained \$854,000.

Bear in mind that every one of the 100-plus managers of the underlying hedge funds had a huge financial incentive to do his or her best. Moreover, the five funds-of-funds managers that Ted selected were similarly incentivized to select the best hedge-fund managers possible because the five were entitled to performance fees based on the results of the underlying funds.

I'm certain that in almost all cases the managers at both levels were honest and intelligent people. But the results for their investors were dismal – *really* dismal. And, alas, the huge fixed fees charged by all of the funds and funds-of-funds involved – fees that were totally unwarranted by performance – were such that their managers were showered with compensation over the nine years that have passed. As Gordon Gekko might have put it: “Fees never sleep.”

The underlying hedge-fund managers in our bet received payments from their limited partners that likely averaged a bit under the prevailing hedge-fund standard of “2 and 20,” meaning a 2% annual fixed fee, payable even when losses are huge, and 20% of profits with no clawback (if good years were followed by bad ones). Under this lopsided arrangement, a hedge fund operator’s ability to simply pile up assets under management has made many of these managers extraordinarily rich, even as their investments have performed poorly.

Still, we’re not through with fees. Remember, there were the fund-of-funds managers to be fed as well. These managers received an additional fixed amount that was usually set at 1% of assets. Then, despite the terrible overall record of the five funds-of-funds, some experienced a few good years and collected “performance” fees. Consequently, I estimate that over the nine-year period roughly 60% – gulp! – of *all* gains achieved by the five funds-of-funds were diverted to the two levels of managers. That was their misbegotten reward for accomplishing something far short of what their many hundreds of limited partners could have effortlessly – and with virtually *no* cost – achieved on their own.

In my opinion, the disappointing results for hedge-fund investors that this bet exposed are almost certain to recur in the future. I laid out my reasons for that belief in a statement that was posted on the Long Bets website when the bet commenced (and that is still posted there). Here is what I asserted:

Over a ten-year period commencing on January 1, 2008, and ending on December 31, 2017, the S&P 500 will outperform a portfolio of funds of hedge funds, when performance is measured on a basis net of fees, costs and expenses.

A lot of very smart people set out to do better than average in securities markets. Call them active investors.

Their opposites, passive investors, will by definition do about average. In aggregate their positions will more or less approximate those of an index fund. Therefore, the balance of the universe—the active investors—must do about average as well. However, these investors will incur far greater costs. So, on balance, their aggregate results after these costs will be worse than those of the passive investors.

Costs skyrocket when large annual fees, large performance fees, and active trading costs are all added to the active investor’s equation. Funds of hedge funds accentuate this cost problem because their fees are superimposed on the large fees charged by the hedge funds in which the funds of funds are invested.

A number of smart people are involved in running hedge funds. But to a great extent their efforts are self-neutralizing, and their IQ will not overcome the costs they impose on investors. Investors, on average and over time, will do better with a low-cost index fund than with a group of funds of funds.

So that was my argument – and now let me put it into a simple equation. If Group A (active investors) and Group B (do-nothing investors) comprise the total investing universe, and B is destined to achieve average results before costs, so, too, must A. Whichever group has the lower costs will win. (The academic in me requires me to mention that there is a very minor point – not worth detailing – that *slightly* modifies this formulation.) And if Group A has exorbitant costs, its shortfall will be substantial.

There are, of course, some skilled individuals who are highly likely to out-perform the S&P over long stretches. In my lifetime, though, I've identified – *early on* – only ten or so professionals that I expected would accomplish this feat.

There are no doubt many hundreds of people – perhaps thousands – whom I have never met and whose abilities would equal those of the people I've identified. The job, after all, is not impossible. The problem simply is that the great majority of managers who attempt to over-perform will fail. The probability is also very high that the person soliciting your funds will not be the exception who does well. Bill Ruane – a truly wonderful human being and a man whom I identified 60 years ago as almost certain to deliver superior investment returns over the long haul – said it well: "In investment management, the progression is from the innovators to the imitators to the swarming incompetents."

Further complicating the search for the rare high-fee manager who is worth his or her pay is the fact that some investment professionals, just as some amateurs, will be lucky over short periods. If 1,000 managers make a market prediction at the beginning of a year, it's very likely that the calls of at least one will be correct for nine consecutive years. Of course, 1,000 monkeys would be just as likely to produce a seemingly all-wise prophet. But there *would* remain a difference: The lucky monkey would not find people standing in line to invest with him.

Finally, there are three connected realities that cause investing success to breed failure. First, a good record quickly attracts a torrent of money. Second, huge sums invariably act as an anchor on investment performance: What is easy with millions, struggles with billions (sob!). Third, most managers will nevertheless seek new money because of their *personal* equation – namely, the more funds they have under management, the more their fees.

These three points are hardly new ground for me: In January 1966, when I was managing \$44 million, I wrote my limited partners: "I feel substantially greater size is more likely to harm future results than to help them. This might not be true for my own personal results, but it is likely to be true for your results. Therefore, . . . I intend to admit no additional partners to BPL. I have notified Susie that if we have any more children, it is up to her to find some other partnership for them."

The bottom line: When trillions of dollars are managed by Wall Streeters charging high fees, it will usually be the managers who reap outsized profits, not the clients. Both large and small investors should stick with low-cost index funds.

* * * * *

If a statue is ever erected to honor the person who has done the most for American investors, the hands-down choice should be Jack Bogle. For decades, Jack has urged investors to invest in ultra-low-cost index funds. In his crusade, he amassed only a tiny percentage of the wealth that has typically flowed to managers who have promised their investors large rewards while delivering them nothing – or, as in our bet, *less* than nothing – of added value.

In his early years, Jack was frequently mocked by the investment-management industry. Today, however, he has the satisfaction of knowing that he helped millions of investors realize far better returns on their savings than they otherwise would have earned. He is a hero to them and to me.

* * * * *

Over the years, I've often been asked for investment advice, and in the process of answering I've learned a good deal about human behavior. My regular recommendation has been a low-cost S&P 500 index fund. To their credit, my friends who possess only modest means have usually followed my suggestion.

I believe, however, that *none* of the mega-rich individuals, institutions or pension funds has followed that same advice when I've given it to them. Instead, these investors politely thank me for my thoughts and depart to listen to the siren song of a high-fee manager or, in the case of many institutions, to seek out another breed of hyper-helper called a consultant.

That professional, however, faces a problem. Can you imagine an investment consultant telling clients, year after year, to keep adding to an index fund replicating the S&P 500? That would be career suicide. Large fees flow to these hyper-helpers, however, if they recommend small managerial shifts every year or so. That advice is often delivered in esoteric gibberish that explains why fashionable investment "styles" or current economic trends make the shift appropriate.

The wealthy are accustomed to feeling that it is their lot in life to get the best food, schooling, entertainment, housing, plastic surgery, sports ticket, you name it. Their money, they feel, should buy them something superior compared to what the masses receive.

In many aspects of life, indeed, wealth does command top-grade products or services. For that reason, the financial "elites" – wealthy individuals, pension funds, college endowments and the like – have great trouble meekly signing up for a financial product or service that is available as well to people investing only a few thousand dollars. This reluctance of the rich normally prevails even though the product at issue is –on an expectancy basis – clearly the best choice. My calculation, admittedly very rough, is that the search by the elite for superior investment advice has caused it, in aggregate, to waste more than \$100 billion over the past decade. Figure it out: Even a 1% fee on a few trillion dollars adds up. Of course, not every investor who put money in hedge funds ten years ago lagged S&P returns. But I believe my calculation of the aggregate shortfall is conservative.

Much of the financial damage befell pension funds for public employees. Many of these funds are woefully underfunded, in part because they have suffered a double whammy: poor investment performance accompanied by huge fees. The resulting shortfalls in their assets will for decades have to be made up by local taxpayers.

Human behavior won't change. Wealthy individuals, pension funds, endowments and the like will continue to feel they deserve something "extra" in investment advice. Those advisors who cleverly play to this expectation will get very rich. This year the magic potion may be hedge funds, next year something else. The likely result from this parade of promises is predicted in an adage: "When a person with money meets a person with experience, the one with experience ends up with the money and the one with money leaves with experience."

Long ago, a brother-in-law of mine, Homer Rogers, was a commission agent working in the Omaha stockyards. I asked him how he induced a farmer or rancher to hire him to handle the sale of their hogs or cattle to the buyers from the big four packers (Swift, Cudahy, Wilson and Armour). After all, hogs were hogs and the buyers were experts who knew to the penny how much any animal was worth. How then, I asked Homer, could any sales agent get a better result than any other?

Homer gave me a pitying look and said: "Warren, it's not how you sell 'em, it's how you tell 'em." What worked in the stockyards continues to work in Wall Street.

* * * * *

And, finally, let me offer an olive branch to Wall Streeters, many of them good friends of mine. Berkshire *loves* to pay fees – even outrageous fees – to investment bankers who bring us acquisitions. Moreover, we have paid substantial sums for over-performance to our two in-house investment managers – and we hope to make even larger payments to them in the future.

To get biblical (Ephesians 3:18), I know the height and the depth and the length and the breadth of the energy flowing from that simple four-letter word – fees – when it is spoken to Wall Street. And when that energy delivers value to Berkshire, I will cheerfully write a big check.

The Annual Meeting

Last year we partnered with Yahoo to air the first-ever webcast of our annual meeting. Thanks to Andy Serwer and his Yahoo crew, the production was a success in all respects, registering 1.1 million unique visits in real-time viewing and 11.5 million more in replays (many of those, to be sure, called up by viewers interested in only certain segments of the webcast).

Berkshire's thank-you mail for initiating the webcast included many notes from three constituencies: the elderly who find travel difficult; the thrifty who find it expensive to travel to Omaha; and those who cannot attend a Saturday meeting for religious reasons.

The webcast cut attendance at last year's meeting to about 37,000 people (we can't get a precise count), which was down about 10%. Nevertheless, both Berkshire's subsidiaries and Omaha hotels and restaurants racked up huge sales. Nebraska Furniture Mart's sales broke their 2015 record volume by 3%, with the Omaha store recording one-week volume of \$45.5 million.

Our Berkshire exhibitors at CenturyLink were open from noon until 5 p.m. on Friday and drew a crowd of 12,000 bargain-hunting shareholders. We will repeat those Friday shopping hours this year on May 5th. Bring money.

The annual meeting falls on May 6th and will again be webcast by Yahoo, whose web address is <https://finance.yahoo.com/brklivestream>. The webcast will go live at 9 a.m. Central Daylight Time. Yahoo will interview directors, managers, stockholders and celebrities before the meeting and during the lunch break. Both those interviews and meeting will be translated simultaneously into Mandarin.

For those attending the meeting in person, the doors at the CenturyLink will open at 7:00 a.m. on Saturday to facilitate shopping prior to our shareholder movie, which begins at 8:30. The question-and-answer period will start at 9:30 and run until 3:30, with a one-hour lunch break at noon. Finally, at 3:45 we will begin the formal shareholder meeting. It will run an hour or so. That is somewhat longer than usual because three proxy items are to be presented by their proponents, who will be given a reasonable amount of time to state their case.

On Saturday morning, we will have our sixth International Newspaper Tossing Challenge. Our target will again be the porch of a Clayton Home, located precisely 35 feet from the throwing line. When I was a teenager – in my one brief flirtation with honest labor – I delivered about 500,000 papers. So I think I'm pretty good at this game. Challenge me! Humiliate me! Knock me down a peg! The papers will run 36 to 42 pages, and you must fold them yourself (no rubber bands allowed). The competition will begin about 7:45, and I'll take on ten or so competitors selected a few minutes earlier by my assistant, Deb Bosanek.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of our subsidiaries will be for sale. Say hello to the many Berkshire managers who will be captaining their exhibits. And be sure to view the terrific BNSF railroad layout that salutes all of our companies. Your children (and you!) will be enchanted with it.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them on Sunday at our fourth annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that will be sent to you with your meeting credentials. Entrants in the race will find themselves running alongside many of Berkshire's managers, directors and associates. (Charlie and I, however, will sleep in; the fudge and peanut brittle we eat throughout the Saturday meeting takes its toll.) Participation in the 5K grows every year. Help us set another record.

A GEICO booth in the shopping area will be staffed by a number of the company's top counselors from around the country. At last year's meeting, we set a record for policy sales, up 21% from 2015. I predict we will be up again this year.

So stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money. Spend the savings on other Berkshire products.

Be sure to visit the Bookworm. This Omaha-based retailer will carry about 35 books and DVDs, among them a couple of new titles. The best book I read last year was *Shoe Dog*, by Nike's Phil Knight. Phil is a very wise, intelligent and competitive fellow who is also a gifted storyteller. The Bookworm will have piles of *Shoe Dog* as well as several investment classics by Jack Bogle.

The Bookworm will once again offer our history of the highlights (and lowlights) of Berkshire's first 50 years. Non-attendees of the meeting can find the book on eBay. Just type in: *Berkshire Hathaway Inc. Celebrating 50 years of a Profitable Partnership* (2nd Edition).

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Keep in mind that airlines have sometimes jacked up prices for the Berkshire weekend – though I must admit I have developed some tolerance, bordering on enthusiasm, for that practice now that Berkshire has made large investments in America's four major carriers. Nevertheless, if you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money. The savings for a couple could run to \$1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, May 2nd and Monday, May 8th inclusive, and must also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. During "Berkshire Weekend," NFM will be open from 10 a.m. to 9 p.m. Monday through Friday, 10 a.m. to 9:30 p.m. on Saturday and 10 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is hosting a picnic to which you are all invited.

This year we have good news for shareholders in the Kansas City and Dallas metro markets who can't attend the meeting or perhaps prefer the webcast. From May 2nd through May 8th, shareholders who present meeting credentials or other evidence of their Berkshire ownership (such as brokerage statements) to their local NFM store will receive the same discounts enjoyed by those visiting the Omaha store.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 5th. The second, the main gala, will be held on Sunday, May 7th, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. Remember, the more you buy, the more you save (or so my daughter tells me when we visit the store).

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, May 1st through Saturday, May 13th. During that period, please identify yourself as a shareholder either by presenting your meeting credential or a brokerage statement showing you own our stock.

On Sunday, in the mall outside of Borsheims, Norman Beck, a remarkable magician and motivational speaker from Dallas, will bewilder onlookers. On the upper level, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play with our shareholders on Sunday afternoon. If they suggest wagering on the game, change the subject. I will join them at some point and hope Ajit, Charlie and Bill Gates will do so also.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine, and even then I was unable to score a point against her. Ariel represented the United States in the 2012 Olympics. Now, she's a senior at Princeton (after interning last summer at JPMorgan Chase). If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates did pretty well playing Ariel last year, so he may be ready to again challenge her. (My advice: Bet on Ariel.)

Gorat's will be open exclusively for Berkshire shareholders on Sunday, May 7th, serving from 1 p.m. until 10 p.m. To make a reservation at Gorat's, call 402-551-3733 on April 3rd (*but not before*). Show you are a sophisticated diner by ordering the T-bone with hash browns.

We will have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, the preeminent business journalist of her time, who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of the New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important to shareholders. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

An accompanying set of questions will be asked by three analysts who follow Berkshire. This year the insurance specialist will be Jay Gelb of Barclays. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Since what we will be conducting is a *shareholders'* meeting, our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. Multi-part questions aren't allowed; we want to give as many questioners as possible a shot at us. Our goal is for you to leave the meeting knowing more about Berkshire than when you came and for you to have a good time while in Omaha.

All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and, if possible, should also have adequate time to digest and analyze it before any trading takes place. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday (a day that also eases traffic and parking problems).

We do not follow the common practice of talking one-on-one with large institutional investors or analysts, treating them instead as we do all other shareholders. There is no one more important to us than the shareholder of limited means who trusts us with a substantial portion of his or her savings. As I run the company day-to-day – and as I write this letter – that is the shareholder whose image is in my mind.

* * * * *

For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I also believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the men and women who work with me at our corporate office. This team efficiently deals with a multitude of SEC and other regulatory requirements, files a 30,450-page Federal income tax return, oversees the filing of 3,580 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities, fact-checks this letter – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year, for example, they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and French fries (smothered in Heinz ketchup, of course) for lunch. In addition, they cheerfully pitch in to help Carrie Sova – our talented ringmaster at the annual meeting – deliver an interesting and entertaining weekend for our shareholders. They are proud to work for Berkshire, and I am proud of them.

I'm a lucky guy, very fortunate in being surrounded by this excellent staff, a team of highly-talented operating managers and a boardroom of very wise and experienced directors. Come to Omaha – the cradle of capitalism – on May 6th and meet the Berkshire Bunch. All of us look forward to seeing you.

February 25, 2017

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
2016	10.7	23.4	12.0
2017	23.0	21.9	21.8
Compounded Annual Gain – 1965-2017	19.1%	20.9%	9.9%
Overall Gain – 1964-2017	1,088,029%	2,404,748%	15,508%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2017 was \$65.3 billion, which increased the per-share book value of both our Class A and Class B stock by 23%. Over the last 53 years (that is, since present management took over), per-share book value has grown from \$19 to \$211,750, a rate of 19.1% compounded annually.*

The format of that opening paragraph has been standard for 30 years. But 2017 was far from standard: A large portion of our gain did *not* come from anything we accomplished at Berkshire.

The \$65 billion gain is nonetheless real – rest assured of that. But only \$36 billion came from Berkshire's operations. The remaining \$29 billion was delivered to us in December when Congress rewrote the U.S. Tax Code. (Details of Berkshire's tax-related gain appear on page K-32 and pages K-89 – K-90.)

After stating those fiscal facts, I would prefer to turn immediately to discussing Berkshire's operations. But, in still another interruption, I must first tell you about a new accounting rule – a generally accepted accounting principle (GAAP) – that in *future* quarterly and annual reports will severely distort Berkshire's net income figures and very often mislead commentators and investors.

The new rule says that the net change in *unrealized* investment gains and losses in stocks we hold must be included in all net income figures we report to you. That requirement will produce some truly wild and capricious swings in our GAAP bottom-line. Berkshire owns \$170 billion of marketable stocks (not including our shares of Kraft Heinz), and the value of these holdings can easily swing by \$10 billion or more within a quarterly reporting period. Including gyrations of that magnitude in reported net income will swamp the truly important numbers that describe our operating performance. For analytical purposes, Berkshire's "bottom-line" will be useless.

The new rule compounds the communication problems we have long had in dealing with the *realized* gains (or losses) that accounting rules compel us to include in our net income. In past quarterly and annual press releases, we have regularly warned you not to pay attention to these realized gains, because they – just like our unrealized gains – fluctuate randomly.

That's largely because we sell securities when that seems the intelligent thing to do, not because we are trying to influence earnings in any way. As a result, we sometimes have reported substantial realized gains for a period when our portfolio, overall, performed poorly (or the converse).

*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for the A shares.

With the new rule about unrealized gains exacerbating the distortion caused by the existing rules applying to realized gains, we will take pains every quarter to explain the adjustments you need in order to make sense of our numbers. But televised commentary on earnings releases is often instantaneous with their receipt, and newspaper headlines almost always focus on the year-over-year change in GAAP net income. Consequently, media reports sometimes highlight figures that unnecessarily frighten or encourage many readers or viewers.

We will attempt to alleviate this problem by continuing our practice of publishing financial reports late on Friday, well after the markets close, or early on Saturday morning. That will allow you maximum time for analysis and give investment professionals the opportunity to deliver informed commentary before markets open on Monday. Nevertheless, I expect considerable confusion among shareholders for whom accounting is a foreign language.

At Berkshire what counts most are increases in our normalized per-share earning power. That metric is what Charlie Munger, my long-time partner, and I focus on – and we hope that you do, too. Our scorecard for 2017 follows.

Acquisitions

There are four building blocks that add value to Berkshire: (1) sizable stand-alone acquisitions; (2) bolt-on acquisitions that fit with businesses we already own; (3) internal sales growth and margin improvement at our many and varied businesses; and (4) investment earnings from our huge portfolio of stocks and bonds. In this section, we will review 2017 acquisition activity.

In our search for new stand-alone businesses, the key qualities we seek are durable competitive strengths; able and high-grade management; good returns on the net tangible assets required to operate the business; opportunities for internal growth at attractive returns; and, finally, *a sensible purchase price*.

That last requirement proved a barrier to virtually all deals we reviewed in 2017, as prices for decent, but far from spectacular, businesses hit an all-time high. Indeed, price seemed almost irrelevant to an army of optimistic purchasers.

Why the purchasing frenzy? In part, it's because the CEO job self-selects for "can-do" types. If Wall Street analysts or board members urge that brand of CEO to consider possible acquisitions, it's a bit like telling your ripening teenager to be sure to have a normal sex life.

Once a CEO hungers for a deal, he or she will never lack for forecasts that justify the purchase. Subordinates will be cheering, envisioning enlarged domains and the compensation levels that typically increase with corporate size. Investment bankers, smelling huge fees, will be applauding as well. (Don't ask the barber whether you need a haircut.) If the historical performance of the target falls short of validating its acquisition, large "synergies" will be forecast. Spreadsheets never disappoint.

The ample availability of extraordinarily cheap debt in 2017 further fueled purchase activity. After all, even a high-priced deal will usually boost per-share earnings if it is debt-financed. At Berkshire, in contrast, we evaluate acquisitions on an all-equity basis, knowing that our taste for overall debt is very low and that to assign a large portion of our debt to any individual business would generally be fallacious (leaving aside certain exceptions, such as debt dedicated to Clayton's lending portfolio or to the fixed-asset commitments at our regulated utilities). We also never factor in, nor do we often find, synergies.

Our aversion to leverage has dampened our returns over the years. But Charlie and I sleep well. Both of us believe it is insane to risk what you have and need in order to obtain what you don't need. We held this view 50 years ago when we each ran an investment partnership, funded by a few friends and relatives who trusted us. We also hold it today after a million or so "partners" have joined us at Berkshire.

Despite our recent drought of acquisitions, Charlie and I believe that from time to time Berkshire will have opportunities to make very large purchases. In the meantime, we will stick with our simple guideline: The less the prudence with which others conduct their affairs, the greater the prudence with which we must conduct our own.

* * * * *

We were able to make one sensible stand-alone purchase last year, a 38.6% partnership interest in Pilot Flying J (“PFJ”). With about \$20 billion in annual volume, the company is far and away the nation’s leading travel-center operator.

PFJ has been run from the get-go by the remarkable Haslam family. “Big Jim” Haslam began with a dream and a gas station 60 years ago. Now his son, Jimmy, manages 27,000 associates at about 750 locations throughout North America. Berkshire has a contractual agreement to increase its partnership interest in PFJ to 80% in 2023; Haslam family members will then own the remaining 20%. Berkshire is delighted to be their partner.

When driving on the Interstate, drop in. PFJ sells gasoline as well as diesel fuel, and the food is good. If it’s been a long day, remember, too, that our properties have 5,200 showers.

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Let’s move now to bolt-on acquisitions. Some of these were small transactions that I will not detail. Here is an account, however, of a few larger purchases whose closings stretched between late 2016 and early 2018.

- Clayton Homes acquired two builders of conventional homes during 2017, a move that more than doubled our presence in a field we entered only three years ago. With these additions – Oakwood Homes in Colorado and Harris Doyle in Birmingham – I expect our 2018 site built volume will exceed \$1 billion.

Clayton’s emphasis, nonetheless, remains manufactured homes, both their construction and their financing. In 2017 Clayton sold 19,168 units through its own retail operation and wholesaled another 26,706 units to independent retailers. All told, Clayton accounted for 49% of the manufactured-home market last year. That industry-leading share – about three times what our nearest competitor did – is a far cry from the 13% Clayton achieved in 2003, the year it joined Berkshire.

Both Clayton Homes and PFJ are based in Knoxville, where the Clayton and Haslam families have long been friends. Kevin Clayton’s comments to the Haslams about the advantages of a Berkshire affiliation, and his admiring comments about the Haslam family to me, helped cement the PFJ deal.

- Near the end of 2016, Shaw Industries, our floor coverings business, acquired U.S. Floors (“USF”), a rapidly growing distributor of luxury vinyl tile. USF’s managers, Piet Dossche and Philippe Erramuzpe, came out of the gate fast, delivering a 40% increase in sales in 2017, during which their operation was integrated with Shaw’s. It’s clear that we acquired both great human assets *and* business assets in making the USF purchase.

Vance Bell, Shaw’s CEO, originated, negotiated and completed this acquisition, which increased Shaw’s sales to \$5.7 billion in 2017 and its employment to 22,000. With the purchase of USF, Shaw has substantially strengthened its position as an important and durable source of earnings for Berkshire.

- I have told you several times about HomeServices, our growing real estate brokerage operation. Berkshire backed into this business in 2000 when we acquired a majority interest in MidAmerican Energy (now named Berkshire Hathaway Energy). MidAmerican’s activities were then largely in the electric utility field, and I originally paid little attention to HomeServices.

But, year-by-year, the company added brokers and, by the end of 2016, HomeServices was the second-largest brokerage operation in the country – still ranking, though, far behind the leader, Realogy. In 2017, however, HomeServices’ growth exploded. We acquired the industry’s third-largest operator, Long and Foster; number 12, Houlihan Lawrence; and Gloria Nilson.

With those purchases we added 12,300 agents, raising our total to 40,950. HomeServices is now close to leading the country in home sales, having participated (including our three acquisitions pro-forma) in \$127 billion of “sides” during 2017. To explain that term, there are two “sides” to every transaction; if we represent both buyer and seller, the dollar value of the transaction is counted twice.

Despite its recent acquisitions, HomeServices is on track to do only about 3% of the country’s home-brokerage business in 2018. That leaves 97% to go. Given sensible prices, we will keep adding brokers in this most fundamental of businesses.

- Finally, Precision Castparts, a company built through acquisitions, bought Wilhelm Schulz GmbH, a German maker of corrosion resistant fittings, piping systems and components. Please allow me to skip a further explanation. I don’t understand manufacturing operations as well as I do the activities of real estate brokers, home builders or truck stops.

Fortunately, I don’t need in this instance to bring knowledge to the table: Mark Donegan, CEO of Precision, is an extraordinary manufacturing executive, and any business in his domain is slated to do well. Betting on people can sometimes be more certain than betting on physical assets.

Let’s now move on to operations, beginning with property-casualty (“p/c”) insurance, a business I *do* understand and the engine that for 51 years has powered Berkshire’s growth.

Insurance

Before I discuss our 2017 insurance results, let me remind you of how and why we entered the field. We began by purchasing National Indemnity and a smaller sister company for \$8.6 million in early 1967. With our purchase we received \$6.7 million of tangible net worth that, by the nature of the insurance business, we were able to deploy in marketable securities. It was easy to rearrange the portfolio into securities we would otherwise have owned at Berkshire itself. In effect, we were “trading dollars” for the net worth portion of the cost.

The \$1.9 million premium over net worth that Berkshire paid brought us an insurance business that usually delivered an underwriting profit. Even more important, the insurance operation carried with it \$19.4 million of “float” – money that belonged to others but was held by our two insurers.

Ever since, float has been of great importance to Berkshire. When we invest these funds, all dividends, interest and gains from their deployment belong to Berkshire. (If we experience investment losses, those, of course, are on our tab as well.)

Float materializes at p/c insurers in several ways: (1) Premiums are generally paid to the company upfront whereas losses occur over the life of the policy, usually a six-month or one-year period; (2) Though some losses, such as car repairs, are quickly paid, others – such as the harm caused by exposure to asbestos – may take many years to surface and even longer to evaluate and settle; (3) Loss payments are sometimes spread over decades in cases, say, of a person employed by one of our workers’ compensation policyholders being permanently injured and thereafter requiring expensive lifetime care.

Float generally grows as premium volume increases. Additionally, certain p/c insurers specialize in lines of business such as medical malpractice or product liability – business labeled “long-tail” in industry jargon – that generate far more float than, say, auto collision and homeowner policies, which require insurers to almost immediately make payments to claimants for needed repairs.

Berkshire has been a leader in long-tail business for many years. In particular, we have specialized in jumbo *reinsurance* policies that leave us assuming long-tail losses already incurred by other p/c insurers. As a result of our emphasizing that sort of business, Berkshire’s growth in float has been extraordinary. We are now the country’s second largest p/c company measured by premium volume and its leader, by far, in float.

Here’s the record:

(in \$ millions)

<u>Year</u>	<u>Premium Volume</u>	<u>Float</u>
1970	\$ 39	\$ 39
1980	185	237
1990	582	1,632
2000	19,343	27,871
2010	30,749	65,832
2017	60,597	114,500

Our 2017 volume was boosted by a huge deal in which we reinsured up to \$20 billion of long-tail losses that AIG had incurred. Our premium for this policy was \$10.2 billion, a world’s record and one we won’t come close to repeating. Premium volume will therefore fall somewhat in 2018.

Float will probably increase slowly for at least a few years. When we eventually experience a decline, it will be modest – at most 3% or so in any single year. Unlike bank deposits or life insurance policies containing surrender options, p/c float can’t be withdrawn. This means that p/c companies can’t experience massive “runs” in times of widespread financial stress, a characteristic of prime importance to Berkshire that we factor into our investment decisions.

Charlie and I *never* will operate Berkshire in a manner that depends on the kindness of strangers – or even that of friends who may be facing liquidity problems of their own. During the 2008-2009 crisis, we liked having Treasury Bills – *loads* of Treasury Bills – that protected us from having to rely on funding sources such as bank lines or commercial paper. We have intentionally constructed Berkshire in a manner that will allow it to comfortably withstand economic discontinuities, including such extremes as extended market closures.

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The downside of float is that it comes with risk, sometimes oceans of risk. What looks predictable in insurance can be anything but. Take the famous Lloyds insurance market, which produced decent results for three centuries. In the 1980’s, though, huge latent problems from a few long-tail lines of insurance surfaced at Lloyds and, for a time, threatened to destroy its storied operation. (It has, I should add, fully recovered.)

Berkshire’s insurance managers are conservative and careful underwriters, who operate in a culture that has long prioritized those qualities. That disciplined behavior has produced underwriting profits in most years, and in such instances, our cost of float was less than zero. In effect, we got *paid* then for holding the huge sums tallied in the earlier table.

I have warned you, however, that we have been fortunate in recent years and that the catastrophe-light period the industry was experiencing was not a new norm. Last September drove home that point, as three significant hurricanes hit Texas, Florida and Puerto Rico.

My guess at this time is that the insured losses arising from the hurricanes are \$100 billion or so. That figure, however, could be *far* off the mark. The pattern with most mega-catastrophes has been that initial loss estimates ran low. As well-known analyst V.J. Dowling has pointed out, the loss reserves of an insurer are similar to a self-graded exam. Ignorance, wishful thinking or, occasionally, downright fraud can deliver inaccurate figures about an insurer's financial condition for a very long time.

We currently estimate Berkshire's losses from the three hurricanes to be \$3 billion (or about \$2 billion after tax). If both that estimate and my industry estimate of \$100 billion are close to accurate, our share of the industry loss was about 3%. I believe that percentage is also what we may reasonably expect to be our share of losses in future American mega-cats.

It's worth noting that the \$2 billion net cost from the three hurricanes reduced Berkshire's GAAP net worth by less than 1%. Elsewhere in the reinsurance industry there were many companies that suffered losses in net worth ranging from 7% to more than 15%. The damage to them could have been *far* worse: Had Hurricane Irma followed a path through Florida only a bit to the east, insured losses might well have been an additional \$100 billion.

We believe that the annual probability of a U.S. mega-catastrophe causing \$400 billion or more of insured losses is about 2%. No one, of course, knows the correct probability. We do know, however, that the risk increases over time because of growth in both the number and value of structures located in catastrophe-vulnerable areas.

No company comes close to Berkshire in being financially prepared for a \$400 billion mega-cat. Our share of such a loss might be \$12 billion or so, an amount far below the annual earnings we expect from our non-insurance activities. Concurrently, much – indeed, perhaps most – of the p/c world would be out of business. Our unparalleled financial strength explains why other p/c insurers come to Berkshire – and *only* Berkshire – when they, themselves, need to purchase huge reinsurance coverages for large payments they may have to make in the far future.

Prior to 2017, Berkshire had recorded 14 consecutive years of underwriting profits, which totaled \$28.3 billion pre-tax. I have regularly told you that I expect Berkshire to attain an underwriting profit in a majority of years, but also to experience losses from time to time. My warning became fact in 2017, as we lost \$3.2 billion pre-tax from underwriting.

A large amount of additional information about our various insurance operations is included in the 10-K at the back of this report. The only point I will add here is that you have some extraordinary managers working for you at our various p/c operations. This is a business in which there are no trade secrets, patents, or locational advantages. What counts are brains and capital. The managers of our various insurance companies supply the brains and Berkshire provides the capital.

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For many years, this letter has described the activities of Berkshire's many other businesses. That discussion has become both repetitious and partially duplicative of information regularly included in the 10-K that follows the letter. Consequently, this year I will give you a simple summary of our dozens of non-insurance businesses. Additional details can be found on pages K-5 – K-22 and pages K-40 – K-50.

Viewed as a group – *and excluding investment income* – our operations other than insurance delivered pre-tax income of \$20 billion in 2017, an increase of \$950 million over 2016. About 44% of the 2017 profit came from two subsidiaries. BNSF, our railroad, and Berkshire Hathaway Energy (of which we own 90.2%). You can read more about these businesses on pages K-5 – K-10 and pages K-40 – K-44.

Proceeding down Berkshire's long list of subsidiaries, our next five non-insurance businesses, as ranked by earnings (but presented here alphabetically) Clayton Homes, International Metalworking Companies, Lubrizol, Marmon and Precision Castparts had aggregate pre-tax income in 2017 of \$5.5 billion, little changed from the \$5.4 billion these companies earned in 2016.

The next five, similarly ranked and listed (Forest River, Johns Manville, MiTek, Shaw and TTI) earned \$2.1 billion last year, up from \$1.7 billion in 2016.

The remaining businesses that Berkshire owns – and there are many – recorded little change in pre-tax income, which was \$3.7 billion in 2017 versus \$3.5 billion in 2016.

Depreciation charges for all of these non-insurance operations totaled \$7.6 billion; capital expenditures were \$11.5 billion. Berkshire is always looking for ways to expand its businesses and regularly incurs capital expenditures that far exceed its depreciation charge. Almost 90% of our investments are made in the United States. America's economic soil remains fertile.

Amortization charges were an additional \$1.3 billion. I believe that in large part this item is not a true economic cost. Partially offsetting this good news is the fact that BNSF (like all other railroads) records depreciation charges that fall well short of the sums regularly needed to keep the railroad in first-class shape.

Berkshire's goal is to substantially increase the earnings of its non-insurance group. For that to happen, we will need to make one or more huge acquisitions. We certainly have the resources to do so. At yearend Berkshire held \$116.0 billion in cash and U.S. Treasury Bills (whose average maturity was 88 days), up from \$86.4 billion at yearend 2016. This extraordinary liquidity earns only a pittance and is far beyond the level Charlie and I wish Berkshire to have. Our smiles will broaden when we have redeployed Berkshire's excess funds into more productive assets.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding – 325,442,152 shares – because Berkshire is part of a control group and therefore must account for this investment on the “equity” method. On its balance sheet, Berkshire carries its Kraft Heinz holding at a GAAP figure of \$17.6 billion. The shares had a yearend market value of \$25.3 billion, and a cost basis of \$9.8 billion.

<u>Shares*</u>	<u>Company</u>	<i>Percentage of Company Owned</i>	<i>Cost**</i> <i>(in millions)</i>	<i>Market</i> <i>(in millions)</i>
151,610,700	American Express Company	17.6	\$ 1,287	\$ 15,056
166,713,209	Apple Inc.	3.3	20,961	28,213
700,000,000	Bank of America Corporation	6.8	5,007	20,664
53,307,534	The Bank of New York Mellon Corporation	5.3	2,230	2,871
225,000,000	BYD Company Ltd.	8.2	232	1,961
6,789,054	Charter Communications, Inc.	2.8	1,210	2,281
400,000,000	The Coca-Cola Company	9.4	1,299	18,352
53,110,395	Delta Airlines Inc.	7.4	2,219	2,974
44,527,147	General Motors Company	3.2	1,343	1,825
11,390,582	The Goldman Sachs Group, Inc.	3.0	654	2,902
24,669,778	Moody's Corporation	12.9	248	3,642
74,587,892	Phillips 66	14.9	5,841	7,545
47,659,456	Southwest Airlines Co.	8.1	1,997	3,119
103,855,045	U.S. Bancorp	6.3	3,343	5,565
482,544,468	Wells Fargo & Company	9.9	11,837	29,276
	Others		14,968	24,294
	Total Common Stocks Carried at Market		<u>\$ 74,676</u>	<u>\$ 170,540</u>

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis; GAAP “cost” differs in a few cases because of write-downs that have been required under GAAP rules.

Some of the stocks in the table are the responsibility of either Todd Combs or Ted Weschler, who work with me in managing Berkshire's investments. Each, *independently of me*, manages more than \$12 billion; I usually learn about decisions they have made by looking at monthly portfolio summaries. Included in the \$25 billion that the two manage is more than \$8 billion of pension trust assets of certain Berkshire subsidiaries. As noted, pension investments are not included in the preceding tabulation of Berkshire holdings.

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Charlie and I view the marketable common stocks that Berkshire owns as interests in *businesses*, not as ticker symbols to be bought or sold based on their "chart" patterns, the "target" prices of analysts or the opinions of media pundits. Instead, we simply believe that if the businesses of the investees are successful (as we believe most will be) our investments will be successful as well. Sometimes the payoffs to us will be modest; occasionally the cash register will ring loudly. And sometimes I will make expensive mistakes. Overall – and over time – we should get decent results. In America, equity investors have the wind at their back.

From our stock portfolio – call our holdings "minority interests" in a diversified group of publicly-owned businesses – Berkshire received \$3.7 billion of dividends in 2017. That's the number included in our GAAP figures, as well as in the "operating earnings" we reference in our quarterly and annual reports.

That dividend figure, however, *far* understates the "true" earnings emanating from our stock holdings. For decades, we have stated in Principle 6 of our "Owner-Related Business Principles" (page 19) that we expect *undistributed* earnings of our investees to deliver us at least equivalent earnings by way of subsequent capital gains.

Our recognition of capital gains (and losses) will be lumpy, particularly as we conform with the new GAAP rule requiring us to constantly record *unrealized* gains or losses in our earnings. I feel confident, however, that the earnings retained by our investees will over time, and with our investees viewed as a group, translate into commensurate capital gains for Berkshire.

The connection of value-building to retained earnings that I've just described will be impossible to detect in the short term. Stocks surge and swoon, seemingly untethered to any year-to-year buildup in their underlying value. Over time, however, Ben Graham's oft-quoted maxim proves true: "In the short run, the market is a voting machine; in the long run, however, it becomes a weighing machine."

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Berkshire, itself, provides some vivid examples of how price randomness in the short term can obscure long-term growth in value. For the last 53 years, the company has built value by reinvesting its earnings and letting compound interest work its magic. Year by year, we have moved forward. Yet Berkshire shares have suffered four truly major dips. Here are the gory details:

<u>Period</u>	<u>High</u>	<u>Low</u>	<u>Percentage Decrease</u>
March 1973-January 1975	93	38	(59.1%)
10/2/87-10/27/87	4,250	2,675	(37.1%)
6/19/98-3/10/2000	80,900	41,300	(48.9%)
9/19/08-3/5/09	147,000	72,400	(50.7%)

This table offers the strongest argument I can muster against ever using borrowed money to own stocks. There is simply no telling how far stocks can fall in a short period. Even if your borrowings are small and your positions aren't immediately threatened by the plunging market, your mind may well become rattled by scary headlines and breathless commentary. And an unsettled mind will not make good decisions.

In the next 53 years our shares (and others) will experience declines resembling those in the table. *No one* can tell you when these will happen. The light can at *any time* go from green to red without pausing at yellow.

When major declines occur, however, they offer extraordinary opportunities to those who are not handicapped by debt. That's the time to heed these lines from Kipling's *If*:

“If you can keep your head when all about you are losing theirs . . .
If you can wait and not be tired by waiting . . .
If you can think – and not make thoughts your aim . . .
If you can trust yourself when all men doubt you . . .
Yours is the Earth and everything that's in it.”

“The Bet” is Over and Has Delivered an Unforeseen Investment Lesson

Last year, at the 90% mark, I gave you a detailed report on a ten-year bet I had made on December 19, 2007. (The full discussion from last year's annual report is reprinted on pages 24 – 26.) Now I have the final tally – and, in several respects, it's an eye-opener.

I made the bet for two reasons: (1) to leverage my outlay of \$318,250 into a disproportionately larger sum that – if things turned out as I expected – would be distributed in early 2018 to Girls Inc. of Omaha; and (2) to publicize my conviction that my pick – a virtually cost-free investment in an unmanaged S&P 500 index fund – would, over time, deliver better results than those achieved by most investment professionals, however well-regarded and incentivized those “helpers” may be.

Addressing this question is of enormous importance. American investors pay staggering sums annually to advisors, often incurring several layers of consequential costs. In the aggregate, do these investors get their money's worth? Indeed, again in the aggregate, do investors get *anything* for their outlays?

Protégé Partners, my counterparty to the bet, picked five “funds-of-funds” that it expected to overperform the S&P 500. That was *not* a small sample. Those five funds-of-funds in turn owned interests in more than 200 hedge funds.

Essentially, Protégé, an advisory firm that knew its way around Wall Street, selected five investment experts who, in turn, employed several hundred other investment experts, each managing his or her own hedge fund. This assemblage was an elite crew, loaded with brains, adrenaline and confidence.

The managers of the five funds-of-funds possessed a further advantage: They could – and did – rearrange their portfolios of hedge funds during the ten years, investing with new “stars” while exiting their positions in hedge funds whose managers had lost their touch.

Every actor on Protégé's side was highly incentivized: Both the fund-of-funds managers and the hedge-fund managers they selected significantly shared in gains, even those achieved simply because the market generally moves upwards. (In 100% of the 43 ten-year periods since we took control of Berkshire, years with gains by the S&P 500 exceeded loss years.)

Those performance incentives, it should be emphasized, were frosting on a huge and tasty cake: Even if the funds *lost* money for their investors during the decade, their managers could grow very rich. That would occur because *fixed* fees averaging a staggering 2½% of assets or so were paid *every year* by the fund-of-funds' investors, with part of these fees going to the managers at the five funds-of-funds and the balance going to the 200-plus managers of the underlying hedge funds.

Here's the final scorecard for the bet:

<u>Year</u>	<u>Fund-of-Funds A</u>	<u>Fund-of-Funds B</u>	<u>Fund-of-Funds C</u>	<u>Fund-of-Funds D</u>	<u>Fund-of-Funds E</u>	<u>S&P Index Fund</u>
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-3.2%	1.9%	-1.7%	2.5%	4.4%	11.9%
2017	12.2%	10.6%	15.6%	N/A	18.0%	21.8%
Final Gain Average	21.7%	42.3%	87.7%	2.8%	27.0%	125.8%
Annual Gain	2.0%	3.6%	6.5%	0.3%	2.4%	8.5%

Footnote: Under my agreement with Protégé Partners, the names of these funds-of-funds have never been publicly disclosed. I, however, have received their annual audits from Protégé. The 2016 figures for funds A, B and C were revised slightly from those originally reported last year. Fund D was liquidated in 2017; its average annual gain is calculated for the nine years of its operation.

The five funds-of-funds got off to a fast start, each beating the index fund in 2008. Then the roof fell in. In *every one* of the nine years that followed, the funds-of-funds as a whole trailed the index fund.

Let me emphasize that there was nothing aberrational about stock-market behavior over the ten-year stretch. If a poll of investment "experts" had been asked late in 2007 for a forecast of long-term common-stock returns, their guesses would have likely averaged close to the 8.5% actually delivered by the S&P 500. Making money in that environment should have been easy. Indeed, Wall Street "helpers" earned staggering sums. While this group prospered, however, many of their investors experienced a lost decade.

Performance comes, performance goes. Fees never falter.

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The bet illuminated another important investment lesson: Though markets are generally rational, they occasionally do crazy things. Seizing the opportunities then offered does *not* require great intelligence, a degree in economics or a familiarity with Wall Street jargon such as alpha and beta. What investors then need instead is an ability to both disregard mob fears or enthusiasms and to focus on a few simple fundamentals. A willingness to look unimaginative for a sustained period – or even to look foolish – is also essential.

Originally, Protégé and I each funded our portion of the ultimate \$1 million prize by purchasing \$500,000 face amount of zero-coupon U.S. Treasury bonds (sometimes called "strips"). These bonds cost each of us \$318,250 – a bit less than 64¢ on the dollar – with the \$500,000 payable in ten years.

As the name implies, the bonds we acquired paid no interest, but (because of the discount at which they were purchased) delivered a 4.56% annual return if held to maturity. Protégé and I originally intended to do no more than tally the annual returns and distribute \$1 million to the winning charity when the bonds matured late in 2017.

After our purchase, however, some very strange things took place in the bond market. By November 2012, our bonds – now with about five years to go before they matured – were selling for 95.7% of their face value. At *that* price, their annual yield to maturity was less than 1%. Or, to be precise, .88%.

Given that pathetic return, our bonds had become a dumb – a *really* dumb – investment compared to American equities. Over time, the S&P 500 – which mirrors a huge cross-section of American business, appropriately weighted by market value – has earned *far* more than 10% annually on shareholders' equity (net worth).

In November 2012, as we were considering all this, the *cash* return from dividends on the S&P 500 was 2½% annually, about triple the yield on our U.S. Treasury bond. These dividend payments were almost certain to grow. Beyond that, huge sums were being retained by the companies comprising the 500. These businesses would use their retained earnings to expand their operations and, frequently, to repurchase their shares as well. Either course would, over time, substantially increase earnings-per-share. And – as has been the case since 1776 – whatever its problems of the minute, the American economy was going to move forward.

Presented late in 2012 with the extraordinary valuation mismatch between bonds and equities, Protégé and I agreed to sell the bonds we had bought five years earlier and use the proceeds to buy 11,200 Berkshire "B" shares. The result: Girls Inc. of Omaha found itself receiving \$2,222,279 last month rather than the \$1 million it had originally hoped for.

Berkshire, it should be emphasized, has not performed brilliantly since the 2012 substitution. But brilliance wasn't needed: After all, Berkshire's gain only had to beat that annual .88% bond bogey – hardly a Herculean achievement.

The only risk in the bonds-to-Berkshire switch was that yearend 2017 would coincide with an exceptionally weak stock market. Protégé and I felt this possibility (which *always* exists) was very low. Two factors dictated this conclusion: The reasonable price of Berkshire in late 2012, and the large asset build-up that was almost certain to occur at Berkshire during the five years that remained before the bet would be settled. Even so, to eliminate *all* risk to the charities from the switch, I agreed to make up any shortfall if sales of the 11,200 Berkshire shares at yearend 2017 didn't produce at least \$1 million.

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Investing is an activity in which consumption today is foregone in an attempt to allow greater consumption at a later date. "Risk" is the possibility that this objective won't be attained.

By that standard, purportedly "risk-free" long-term bonds in 2012 were a *far* riskier investment than a long-term investment in common stocks. At that time, even a 1% annual rate of inflation between 2012 and 2017 would have decreased the purchasing-power of the government bond that Protégé and I sold.

I want to quickly acknowledge that in *any* upcoming day, week or even year, stocks will be riskier – far riskier – than short-term U.S. bonds. As an investor's investment horizon lengthens, however, a diversified portfolio of U.S. equities becomes progressively *less* risky than bonds, assuming that the stocks are purchased at a sensible multiple of earnings relative to then-prevailing interest rates.

It is a terrible mistake for investors with long-term horizons – among them, pension funds, college endowments and savings-minded individuals – to measure their investment "risk" by their portfolio's ratio of bonds to stocks. Often, high-grade bonds in an investment portfolio *increase* its risk.

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A final lesson from our bet: Stick with big, "easy" decisions and eschew activity. During the ten-year bet, the 200-plus hedge-fund managers that were involved almost certainly made tens of thousands of buy and sell decisions. Most of those managers undoubtedly thought hard about their decisions, each of which they believed would prove advantageous. In the process of investing, they studied 10-Ks, interviewed managements, read trade journals and conferred with Wall Street analysts.

Protégé and I, meanwhile, leaning neither on research, insights nor brilliance, made only one investment decision during the ten years. We simply decided to sell our bond investment at a price of more than 100 times earnings (95.7 sale price/.88 yield), those being “earnings” that could not increase during the ensuing five years.

We made the sale in order to move our money into a single security – Berkshire – that, in turn, owned a diversified group of solid businesses. Fueled by retained earnings, Berkshire’s growth in value was unlikely to be less than 8% annually, even if we were to experience a so-so economy.

After that kindergarten-like analysis, Protégé and I made the switch and relaxed, confident that, over time, 8% was certain to beat .88%. By a lot.

The Annual Meeting

The annual meeting falls on May 5th and will again be webcast by Yahoo!, whose web address is <https://finance.yahoo.com/brklivestream>. The webcast will go live at 8:45 a.m. Central Daylight Time. Yahoo! will interview directors, managers, stockholders and celebrities before the meeting and during the lunch break. Both the interviews and meeting will be translated simultaneously into Mandarin.

Our partnership with Yahoo! began in 2016 and shareholders have responded enthusiastically. Last year, real-time viewership increased 72% to about 3.1 million and replays of short segments totaled 17.1 million.

For those attending the meeting in person, the doors at the CenturyLink will open at 7:00 a.m. on Saturday to facilitate shopping prior to our shareholder movie, which begins at 8:30. The question-and-answer period will start at 9:15 and run until 3:30, with a one-hour lunch break at noon. Finally, at 3:45 we will begin the formal shareholder meeting, which usually runs from 15 to 45 minutes. Shopping will end at 4:30.

On Friday, May 4th, our Berkshire exhibitors at CenturyLink will be open from noon until 5 p.m. We added that extra shopping time in 2015, and serious shoppers love it. Last year about 12,000 people came through the doors in the five hours we were open on Friday.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of our subsidiaries will be *for sale*. (Your Chairman discourages freebies.) Say hello to the many Berkshire managers who will be captaining their exhibits. And be sure to view the terrific BNSF railroad layout that salutes all of our companies.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them on Sunday at our sixth annual “Berkshire 5K,” an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor’s Guide that will be sent to you with your meeting credentials. Entrants in the race will find themselves running alongside many of Berkshire’s managers, directors and associates. (Charlie and I, however, will sleep in; even with Brooks running shoes, our times would be embarrassing.) Participation in the 5K grows every year. Help us set another record.

A GEICO booth in the shopping area will be staffed by a number of the company’s top counselors from around the country. At last year’s meeting, we set a record for policy sales, up 43% from 2016.

So stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money. Spend the savings on other Berkshire products.

Be sure to visit the Bookworm. This Omaha-based retailer will carry more than 40 books and DVDs, among them a couple of new titles. Berkshire shareholders are a bookseller’s dream: When *Poor Charlie’s Almanack* (yes, *our* Charlie) made its debut some years ago, we sold 3,500 copies at the meeting. The book weighed 4.85 pounds. Do the math: Our shareholders left the building that day carrying about 8½ tons of Charlie’s wisdom.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Keep in mind that most airlines substantially increase prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money. The savings for a couple could run to \$1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having “Berkshire Weekend” discount pricing. To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, May 1st and Monday, May 7th inclusive, and must also present your meeting credential. Last year, the one-week volume for the store was a staggering \$44.6 million. Bricks and mortar are alive and well at NFM.

The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. During “Berkshire Weekend,” NFM will be open from 10 a.m. to 9 p.m. Monday through Saturday and 11 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is hosting a picnic to which you are all invited.

NFM will again extend its shareholder's discount offerings to our Kansas City and Dallas stores. From May 1st through May 7th, shareholders who present meeting credentials or other evidence of their Berkshire ownership (such as brokerage statements) to those NFM stores will receive the same discounts enjoyed by those visiting the Omaha store.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 4th. The second, the main gala, will be held on Sunday, May 6th, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. Remember, the more you buy, the more you save (or so my daughter tells me when we visit the store).

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 30th through Saturday, May 12th. During that period, please identify yourself as a shareholder either by presenting your meeting credential or a brokerage statement showing you own our stock.

On Sunday afternoon, on the upper level above Borsheims, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play with our shareholders. If they suggest wagering on the game, change the subject. Ajit, Charlie, Bill Gates and I will likely drop by as well.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine, and even then I was unable to score a point against her. Ariel represented the United States in the 2012 Olympics. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates did pretty well playing Ariel last year, so he may be ready to again challenge her. (My advice: Bet on Ariel.) I will participate on an advisory basis only.

Gorat's will be open exclusively for Berkshire shareholders on Sunday, May 6th, serving from 12 p.m. until 10 p.m. To make a reservation at Gorat's, call 402-551-3733 on April 2nd (*but not before*). Show you are a sophisticated diner by ordering the T-bone with hash browns.

We will have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, the preeminent business journalist of her time, who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of the New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important to shareholders. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

An accompanying set of questions will be asked by three analysts who follow Berkshire. This year the insurance specialist will be Gary Ransom of Dowling & Partners. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Since what we will be conducting is a *shareholders'* meeting, our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. Multi-part questions aren't allowed; we want to give as many questioners as possible a shot at us. Our goal is for you to leave the meeting knowing more about Berkshire than when you came and for you to have a good time while in Omaha.

All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. After the 54th, all questions come from the audience. Charlie and I have often tackled more than 60 by 3:30.

The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and, if possible, should also have adequate time to digest and analyze that information before any trading takes place. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday (a day that also eases traffic and parking problems).

We do not follow the common practice of talking one-on-one with large institutional investors or analysts, treating them instead as we do all other shareholders. There is no one more important to us than the shareholder of limited means who trusts us with a substantial portion of his or her savings. As I run the company day-to-day – and as I write this letter – that is the shareholder whose image is in my mind.

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For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I also believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

If managers (or directors) own Berkshire shares – and many do – it's from open-market purchases they have made or because they received shares when they sold their businesses to us. *None*, however, gets the upside of ownership without risking the downside. Our directors and managers stand in your shoes.

We continue to have a wonderful group at headquarters. This team efficiently deals with a multitude of SEC and other regulatory requirements, files a 32,700-page Federal income tax return, oversees the filing of 3,935 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities, fact-checks this letter – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year, for example, they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and French fries (smothered in Heinz ketchup, of course) for lunch. In addition, they cheerfully pitch in to help at the annual meeting in whatever way they are needed. They are proud to work for Berkshire, and I am proud of them.

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I've saved the best for last. Early in 2018, Berkshire's board elected Ajit Jain and Greg Abel as directors of Berkshire and also designated each as Vice Chairman. Ajit is now responsible for insurance operations, and Greg oversees the rest of our businesses. Charlie and I will focus on investments and capital allocation.

You and I are lucky to have Ajit and Greg working for us. Each has been with Berkshire for decades, and Berkshire's blood flows through their veins. The character of each man matches his talents. And that says it all.

Come to Omaha – the cradle of capitalism – on May 5th and meet the Berkshire Bunch. All of us look forward to your visit.

February 24, 2018

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change		
	in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
2016	10.7	23.4	12.0
2017	23.0	21.9	21.8
2018	0.4	2.8	(4.4)
Compounded Annual Gain – 1965-2018	18.7%	20.5%	9.7%
Overall Gain – 1964-2018	1,091,899%	2,472,627%	15,019%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire earned \$4.0 billion in 2018 utilizing generally accepted accounting principles (commonly called “GAAP”). The components of that figure are \$24.8 billion in operating earnings, a \$3.0 billion non-cash loss from an impairment of intangible assets (arising almost entirely from our equity interest in Kraft Heinz), \$2.8 billion in realized capital gains from the sale of investment securities and a \$20.6 billion *loss* from a reduction in the amount of unrealized capital gains that existed in our investment holdings.

A new GAAP rule requires us to include that last item in earnings. As I emphasized in the 2017 annual report, neither Berkshire’s Vice Chairman, Charlie Munger, nor I believe that rule to be sensible. Rather, both of us have consistently thought that at Berkshire this mark-to-market change would produce what I described as “wild and capricious swings in our bottom line.”

The accuracy of that prediction can be suggested by our quarterly results during 2018. In the first and fourth quarters, we reported GAAP *losses* of \$1.1 billion and \$25.4 billion respectively. In the second and third quarters, we reported *profits* of \$12 billion and \$18.5 billion. In complete contrast to these gyrations, the many businesses that Berkshire owns delivered consistent and satisfactory operating earnings in *all* quarters. For the year, those earnings exceeded their 2016 high of \$17.6 billion by 41%.

Wide swings in our quarterly GAAP earnings will inevitably continue. That’s because our huge equity portfolio – valued at nearly \$173 billion at the end of 2018 – will often experience one-day price fluctuations of \$2 billion or more, all of which the new rule says must be dropped immediately to our bottom line. Indeed, in the fourth quarter, a period of high volatility in stock prices, we experienced several days with a “profit” or “loss” of more than \$4 billion.

Our advice? Focus on operating earnings, paying little attention to gains or losses of any variety. My saying that in no way diminishes the importance of our investments to Berkshire. Over time, Charlie and I expect them to deliver substantial gains, albeit with highly irregular timing.

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Long-time readers of our annual reports will have spotted the different way in which I opened this letter. For nearly three decades, the initial paragraph featured the percentage change in Berkshire’s per-share book value. It’s now time to abandon that practice.

The fact is that the annual change in Berkshire’s book value – which makes its farewell appearance on page 2 – is a metric that has lost the relevance it once had. Three circumstances have made that so. First, Berkshire has gradually morphed from a company whose assets are concentrated in marketable stocks into one whose major value resides in operating businesses. Charlie and I expect that reshaping to continue in an irregular manner. Second, while our *equity holdings* are valued at market prices, accounting rules require our collection of *operating companies* to be included in book value at an amount far below their current value, a mismark that has grown in recent years. Third, it is likely that – over time – Berkshire will be a significant repurchaser of its shares, transactions that will take place at prices above book value but below our estimate of intrinsic value. The math of such purchases is simple: Each transaction makes per-share intrinsic value go up, while per-share book value goes down. That combination causes the book-value scorecard to become increasingly out of touch with economic reality.

In future tabulations of our financial results, we expect to focus on Berkshire's market price. Markets can be extremely capricious: Just look at the 54-year history laid out on page 2. Over time, however, Berkshire's stock price will provide the best measure of business performance.

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Before moving on, I want to give you some good news – *really* good news – that is not reflected in our financial statements. It concerns the management changes we made in early 2018, when Ajit Jain was put in charge of all insurance activities and Greg Abel was given authority over all other operations. These moves were overdue. Berkshire is now far better managed than when I alone was supervising operations. Ajit and Greg have rare talents, and Berkshire blood flows through their veins.

Now let's take a look at what you own.

Focus on the Forest – Forget the Trees

Investors who evaluate Berkshire sometimes obsess on the details of our many and diverse businesses – our economic “trees,” so to speak. Analysis of that type can be mind-numbing, given that we own a vast array of specimens, ranging from twigs to redwoods. A few of our trees are diseased and unlikely to be around a decade from now. Many others, though, are destined to grow in size and beauty.

Fortunately, it's not necessary to evaluate each tree individually to make a rough estimate of Berkshire's intrinsic business value. That's because our forest contains five “groves” of major importance, each of which can be appraised, with reasonable accuracy, in its entirety. Four of those groves are differentiated clusters of businesses and financial assets that are easy to understand. The fifth – our huge and diverse insurance operation – delivers great value to Berkshire in a less obvious manner, one I will explain later in this letter.

Before we look more closely at the first four groves, let me remind you of our prime goal in the deployment of your capital: to buy ably-managed businesses, *in whole or part*, that possess favorable and durable economic characteristics. We also need to make these purchases at sensible prices.

Sometimes we can buy control of companies that meet our tests. Far more often, we find the attributes we seek in publicly-traded businesses, in which we normally acquire a 5% to 10% interest. Our two-pronged approach to huge-scale capital allocation is rare in corporate America and, at times, gives us an important advantage.

In recent years, the sensible course for us to follow has been clear: Many stocks have offered far more for our money than we could obtain by purchasing businesses in their entirety. That disparity led us to buy about \$43 billion of marketable equities last year, while selling only \$19 billion. Charlie and I believe the companies in which we invested offered excellent value, far exceeding that available in takeover transactions.

Despite our recent additions to marketable equities, the most valuable grove in Berkshire's forest remains the many dozens of non-insurance businesses that Berkshire controls (usually with 100% ownership and never with less than 80%). Those subsidiaries earned \$16.8 billion last year. When we say “earned,” moreover, we are describing what remains after *all* income taxes, interest payments, managerial compensation (whether cash or stock-based), restructuring expenses, depreciation, amortization and home-office overhead.

That brand of earnings is a far cry from that frequently touted by Wall Street bankers and corporate CEOs. Too often, their presentations feature “adjusted EBITDA,” a measure that redefines “earnings” to exclude a variety of all-too-real costs.

For example, managements sometimes assert that their company's stock-based compensation shouldn't be counted as an expense. (What else could it be – a *gift* from shareholders?) And restructuring expenses? Well, maybe last year's exact rearrangement won't recur. But restructurings of one sort or another are common in business – Berkshire has gone down that road dozens of times, and our shareholders have always borne the costs of doing so.

Abraham Lincoln once posed the question: "If you call a dog's tail a leg, how many legs does it have?" and then answered his own query: "Four, because calling a tail a leg doesn't make it one." Abe would have felt lonely on Wall Street.

Charlie and I do contend that our acquisition-related amortization expenses of \$1.4 billion (detailed on page K-84) are not a true economic cost. We add back such amortization "costs" to GAAP earnings when we are evaluating both private businesses and marketable stocks.

In contrast, Berkshire's \$8.4 billion depreciation charge understates our true economic cost. In fact, we need to spend *more* than this sum annually to simply remain competitive in our many operations. Beyond those "maintenance" capital expenditures, we spend large sums in pursuit of growth. Overall, Berkshire invested a record \$14.5 billion last year in plant, equipment and other fixed assets, with 89% of that spent in America.

Berkshire's runner-up grove by value is its collection of equities, typically involving a 5% to 10% ownership position in a very large company. As noted earlier, our equity investments were worth nearly \$173 billion at yearend, an amount far above their cost. If the portfolio had been sold at its yearend valuation, federal income tax of about \$14.7 billion would have been payable on the gain. In all likelihood, we will hold most of these stocks for a long time. Eventually, however, gains generate taxes at whatever rate prevails at the time of sale.

Our investees paid us dividends of \$3.8 billion last year, a sum that will increase in 2019. Far more important than the dividends, though, are the huge earnings that are annually retained by these companies. Consider, as an indicator, these figures that cover only our five largest holdings.

<u>Company</u>	<u>Yearend Ownership</u>	<u>Berkshire's Share in \$ millions of</u>	
		<u>Dividends(1)</u>	<u>Retained Earnings(2)</u>
American Express	17.9%	\$ 237	\$ 997
Apple	5.4%	745	2,502
Bank of America	9.5%	551	2,096
Coca-Cola	9.4%	624	(21)
Wells Fargo	9.8%	809	1,263
Total		<u><u>\$2,966</u></u>	<u><u>\$6,837</u></u>

(1) Based on current annual rate.

(2) Based on 2018 earnings minus common and preferred dividends paid.

GAAP – which dictates the earnings we report – does not allow us to include the retained earnings of investees in our financial accounts. But those earnings are of enormous value to us: Over the years, earnings retained by our investees (viewed as a group) have eventually delivered capital gains to Berkshire that totaled more than one dollar for each dollar these companies reinvested for us.

All of our major holdings enjoy excellent economics, and most use a portion of their retained earnings to repurchase their shares. We very much like that: If Charlie and I think an investee's stock is underpriced, we rejoice when management employs some of its earnings to increase Berkshire's ownership percentage.

Here's one example drawn from the table above: Berkshire's holdings of American Express have remained unchanged over the past eight years. Meanwhile, our ownership increased from 12.6% to 17.9% because of repurchases made by the company. Last year, Berkshire's portion of the \$6.9 billion earned by American Express was \$1.2 billion, about 96% of the \$1.3 billion we paid for our stake in the company. When earnings increase and shares outstanding decrease, owners – over time – usually do well.

A third category of Berkshire's business ownership is a quartet of companies in which we share control with other parties. Our portion of the after-tax operating earnings of these businesses – 26.7% of Kraft Heinz, 50% of Berkadia and Electric Transmission Texas, and 38.6% of Pilot Flying J – totaled about \$1.3 billion in 2018.

In our fourth grove, Berkshire held \$112 billion at yearend in U.S. Treasury bills and other cash equivalents, and another \$20 billion in miscellaneous fixed-income instruments. We consider a portion of that stash to be untouchable, having pledged to always hold at least \$20 billion in cash equivalents to guard against external calamities. We have also promised to avoid *any* activities that could threaten our maintaining that buffer.

Berkshire will forever remain a financial fortress. In managing, I will make expensive mistakes of commission and will also miss many opportunities, some of which should have been obvious to me. At times, our stock will tumble as investors flee from equities. But I will never risk getting caught short of cash.

In the years ahead, we hope to move much of our excess liquidity into businesses that Berkshire will permanently own. The immediate prospects for that, however, are not good: Prices are sky-high for businesses possessing decent long-term prospects.

That disappointing reality means that 2019 will likely see us again expanding our holdings of marketable equities. We continue, nevertheless, to hope for an elephant-sized acquisition. Even at our ages of 88 and 95 – *I'm the young one* – that prospect is what causes my heart and Charlie's to beat faster. (Just writing about the possibility of a huge purchase has caused my pulse rate to soar.)

My expectation of more stock purchases is *not* a market call. Charlie and I have no idea as to how stocks will behave next week or next year. Predictions of that sort have *never* been a part of our activities. Our thinking, rather, is focused on calculating whether a portion of an attractive business is worth more than its market price.

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I believe Berkshire's intrinsic value can be *approximated* by summing the values of our four asset-laden groves and then subtracting an appropriate amount for taxes eventually payable on the sale of marketable securities.

You may ask whether an allowance should not also be made for the major tax costs Berkshire would incur if we were to sell certain of our wholly-owned businesses. Forget that thought: It would be foolish for us to sell any of our wonderful companies even if *no* tax would be payable on its sale. Truly good businesses are exceptionally hard to find. Selling any you are lucky enough to own makes no sense at all.

The interest cost on *all* of our debt has been deducted as an expense in calculating the earnings at Berkshire's non-insurance businesses. Beyond that, much of our ownership of the first four groves is financed by funds generated from Berkshire's fifth grove – a collection of exceptional insurance companies. We call those funds "float," a source of financing that we expect to be cost-free – or maybe even better than that – over time. We will explain the characteristics of float later in this letter.

Finally, a point of key and lasting importance: Berkshire's value is maximized by our having assembled the five groves into a single entity. This arrangement allows us to seamlessly and objectively allocate major amounts of capital, eliminate enterprise risk, avoid insularity, fund assets at exceptionally low cost, occasionally take advantage of tax efficiencies, and minimize overhead.

At Berkshire, the whole is greater – considerably greater – than the sum of the parts.

Repurchases and Reporting

Earlier I mentioned that Berkshire will from time to time be repurchasing its own stock. Assuming that we buy at a discount to Berkshire's intrinsic value – which certainly will be our intention – repurchases will benefit both those shareholders leaving the company and those who stay.

True, the upside from repurchases is very slight for those who are leaving. That's because careful buying by us will minimize any impact on Berkshire's stock price. Nevertheless, there is *some* benefit to sellers in having an extra buyer in the market.

For continuing shareholders, the advantage is obvious: If the market prices a departing partner's interest at, say, 90¢ on the dollar, continuing shareholders reap an increase in per-share intrinsic value with every repurchase by the company. Obviously, repurchases should be price-sensitive: Blindly buying an overpriced stock is value-destructive, a fact lost on many promotional or ever-optimistic CEOs.

When a company says that it contemplates repurchases, it's vital that all shareholder-partners be given the information they need to make an intelligent estimate of value. Providing that information is what Charlie and I try to do in this report. We do not want a partner to sell shares back to the company because he or she has been misled or inadequately informed.

Some sellers, however, may disagree with our calculation of value and others may have found investments that they consider more attractive than Berkshire shares. Some of that second group will be right: There are unquestionably many stocks that will deliver far greater gains than ours.

In addition, certain shareholders will simply decide it's time for them or their families to become net consumers rather than continuing to build capital. Charlie and I have no current interest in joining that group. Perhaps we will become big spenders in our old age.

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For 54 years our managerial decisions at Berkshire have been made from the viewpoint of the shareholders who are staying, not those who are leaving. Consequently, Charlie and I have *never* focused on current-quarter results.

Berkshire, in fact, may be the only company in the Fortune 500 that does not prepare monthly earnings reports or balance sheets. I, of course, regularly view the monthly financial reports of most subsidiaries. But Charlie and I learn of Berkshire's overall earnings and financial position only on a quarterly basis.

Furthermore, Berkshire has no company-wide budget (though many of our subsidiaries find one useful). Our lack of such an instrument means that the parent company has *never* had a quarterly "number" to hit. Shunning the use of this bogey sends an important message to our many managers, reinforcing the culture we prize.

Over the years, Charlie and I have seen all sorts of bad corporate behavior, both accounting and operational, induced by the desire of management to meet Wall Street expectations. What starts as an "innocent" fudge in order to not disappoint "the Street" – say, trade-loading at quarter-end, turning a blind eye to rising insurance losses, or drawing down a "cookie-jar" reserve – can become the first step toward full-fledged fraud. Playing with the numbers "just this once" may well be the CEO's intent; it's seldom the end result. And if it's okay for the boss to cheat a little, it's easy for subordinates to rationalize similar behavior.

At Berkshire, our audience is neither analysts nor commentators: Charlie and I are working for our shareholder-partners. The numbers that flow up to us will be the ones we send on to you.

Non-Insurance Operations – From Lollipops to Locomotives

Let's now look further at Berkshire's most valuable grove – our collection of non-insurance businesses – keeping in mind that we do not wish to unnecessarily hand our competitors information that might be useful to them. Additional details about individual operations can be found on pages K-5 – K-22 and pages K-40 – K-51.

Viewed as a group, these businesses earned pre-tax income in 2018 of \$20.8 billion, a 24% increase over 2017. Acquisitions we made in 2018 delivered only a trivial amount of that gain.

I will stick with pre-tax figures in this discussion. But our after-tax gain in 2018 from these businesses was *far* greater – 47% – thanks in large part to the cut in the corporate tax rate that became effective at the beginning of that year. Let's look at why the impact was so dramatic.

Begin with an economic reality: Like it or not, the U.S. Government "owns" an interest in Berkshire's earnings of a size determined by Congress. In effect, our country's Treasury Department holds a special class of our stock – call this holding the AA shares – that receives large "dividends" (that is, tax payments) from Berkshire. In 2017, as in many years before, the corporate tax rate was 35%, which meant that the Treasury was doing very well with its AA shares. Indeed, the Treasury's "stock," which was paying nothing when we took over in 1965, had evolved into a holding that delivered billions of dollars annually to the federal government.

Last year, however, 40% of the government's "ownership" (14/35^{ths}) was returned to Berkshire – free of charge – when the corporate tax rate was reduced to 21%. Consequently, our "A" and "B" shareholders received a major boost in the earnings attributable to *their* shares.

This happening materially increased the intrinsic value of the Berkshire shares you and I own. The same dynamic, moreover, enhanced the intrinsic value of almost all of the stocks Berkshire holds.

Those are the headlines. But there are other factors to consider that tempered our gain. For example, the tax benefits garnered by our large utility operation get passed along to its customers. Meanwhile, the tax rate applicable to the substantial dividends we receive from domestic corporations is little changed at about 13%. (This lower rate has long been logical because our investees have already paid tax on the earnings that they pay to us.) Overall, however, the new law made our businesses and the stocks we own *considerably* more valuable.

Which suggests that we return to the performance of our non-insurance businesses. Our two towering redwoods in this grove are BNSF and Berkshire Hathaway Energy (90.9% owned). Combined, they earned \$9.3 billion before tax last year, up 6% from 2017. You can read more about these businesses on pages K-5 – K-10 and pages K-40 – K-45.

Our next five non-insurance subsidiaries, as ranked by earnings (but presented here alphabetically), Clayton Homes, International Metalworking, Lubrizol, Marmon and Precision Castparts, had aggregate pre-tax income in 2018 of \$6.4 billion, up from the \$5.5 billion these companies earned in 2017.

The next five, similarly ranked and listed (Forest River, Johns Manville, MiTek, Shaw and TTI) earned \$2.4 billion pre-tax last year, up from \$2.1 billion in 2017.

The remaining non-insurance businesses that Berkshire owns – and there are many – had pre-tax income of \$3.6 billion in 2018 vs. \$3.3 billion in 2017.

Insurance, “Float,” and the Funding of Berkshire

Our property/casualty (“P/C”) insurance business – our fifth grove – has been the engine propelling Berkshire’s growth since 1967, the year we acquired National Indemnity and its sister company, National Fire & Marine, for \$8.6 million. Today, National Indemnity is the largest property/casualty company in the world as measured by net worth.

One reason we were attracted to the P/C business was the industry’s business model: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as claims arising from exposure to asbestos, or severe workplace accidents, payments can stretch over many decades.

This collect-now, pay-later model leaves P/C companies holding large sums – money we call “float” – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* it has grown, as the following table shows:

<u>Year</u>	<u>Float (in millions)*</u>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2018	122,732

* Includes float arising from life, annuity and health insurance businesses.

We may in time experience a decline in float. If so, the decline will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. That structure is by design and is a key component in the unequaled financial strength of our insurance companies. That strength will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, our insurance operation registers an underwriting profit that adds to the investment income the float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it sometimes causes the P/C industry as a whole to operate at a significant underwriting *loss*. That loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses.

Nevertheless, I like our own prospects. Berkshire’s unrivaled financial strength allows us far more flexibility in investing our float than that generally available to P/C companies. The many alternatives available to us are always an advantage and occasionally offer major opportunities. When other insurers are constrained, our choices expand.

Moreover, our P/C companies have an excellent underwriting record. Berkshire has now operated at an underwriting profit for 15 of the past 16 years, the exception being 2017, when our pre-tax loss was \$3.2 billion. For the entire 16-year span, our pre-tax gain totaled \$27 billion, of which \$2 billion was recorded in 2018.

That record is no accident: Disciplined risk evaluation is the daily focus of our insurance managers, who know that the benefits of float can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

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In most cases, the funding of a business comes from two sources – debt and equity. At Berkshire, we have two additional arrows in the quiver to talk about, but let's first address the conventional components.

We use debt sparingly. Many managers, it should be noted, will disagree with this policy, arguing that significant debt juices the returns for equity owners. And these more venturesome CEOs will be right *most* of the time.

At rare and unpredictable intervals, however, credit vanishes and debt becomes financially fatal. A Russian-roulette equation – usually win, occasionally die – may make financial sense for someone who gets a piece of a company's upside but does not share in its downside. But that strategy would be madness for Berkshire. Rational people don't risk what they have and need for what they don't have and don't need.

Most of the debt you see on our consolidated balance sheet – see page K-65 – resides at our railroad and energy subsidiaries, both of them asset-heavy companies. During recessions, the cash generation of these businesses remains bountiful. The debt they use is both appropriate for their operations and *not* guaranteed by Berkshire.

Our level of equity capital is a different story: Berkshire's \$349 billion is unmatched in corporate America. By retaining all earnings for a very long time, and allowing compound interest to work its magic, we have amassed funds that have enabled us to purchase and develop the valuable groves earlier described. Had we instead followed a 100% payout policy, we would still be working with the \$22 million with which we began fiscal 1965.

Beyond using debt and equity, Berkshire has benefitted in a major way from two less-common sources of corporate funding. The larger is the float I have described. So far, those funds, though they are recorded as a huge net *liability* on our balance sheet, have been of more utility to us than an equivalent amount of equity. That's because they have usually been accompanied by underwriting earnings. In effect, we have been *paid* in most years for holding and using other people's money.

As I have often done before, I will emphasize that this happy outcome is far from a sure thing: Mistakes in assessing insurance risks can be huge and can take many years to surface. (Think asbestos.) A major catastrophe that will dwarf hurricanes Katrina and Michael *will* occur – perhaps tomorrow, perhaps many decades from now. "The Big One" may come from a traditional source, such as a hurricane or earthquake, or it may be a total surprise involving, say, a cyber attack having disastrous consequences beyond anything insurers now contemplate. When such a mega-catastrophe strikes, we will get our share of the losses and they will be big – *very* big. Unlike many other insurers, however, we will be looking to add business the next day.

The final funding source – which again Berkshire possesses to an unusual degree – is deferred income taxes. These are liabilities that we will eventually pay but that are meanwhile interest-free.

As I indicated earlier, about \$14.7 billion of our \$50.5 billion of deferred taxes arises from the unrealized gains in our equity holdings. These liabilities are accrued in our financial statements at the current 21% corporate tax rate but will be paid at the rates prevailing when our investments are sold. Between now and then, we in effect have an interest-free "loan" that allows us to have more money working for us in equities than would otherwise be the case.

A further \$28.3 billion of deferred tax results from our being able to accelerate the depreciation of assets such as plant and equipment in calculating the tax we must currently pay. The front-ended savings in taxes that we record gradually reverse in future years. We regularly purchase additional assets, however. As long as the present tax law prevails, this source of funding should trend upward.

Over time, Berkshire's funding base – that's the right-hand side of our balance sheet – should grow, primarily through the earnings we retain. Our job is to put the money retained to good use on the left-hand side, by adding attractive assets.

GEICO and Tony Nicely

That title says it all: The company and the man are inseparable.

Tony joined GEICO in 1961 at the age of 18; I met him in the mid-1970s. At that time, GEICO, after a four-decade record of both rapid growth and outstanding underwriting results, suddenly found itself near bankruptcy. A recently-installed management had grossly underestimated GEICO's loss costs and consequently underpriced its product. It would take many months until those loss-generating policies on GEICO's books – there were no less than 2.3 million of them – would expire and could then be repriced. The company's net worth in the meantime was rapidly approaching zero.

In 1976, Jack Byrne was brought in as CEO to rescue GEICO. Soon after his arrival, I met him, concluded that he was the perfect man for the job, and began to aggressively buy GEICO shares. Within a few months, Berkshire bought about $\frac{1}{3}$ of the company, a portion that later grew to roughly $\frac{1}{2}$ without our spending a dime. That stunning accretion occurred because GEICO, after recovering its health, consistently repurchased its shares. All told, this half-interest in GEICO cost Berkshire \$47 million, about what you might pay today for a trophy apartment in New York.

Let's now fast-forward 17 years to 1993, when Tony Nicely was promoted to CEO. At that point, GEICO's reputation and profitability had been restored – but not its growth. Indeed, at yearend 1992 the company had only 1.9 million auto policies on its books, far less than its pre-crisis high. In sales volume among U.S. auto insurers, GEICO then ranked an undistinguished seventh.

Late in 1995, after Tony had re-energized GEICO, Berkshire made an offer to buy the remaining 50% of the company for \$2.3 billion, about 50 times what we had paid for the first half (and people say I never pay up!). Our offer was successful and brought Berkshire a wonderful, but underdeveloped, company and an equally wonderful CEO, who would move GEICO forward beyond my dreams.

GEICO is now America's Number Two auto insurer, with sales 1,200% greater than it recorded in 1995. Underwriting profits have totaled \$15.5 billion (pre-tax) since our purchase, and float available for investment has grown from \$2.5 billion to \$22.1 billion.

By my estimate, Tony's management of GEICO has increased Berkshire's intrinsic value by more than \$50 billion. On top of that, he is a model for everything a manager should be, helping his 40,000 associates to identify and polish abilities they didn't realize they possessed.

Last year, Tony decided to retire as CEO, and on June 30th he turned that position over to Bill Roberts, his long-time partner. I've known and watched Bill operate for several decades, and once again Tony made the right move. Tony remains Chairman and will be helpful to GEICO for the rest of his life. He's incapable of doing less.

All Berkshire shareholders owe Tony their thanks. I head the list.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding – 325,442,152 shares – because Berkshire is part of a control group and therefore must account for this investment on the “equity” method. On its balance sheet, Berkshire carries its Kraft Heinz holding at a GAAP figure of \$13.8 billion, an amount reduced by our share of the large write-off of intangible assets taken by Kraft Heinz in 2018. At yearend, our Kraft Heinz holding had a market value of \$14 billion and a cost basis of \$9.8 billion.

<u>Shares*</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	12/31/18	
			<u>Cost**</u>	<u>Market</u>
(in millions)				
151,610,700	American Express Company	17.9	\$ 1,287	\$ 14,452
255,300,329	Apple Inc.	5.4	36,044	40,271
918,919,000	Bank of America Corp.	9.5	11,650	22,642
84,488,751	The Bank of New York Mellon Corp.	8.8	3,860	3,977
6,789,054	Charter Communications, Inc.	3.0	1,210	1,935
400,000,000	The Coca-Cola Company	9.4	1,299	18,940
65,535,000	Delta Air Lines, Inc.	9.6	2,860	3,270
18,784,698	The Goldman Sachs Group, Inc.	4.9	2,380	3,138
50,661,394	JPMorgan Chase & Co.	1.5	5,605	4,946
24,669,778	Moody’s Corporation	12.9	248	3,455
47,890,899	Southwest Airlines Co.	8.7	2,005	2,226
21,938,642	United Continental Holdings Inc.	8.1	1,195	1,837
146,346,999	U.S. Bancorp	9.1	5,548	6,688
43,387,980	USG Corporation	31.0	836	1,851
449,349,102	Wells Fargo & Company	9.8	10,639	20,706
	Others		16,201	22,423
Total Common Stocks Carried at Market			\$ 102,867	\$ 172,757

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis.

Charlie and I do *not* view the \$172.8 billion detailed above as a collection of ticker symbols – a financial dalliance to be terminated because of downgrades by “the Street,” expected Federal Reserve actions, possible political developments, forecasts by economists or whatever else might be the subject *du jour*.

What we see in our holdings, rather, is an assembly of companies that we partly own and that, on a weighted basis, are earning about 20% on the net tangible equity capital required to run their businesses. These companies, also, earn their profits without employing excessive levels of debt.

Returns of that order by large, established and understandable businesses are remarkable under any circumstances. They are truly mind-blowing when compared against the return that many investors have accepted on bonds over the last decade – 3% or less on 30-year U.S. Treasury bonds, for example.

On occasion, a ridiculously-high purchase price for a given stock will cause a splendid business to become a poor investment – if not permanently, at least for a painfully long period. Over time, however, investment performance converges with business performance. And, as I will next spell out, the record of American business has been extraordinary.

The American Tailwind

On March 11th, it will be 77 years since I first invested in an American business. The year was 1942, I was 11, and I went all in, investing \$114.75 I had begun accumulating at age six. What I bought was three shares of Cities Service preferred stock. I had become a capitalist, and it felt good.

Let's now travel back through the two 77-year periods that preceded my purchase. That leaves us starting in 1788, a year prior to George Washington's installation as our first president. Could anyone then have imagined what their new country would accomplish in only three 77-year lifetimes?

During the two 77-year periods prior to 1942, the United States had grown from four million people – about ½ of 1% of the world's population – into the most powerful country on earth. In that spring of 1942, though, it faced a crisis: The U.S. and its allies were suffering heavy losses in a war that we had entered only three months earlier. Bad news arrived daily.

Despite the alarming headlines, almost all Americans believed on that March 11th that the war would be won. Nor was their optimism limited to that victory. Leaving aside congenital pessimists, Americans believed that their children and generations beyond would live far better lives than they themselves had led.

The nation's citizens understood, of course, that the road ahead would not be a smooth ride. It never had been. Early in its history our country was tested by a Civil War that killed 4% of all American males and led President Lincoln to openly ponder whether "a nation so conceived and so dedicated could long endure." In the 1930s, America suffered through the Great Depression, a punishing period of massive unemployment.

Nevertheless, in 1942, when I made my purchase, the nation expected post-war growth, a belief that proved to be well-founded. In fact, the nation's achievements can best be described as breathtaking.

Let's put numbers to that claim: If my \$114.75 had been invested in a no-fee S&P 500 index fund, and all dividends had been reinvested, my stake would have grown to be worth (pre-taxes) \$606,811 on January 31, 2019 (the latest data available before the printing of this letter). That is a gain of *5,288 for 1*. Meanwhile, a \$1 million investment by a tax-free institution of that time – say, a pension fund or college endowment – would have grown to about *\$5.3 billion*.

Let me add one additional calculation that I believe will shock you: If that hypothetical institution had paid only *1%* of assets annually to various "helpers," such as investment managers and consultants, its gain would have been *cut in half*, to \$2.65 billion. That's what happens over 77 years when the 11.8% annual return actually achieved by the S&P 500 is recalculated at a 10.8% rate.

Those who regularly preach doom because of government budget deficits (as I regularly did myself for many years) might note that our country's national debt has increased roughly 400-fold during the last of my 77-year periods. That's 40,000%! Suppose you had foreseen this increase and panicked at the prospect of runaway deficits and a worthless currency. To "protect" yourself, you might have eschewed stocks and opted instead to buy 3 1/4 ounces of gold with your \$114.75.

And what would that supposed protection have delivered? You would now have an asset worth about \$4,200, *less than 1% of what* would have been realized from a simple unmanaged investment in American business. The magical metal was no match for the American mettle.

Our country's almost unbelievable prosperity has been gained in a bipartisan manner. Since 1942, we have had seven Republican presidents and seven Democrats. In the years they served, the country contended at various times with a long period of viral inflation, a 21% prime rate, several controversial and costly wars, the resignation of a president, a pervasive collapse in home values, a paralyzing financial panic and a host of other problems. All engendered scary headlines; all are now history.

Christopher Wren, architect of St. Paul's Cathedral, lies buried within that London church. Near his tomb are posted these words of description (translated from Latin): "If you would seek my monument, look around you." Those skeptical of America's economic playbook should heed his message.

In 1788 – to go back to our starting point – there really wasn't much here *except* for a small band of ambitious people and an embryonic governing framework aimed at turning their dreams into reality. Today, the Federal Reserve estimates our household wealth at \$108 *trillion*, an amount almost impossible to comprehend.

Remember, earlier in this letter, how I described retained earnings as having been the key to Berkshire's prosperity? So it has been with America. In the nation's accounting, the comparable item is labeled "savings." And save we have. If our forefathers had instead consumed all they produced, there would have been no investment, no productivity gains and no leap in living standards.

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Charlie and I happily acknowledge that much of Berkshire's success has simply been a product of what I think should be called *The American Tailwind*. It is beyond arrogance for American businesses or individuals to boast that they have "done it alone." The tidy rows of simple white crosses at Normandy should shame those who make such claims.

There are also many other countries around the world that have bright futures. About that, we should rejoice: Americans will be both more prosperous and safer if *all* nations thrive. At Berkshire, we hope to invest significant sums across borders.

Over the next 77 years, however, the major source of our gains will almost certainly be provided by The American Tailwind. We are lucky – gloriously lucky – to have that force at our back.

The Annual Meeting

Berkshire's 2019 annual meeting will take place on Saturday, May 4th. If you are thinking about attending – and Charlie and I hope you come – check out the details on pages A-2 – A-3. They describe the same schedule we've followed for some years.

If you can't join us in Omaha, attend via Yahoo's webcast. Andy Serwer and his Yahoo associates do an outstanding job, both in covering the entire meeting and interviewing many Berkshire managers, celebrities, financial experts and shareholders from the U.S. and abroad. The world's knowledge of what goes on in Omaha the first Saturday of every May has grown dramatically since Yahoo came on board. Its coverage begins at 8:45 a.m. CDT and provides Mandarin translation.

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For 54 years, Charlie and I have loved our jobs. Daily, we do what we find interesting, working with people we like and trust. And now our new management structure has made our lives even more enjoyable.

With the whole ensemble – that is, with Ajit and Greg running operations, a great collection of businesses, a Niagara of cash-generation, a cadre of talented managers and a rock-solid culture – your company is in good shape for whatever the future brings.

February 23, 2019

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
Compounded Annual Gain – 1965-2019	20.3%	10.0%
Overall Gain – 1964-2019	2,744,062%	19,784%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire earned \$81.4 billion in 2019 according to generally accepted accounting principles (commonly called “GAAP”). The components of that figure are \$24 billion of operating earnings, \$3.7 billion of realized capital gains and a \$53.7 billion gain from an increase in the amount of net *unrealized* capital gains that exist in the stocks we hold. Each of those components of earnings is stated on an after-tax basis.

That \$53.7 billion gain requires comment. It resulted from a new GAAP rule, imposed in 2018, that requires a company holding equity securities to include in earnings the net change in the *unrealized* gains and losses of those securities. As we stated in last year’s letter, neither Charlie Munger, my partner in managing Berkshire, nor I agree with that rule.

The adoption of the rule by the accounting profession, in fact, was a monumental shift in its own thinking. Before 2018, GAAP insisted – with an exception for companies whose business was to trade securities – that unrealized *gains* within a portfolio of stocks were *never* to be included in earnings and unrealized *losses* were to be included *only* if they were deemed “other than temporary.” Now, Berkshire must enshrine in each quarter’s bottom line – a key item of news for many investors, analysts and commentators – every up and down movement of the stocks it owns, however capricious those fluctuations may be.

Berkshire’s 2018 and 2019 years glaringly illustrate the argument we have with the new rule. In 2018, a down year for the stock market, our net unrealized gains *decreased* by \$20.6 billion, and we therefore reported GAAP earnings of only \$4 billion. In 2019, *rising* stock prices increased net unrealized gains by the aforementioned \$53.7 billion, pushing GAAP earnings to the \$81.4 billion reported at the beginning of this letter. Those market gyrations led to a crazy 1,900% increase in GAAP earnings!

Meanwhile, in what we might call the real world, as opposed to accounting-land, Berkshire’s equity holdings averaged about \$200 billion during the two years, and the *intrinsic value* of the stocks we own grew steadily and substantially throughout the period.

Charlie and I urge you to focus on operating earnings – which were little changed in 2019 – and to ignore both quarterly and annual gains or losses from investments, whether these are realized or unrealized.

Our advising that *in no way* diminishes the importance of these investments to Berkshire. Over time, Charlie and I expect our equity holdings – as a group – to deliver *major* gains, albeit in an unpredictable and highly irregular manner. To see why we are optimistic, move on to the next discussion.

The Power of Retained Earnings

In 1924, Edgar Lawrence Smith, an obscure economist and financial advisor, wrote *Common Stocks as Long Term Investments*, a slim book that changed the investment world. Indeed, writing the book changed Smith himself, forcing him to reassess his own investment beliefs.

Going in, he planned to argue that stocks would perform better than bonds during inflationary periods and that bonds would deliver superior returns during deflationary times. That seemed sensible enough. But Smith was in for a shock.

His book began, therefore, with a confession: “These studies are the record of a failure – the failure of facts to sustain a preconceived theory.” Luckily for investors, that failure led Smith to think more deeply about how stocks should be evaluated.

For the crux of Smith’s insight, I will quote an early reviewer of his book, none other than John Maynard Keynes: “I have kept until last what is perhaps Mr. Smith’s most important, and is certainly his most novel, point. Well-managed industrial companies do not, as a rule, distribute to the shareholders the whole of their earned profits. In good years, if not in all years, they retain a part of their profits and put them back into the business. Thus *there is an element of compound interest* (Keynes’ italics) operating in favour of a sound industrial investment. Over a period of years, the real value of the property of a sound industrial is increasing at compound interest, quite apart from the dividends paid out to the shareholders.”

And with that sprinkling of holy water, Smith was no longer obscure.

It’s difficult to understand why retained earnings were unappreciated by investors before Smith’s book was published. After all, it was no secret that mind-boggling wealth had earlier been amassed by such titans as Carnegie, Rockefeller and Ford, all of whom had retained a huge portion of their business earnings to fund growth and produce ever-greater profits. Throughout America, also, there had long been small-time capitalists who became rich following the same playbook.

Nevertheless, when business ownership was sliced into small pieces – “stocks” – buyers in the pre-Smith years usually thought of their shares as a short-term gamble on market movements. Even at their best, stocks were considered speculations. *Gentlemen preferred bonds.*

Though investors were slow to wise up, the math of retaining and reinvesting earnings is now well understood. Today, school children learn what Keynes termed “novel”: combining savings with compound interest works wonders.

* * * * *

At Berkshire, Charlie and I have long focused on using retained earnings advantageously. Sometimes this job has been easy – at other times, more than difficult, particularly when we began working with huge and ever-growing sums of money.

In our deployment of the funds we retain, we first seek to invest in the many and diverse businesses we already own. During the past decade, Berkshire’s depreciation charges have aggregated \$65 billion whereas the company’s *internal* investments in property, plant and equipment have totaled \$121 billion. Reinvestment in productive operational assets will forever remain our top priority.

In addition, we constantly seek to buy new businesses that meet three criteria. First, they must earn good returns on the net tangible capital required in their operation. Second, they must be run by able and honest managers. Finally, they must be available at a sensible price.

When we spot such businesses, our preference would be to buy 100% of them. But the opportunities to make major acquisitions possessing our required attributes are rare. Far more often, a fickle stock market serves up opportunities for us to buy large, *but non-controlling*, positions in publicly-traded companies that meet our standards.

Whichever way we go – controlled companies or only a major stake by way of the stock market – Berkshire’s financial results from the commitment will in large part be determined by the future earnings of the business we have purchased. Nonetheless, there is between the two investment approaches a hugely important accounting difference, essential for you to understand.

In our controlled companies, (defined as those in which Berkshire owns more than 50% of the shares), the earnings of each business flow directly into the operating earnings that we report to you. What you see is what you get.

In the non-controlled companies, in which we own marketable stocks, *only* the dividends that Berkshire receives are recorded in the operating earnings we report. The retained earnings? They're working hard and creating much added value, but *not* in a way that deposits those gains directly into Berkshire's reported earnings.

At almost all major companies other than Berkshire, investors would *not* find what we'll call this "non-recognition of earnings" important. For us, however, it is a standout omission, of a magnitude that we lay out for you below.

Here, we list our 10 largest stock-market holdings of businesses. The list distinguishes between their earnings that are reported to you under GAAP accounting – these are the dividends Berkshire receives from those 10 investees – and our share, so to speak, of the earnings the investees retain and put to work. Normally, those companies use retained earnings to expand their business and increase its efficiency. Or sometimes they use those funds to repurchase significant portions of their own stock, an act that enlarges Berkshire's share of the company's future earnings.

<u>Company</u>	<u>Yearend Ownership</u>	<i>Berkshire's Share (in millions)</i>	
		<u>Dividends(1)</u>	<u>Retained Earnings(2)</u>
American Express	18.7%	\$ 261	\$ 998
Apple	5.7%	773	2,519
Bank of America	10.7%	682	2,167
Bank of New York Mellon	9.0%	101	288
Coca-Cola	9.3%	640	194
Delta Airlines	11.0%	114	416
J.P. Morgan Chase	1.9%	216	476
Moody's	13.1%	55	137
U.S. Bancorp	9.7%	251	407
Wells Fargo	8.4%	705	730
Total		<u>\$3,798</u>	<u>\$8,332</u>

(1) Based on current annual rate.

(2) Based on 2019 earnings minus common and preferred dividends paid.

Obviously, the realized gains we will eventually record from partially owning each of these companies will not neatly correspond to "our" share of their retained earnings. Sometimes, alas, retentions produce nothing. But both logic and our past experience indicate that from the *group* we will realize capital gains at least equal to – and probably better than – the earnings of ours that they retained. (When we sell shares and realize gains, we will pay income tax on the gain at whatever rate then prevails. Currently, the federal rate is 21%.)

It is certain that Berkshire's rewards from these 10 companies, as well as those from our many other equity holdings, will manifest themselves in a highly irregular manner. Periodically, there will be losses, sometimes company-specific, sometimes linked to stock-market swoons. At other times – last year was one of those – our gain will be outsized. Overall, the retained earnings of our investees are certain to be of *major* importance in the growth of Berkshire's value.

Mr. Smith got it right.

Non-Insurance Operations

Tom Murphy, a valued director of Berkshire and an all-time great among business managers, long ago gave me some important advice about acquisitions: “To achieve a reputation as a good manager, just be sure you buy good businesses.”

Over the years Berkshire has acquired many dozens of companies, all of which I initially regarded as “good businesses.” Some, however, proved disappointing; more than a few were outright disasters. A reasonable number, on the other hand, have exceeded my hopes.

In reviewing my uneven record, I’ve concluded that acquisitions are similar to marriage: They start, of course, with a joyful wedding – but then reality tends to diverge from pre-nuptial expectations. Sometimes, wonderfully, the new union delivers bliss beyond either party’s hopes. In other cases, disillusionment is swift. Applying those images to corporate acquisitions, I’d have to say it is usually the buyer who encounters unpleasant surprises. It’s easy to get dreamy-eyed during corporate courtships.

Pursuing that analogy, I would say that our marital record remains largely acceptable, with all parties happy with the decisions they made long ago. Some of our tie-ups have been positively idyllic. A meaningful number, however, have caused me all too quickly to wonder what I was thinking when I proposed.

Fortunately, the fallout from many of my errors has been reduced by a characteristic shared by most businesses that disappoint: As the years pass, the “poor” business tends to stagnate, thereupon entering a state in which its operations require an ever-smaller *percentage* of Berkshire’s capital. Meanwhile, our “good” businesses often tend to grow and find opportunities for investing additional capital at attractive rates. Because of these contrasting trajectories, the assets employed at Berkshire’s winners gradually become an expanding portion of our total capital.

As an extreme example of those financial movements, witness Berkshire’s original textile business. When we acquired control of the company in early 1965, this beleaguered operation required nearly *all* of Berkshire’s capital. For some time, therefore, Berkshire’s non-earning textile assets were a huge drag on our overall returns. Eventually, though, we acquired a spread of “good” businesses, a shift that by the early 1980s caused the dwindling textile operation to employ only a tiny portion of our capital.

Today, we have most of your money deployed in controlled businesses that achieve good-to-excellent returns on the net tangible assets each requires for its operations. Our insurance business has been the superstar. That operation has special characteristics that give it a unique metric for calibrating success, one unfamiliar to many investors. We will save that discussion for the next section.

In the paragraphs that follow, we group our wide array of non-insurance businesses by size of earnings, *after* interest, depreciation, taxes, non-cash compensation, restructuring charges – all of those pesky, but very real, costs that CEOs and Wall Street sometimes urge investors to ignore. Additional information about these operations can be found on pages K-6 – K-21 and pages K-40 – K-52.

Our BNSF railroad and Berkshire Hathaway Energy (“BHE”) – the two lead dogs of Berkshire’s non-insurance group – earned a combined \$8.3 billion in 2019 (including only our 91% share of BHE), an increase of 6% from 2018.

Our next five non-insurance subsidiaries, as ranked by earnings (but presented here alphabetically), Clayton Homes, International Metalworking, Lubrizol, Marmon and Precision Castparts, had aggregate earnings in 2019 of \$4.8 billion, little changed from what these companies earned in 2018.

The next five, similarly ranked and listed (Berkshire Hathaway Automotive, Johns Manville, NetJets, Shaw and TTI) earned \$1.9 billion last year, up from the \$1.7 billion earned by this tier in 2018.

The remaining non-insurance businesses that Berkshire owns – and there are many – had aggregate earnings of \$2.7 billion in 2019, down from \$2.8 billion in 2018.

Our total net income in 2019 from the non-insurance businesses we control amounted to \$17.7 billion, an increase of 3% from the \$17.2 billion this group earned in 2018. Acquisitions and dispositions had almost no net effect on these results.

* * * * *

I must add one final item that underscores the wide scope of Berkshire's operations. Since 2011, we have owned Lubrizol, an Ohio-based company that produces and markets oil additives throughout the world. On September 26, 2019, a fire originating at a small next-door operation spread to a large French plant owned by Lubrizol.

The result was significant property damage and a major disruption in Lubrizol's business. Even so, both the company's property loss and business-interruption loss will be mitigated by substantial insurance recoveries that Lubrizol will receive.

But, as the late Paul Harvey was given to saying in his famed radio broadcasts, "Here's the rest of the story." One of the largest insurers of Lubrizol was a company owned by . . . uh, Berkshire.

In Matthew 6:3, the Bible instructs us to "Let not the left hand know what the right hand doeth." Your chairman has clearly behaved as ordered.

Property/Casualty Insurance

Our property/casualty ("P/C") insurance business has been the engine propelling Berkshire's growth since 1967, the year we acquired National Indemnity and its sister company, National Fire & Marine, for \$8.6 million. Today, National Indemnity is the largest P/C company in the world as measured by net worth. Insurance is a business of promises, and Berkshire's ability to honor its commitments is unmatched.

One reason we were attracted to the P/C business was the industry's business model: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as claims arising from exposure to asbestos, or severe workplace accidents, payments can stretch over many decades.

This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* it has grown, as the following table shows:

<u>Year</u>	<u>Float (in millions)</u>
1970	\$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2018	122,732
2019	129,423

We may in time experience a decline in float. If so, the decline will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. That structure is by design and is a key component in the unequaled financial strength of our insurance companies. That strength will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, our insurance operation registers an underwriting profit that adds to the investment income the float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

For the P/C industry as a whole, the financial value of float is now far less than it was for many years. That's because the standard investment strategy for almost all P/C companies is heavily – and *properly* – skewed toward high-grade bonds. Changes in interest rates therefore matter enormously to these companies, and during the last decade the bond market has offered pathetically low rates.

Consequently, insurers suffered, as year by year they were forced – by maturities or issuer-call provisions – to recycle their “old” investment portfolios into new holdings providing much lower yields. Where once these insurers could safely earn 5 cents or 6 cents on each dollar of float, they now take in only 2 cents or 3 cents (or even less if their operations are concentrated in countries mired in the never-never land of negative rates).

Some insurers may try to mitigate their loss of revenue by buying lower-quality bonds or non-liquid “alternative” investments promising higher yields. But those are dangerous games and activities that most institutions are ill-equipped to play.

Berkshire's situation is more favorable than that of insurers in general. Most important, our unrivaled mountain of capital, abundance of cash and a huge and diverse stream of non-insurance earnings allow us far more investment flexibility than is generally available to other companies in the industry. The many choices open to us are always advantageous – and sometimes have presented us with major opportunities.

Our P/C companies have meanwhile had an excellent underwriting record. Berkshire has now operated at an underwriting profit for 16 of the last 17 years, the exception being 2017, when our pre-tax loss was a whopping \$3.2 billion. For the entire 17-year span, our pre-tax gain totaled \$27.5 billion, of which \$400 million was recorded in 2019.

That record is no accident: Disciplined risk evaluation is the daily focus of our insurance managers, who know that the rewards of float can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

As I have repeatedly done in the past, I will emphasize now that happy outcomes in insurance are far from a sure thing: We will most certainly not have an underwriting profit in 16 of the next 17 years. Danger always lurks.

Mistakes in assessing insurance risks can be huge and can take many years – even decades – to surface and ripen. (Think asbestos.) A major catastrophe that will dwarf hurricanes Katrina and Michael *will* occur – perhaps tomorrow, perhaps many decades from now. “The Big One” may come from a traditional source, such as wind or earthquake, or it may be a total surprise involving, say, a cyber attack having disastrous consequences beyond anything insurers now contemplate. When such a mega-catastrophe strikes, Berkshire will get its share of the losses and they will be big – *very* big. Unlike many other insurers, however, handling the loss will not come close to straining our resources, and we will be eager to *add* to our business the next day.

* * * * *

Close your eyes for a moment and try to envision a locale that might spawn a dynamic P/C insurer. New York? London? Silicon Valley?

How about Wilkes-Barre?

Late in 2012, Ajit Jain, the invaluable manager of our insurance operations, called to tell me that he was buying a tiny company – GUARD Insurance Group – in that small Pennsylvania city for \$221 million (roughly its net worth at the time). He added that Sy Foguel, GUARD’s CEO, was going to be a star at Berkshire. Both GUARD and Sy were new names to me.

Bingo and bingo: In 2019, GUARD had premium volume of \$1.9 billion, up 379% since 2012, and also delivered a satisfactory underwriting profit. Since joining Berkshire, Sy has led the company into both new products and new regions of the country and has increased GUARD’s float by 265%.

In 1967, Omaha seemed an unlikely launching pad for a P/C giant. Wilkes-Barre may well deliver a similar surprise.

Berkshire Hathaway Energy

Berkshire Hathaway Energy is now celebrating its 20th year under our ownership. That anniversary suggests that we should be catching up with the company’s accomplishments.

We’ll start with the topic of electricity rates. When Berkshire entered the utility business in 2000, purchasing 76% of BHE, the company’s residential customers in Iowa paid an average of 8.8 cents per kilowatt-hour (kWh). Prices for residential customers have since risen less than 1% a year, and we have promised that there will be no base rate price increases through 2028. In contrast, here’s what is happening at the other large investor-owned Iowa utility: Last year, the rates it charged its residential customers were 61% higher than BHE’s. Recently, that utility received a rate increase that will widen the gap to 70%.

The extraordinary differential between our rates and theirs is largely the result of our huge accomplishments in converting wind into electricity. In 2021, we expect BHE’s operation to generate about 25.2 million megawatt-hours of electricity (MWh) in Iowa from wind turbines that it both owns and operates. That output will totally cover the annual needs of its Iowa customers, which run to about 24.6 million MWh. In other words, our utility will have attained wind self-sufficiency in the state of Iowa.

In still another contrast, that other Iowa utility generates less than 10% of its power from wind. Furthermore, we know of no other investor-owned utility, wherever located, that by 2021 will have achieved a position of wind self-sufficiency. In 2000, BHE was serving an agricultural-based economy; today, three of its five largest customers are high-tech giants. I believe their decisions to site plants in Iowa were in part based upon BHE’s ability to deliver renewable, low-cost energy.

Of course, wind is intermittent, and our blades in Iowa turn only part of the time. In certain periods, when the air is still, we look to our non-wind generating capacity to secure the electricity we need. At opposite times, we sell the excess power that wind provides us to other utilities, serving them through what’s called “the grid.” The power we sell them supplants their need for a carbon resource – coal, say, or natural gas.

Berkshire Hathaway now owns 91% of BHE in partnership with Walter Scott, Jr. and Greg Abel. BHE has never paid Berkshire Hathaway a dividend since our purchase and has, as the years have passed, retained \$28 billion of earnings. That pattern is an outlier in the world of utilities, whose companies customarily pay big dividends – sometimes reaching, or even exceeding, 80% of earnings. Our view: The more we can invest, the more we like it.

Today, BHE has the operating talent and experience to manage truly huge utility projects – requiring investments of \$100 billion or more – that could support infrastructure benefitting our country, our communities and our shareholders. We stand ready, willing and able to take on such opportunities.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding – 325,442,152 shares – because Berkshire is part of a control group and therefore must account for this investment on the “equity” method. On its balance sheet, Berkshire carries the Kraft Heinz holding at a GAAP figure of \$13.8 billion, an amount that represents Berkshire’s share of the audited net worth of Kraft Heinz at December 31, 2019. Please note, though, that the market value of our shares on that date was only \$10.5 billion.

<i>Shares*</i>	<i>Company</i>	<i>Percentage of Company Owned</i>	<i>12/31/19</i>	<i>Cost**</i>	<i>Market</i>
<i>(in millions)</i>					
151,610,700	American Express Company	18.7	\$ 1,287	\$ 18,874	
250,866,566	Apple Inc.	5.7	35,287	73,667	
947,760,000	Bank of America Corp.	10.7	12,560	33,380	
81,488,751	The Bank of New York Mellon Corp.	9.0	3,696	4,101	
5,426,609	Charter Communications, Inc.	2.6	944	2,632	
400,000,000	The Coca-Cola Company	9.3	1,299	22,140	
70,910,456	Delta Air Lines, Inc.	11.0	3,125	4,147	
12,435,814	The Goldman Sachs Group, Inc.	3.5	890	2,859	
60,059,932	JPMorgan Chase & Co.	1.9	6,556	8,372	
24,669,778	Moody’s Corporation	13.1	248	5,857	
46,692,713	Southwest Airlines Co.	9.0	1,940	2,520	
21,938,642	United Continental Holdings Inc.	8.7	1,195	1,933	
149,497,786	U.S. Bancorp	9.7	5,709	8,864	
10,239,160	Visa Inc.	0.6	349	1,924	
345,688,918	Wells Fargo & Company	8.4	7,040	18,598	
	Others***		28,215	38,159	
	Total Equity Investments Carried at Market		<u>\$110,340</u>	<u>\$248,027</u>	

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis.

*** Includes \$10 billion investment in Occidental Petroleum Corporation consisting of preferred stock and warrants to buy common stock.

Charlie and I do *not* view the \$248 billion detailed above as a collection of stock market wagers – dalliances to be terminated because of downgrades by “the Street,” an earnings “miss,” expected Federal Reserve actions, possible political developments, forecasts by economists or whatever else might be the subject *du jour*.

What we see in our holdings, rather, is an assembly of companies that we partly own and that, on a weighted basis, are earning more than 20% on the net tangible equity capital required to run their businesses. These companies, also, earn their profits without employing excessive levels of debt.

Returns of that order by large, established and understandable businesses are remarkable under any circumstances. They are truly mind-blowing when compared to the returns that many investors have accepted on bonds over the last decade – 2½% or even less on 30-year U.S. Treasury bonds, for example.

Forecasting interest rates has never been our game, and Charlie and I have *no* idea what rates will average over the next year, or ten or thirty years. Our perhaps jaundiced view is that the pundits who opine on these subjects reveal, by that very behavior, far more about themselves than they reveal about the future.

What we *can* say is that if something close to current rates should prevail over the coming decades and if corporate tax rates also remain near the low level businesses now enjoy, it is almost certain that equities will *over time* perform far better than long-term, fixed-rate debt instruments.

That rosy prediction comes with a warning: *Anything* can happen to stock prices tomorrow. Occasionally, there will be major drops in the market, perhaps of 50% magnitude or even greater. But the combination of The American Tailwind, about which I wrote last year, and the compounding wonders described by Mr. Smith, will make equities the much better long-term choice for the individual who does not use borrowed money and who can control his or her emotions. Others? Beware!

The Road Ahead

Three decades ago, my Midwestern friend, Joe Rosenfield, then in his 80s, received an irritating letter from his local newspaper. In blunt words, the paper asked for biographical data it planned to use in Joe's obituary. Joe didn't respond. So? A month later, he got a second letter from the paper, this one labeled "URGENT."

Charlie and I long ago entered the urgent zone. That's not exactly great news for us. But Berkshire shareholders need not worry: Your company is 100% prepared for our departure.

The two of us base our optimism upon five factors. First, Berkshire's assets are deployed in an extraordinary variety of wholly or partly-owned businesses that, averaged out, earn attractive returns on the capital they use. Second, Berkshire's positioning of its "controlled" businesses within a single entity endows it with some important and enduring economic advantages. Third, Berkshire's financial affairs will unfailingly be managed in a manner allowing the company to withstand external shocks of an extreme nature. Fourth, we possess skilled and *devoted* top managers for whom running Berkshire is far more than simply having a high-paying and/or prestigious job. Finally, Berkshire's directors – your guardians – are constantly focused on both the welfare of owners and the nurturing of a culture that is rare among giant corporations. (The value of this culture is explored in *Margin of Trust*, a new book by Larry Cunningham and Stephanie Cuba that will be available at our annual meeting.)

Charlie and I have very pragmatic reasons for wanting to assure Berkshire's prosperity in the years following our exit: The Mungers have Berkshire holdings that dwarf any of the family's other investments, and I have a full 99% of my net worth lodged in Berkshire stock. I have never sold any shares and have no plans to do so. My only disposal of Berkshire shares, aside from charitable donations and minor personal gifts, took place in 1980, when I, along with other Berkshire stockholders who elected to participate, exchanged some of our Berkshire shares for the shares of an Illinois bank that Berkshire had purchased in 1969 and that, in 1980, needed to be offloaded because of changes in the bank holding company law.

Today, my will specifically directs its executors – as well as the trustees who will succeed them in administering my estate after the will is closed – not to sell *any* Berkshire shares. My will also absolves both the executors and the trustees from liability for maintaining what obviously will be an extreme concentration of assets.

The will goes on to instruct the executors – and, in time, the trustees – to each year convert a portion of my A shares into B shares and then distribute the Bs to various foundations. Those foundations will be required to deploy their grants promptly. In all, I estimate that it will take 12 to 15 years for the entirety of the Berkshire shares I hold at my death to move into the market.

Absent my will's directive that all my Berkshire shares should be held until their scheduled distribution dates, the "safe" course for both my executors and trustees would be to sell the Berkshire shares under their temporary control and reinvest the proceeds in U.S. Treasury bonds with maturities matching the scheduled dates for distributions. That strategy would leave the fiduciaries immune from both public criticism and the possibility of personal liability for failure to act in accordance with the "prudent man" standard.

I myself feel comfortable that Berkshire shares will provide a safe and rewarding investment during the disposal period. There is always a chance – unlikely, but not negligible – that events will prove me wrong. I believe, however, that there is a high probability that my directive will deliver substantially greater resources to society than would result from a conventional course of action.

Key to my “Berkshire-only” instructions is my faith in the future judgment and fidelity of Berkshire directors. They will regularly be tested by Wall Streeters bearing fees. At many companies, these super-salesmen might win. I do not, however, expect that to happen at Berkshire.

Boards of Directors

In recent years, both the composition of corporate boards and their purpose have become hot topics. Once, debate about the responsibilities of boards was largely limited to lawyers; today, institutional investors and politicians have weighed in as well.

My credentials for discussing corporate governance include the fact that, over the last 62 years, I have served as a director of 21 publicly-owned companies (listed below). In all but two of them, I have represented a substantial holding of stock. In a few cases, I have tried to implement important change.

During the first 30 or so years of my services, it was rare to find a woman in the room unless she represented a family controlling the enterprise. This year, it should be noted, marks the 100th anniversary of the 19th Amendment, which guaranteed American women the right to have their voices heard in a voting booth. Their attaining similar status in a board room remains a work in progress.

Over the years, many new rules and guidelines pertaining to board composition and duties have come into being. The bedrock challenge for directors, nevertheless, remains constant: Find and retain a talented CEO – possessing integrity, for sure – who will be *devoted* to the company for his/her business lifetime. Often, that task is hard. When directors get it right, though, they need to do little else. But when they mess it up,

Audit committees now work much harder than they once did and almost always view the job with appropriate seriousness. Nevertheless, these committees remain no match for managers who wish to game numbers, an offense that has been encouraged by the scourge of earnings “guidance” and the desire of CEOs to “hit the number.” My direct experience (limited, thankfully) with CEOs who have played with a company’s numbers indicates that they were more often prompted by ego than by a desire for financial gain.

Compensation committees now rely much more heavily on consultants than they used to. Consequently, compensation arrangements have become more complicated – what committee member wants to explain paying large fees year after year for a *simple* plan? – and the reading of proxy material has become a mind-numbing experience.

One *very* important improvement in corporate governance has been mandated: a regularly-scheduled “executive session” of directors at which the CEO is barred. Prior to that change, truly frank discussions of a CEO’s skills, acquisition decisions and compensation were rare.

Acquisition proposals remain a particularly vexing problem for board members. The legal orchestration for making deals has been refined and expanded (a word aptly describing attendant costs as well). But I have yet to see a CEO who craves an acquisition bring in an informed and articulate critic to argue against it. And yes, include me among the guilty.

Berkshire, Blue Chip Stamps, Cap Cities-ABC, Coca-Cola, Data Documents, Dempster, General Growth, Gillette, Kraft Heinz, Maracaibo Oil, Munsingwear, Omaha National Bank, Pinkerton’s, Portland Gas Light, Salomon, Sanborn Map, Tribune Oil, U.S. Air, Vornado, Washington Post, Wesco Financial

Overall, the deck is stacked in favor of the deal that's coveted by the CEO and his/her obliging staff. It would be an interesting exercise for a company to hire two "expert" acquisition advisors, one pro and one con, to deliver his or her views on a proposed deal to the board – with the winning advisor to receive, say, ten times a token sum paid to the loser. Don't hold your breath awaiting this reform: The current system, whatever its shortcomings for shareholders, works magnificently for CEOs and the many advisors and other professionals who feast on deals. A venerable caution will forever be true when advice from Wall Street is contemplated: Don't ask the barber whether you need a haircut.

Over the years, board "independence" has become a new area of emphasis. One key point relating to this topic, though, is almost invariably overlooked: Director compensation has now soared to a level that inevitably makes pay a subconscious factor affecting the behavior of many non-wealthy members. Think, for a moment, of the director earning \$250,000-300,000 for board meetings consuming a pleasant couple of days six or so times a year. Frequently, the possession of one such directorship bestows on its holder three to four times the *annual* median income of U.S. households. (I missed much of this gravy train: As a director of Portland Gas Light in the early 1960s, I received \$100 *annually* for my service. To earn this princely sum, I commuted to Maine four times a year.)

And job security now? It's fabulous. Board members may get politely ignored, but they seldom get fired. Instead, generous age limits – usually 70 or higher – act as the standard method for the genteel ejection of directors.

Is it any wonder that a non-wealthy director ("NWD") now hopes – or even yearns – to be asked to join a second board, thereby vaulting into the \$500,000-600,000 class? To achieve this goal, the NWD will need help. The CEO of a company searching for board members will almost certainly check with the NWD's current CEO as to whether NWD is a "good" director. "Good," of course, is a code word. If the NWD has seriously challenged his/her present CEO's compensation or acquisition dreams, his or her candidacy will silently die. When seeking directors, CEOs don't look for pit bulls. It's the cocker spaniel that gets taken home.

Despite the illogic of it all, the director for whom fees are important – indeed, craved – is almost universally classified as "independent" while many directors possessing fortunes very substantially linked to the welfare of the corporation are deemed lacking in independence. Not long ago, I looked at the proxy material of a large American company and found that *eight* directors had never purchased a share of the company's stock *using their own money*. (They, of course, had received *grants* of stock as a supplement to their generous cash compensation.) This particular company had long been a laggard, but the directors were doing wonderfully.

Paid-with-my-own-money ownership, of course, does *not* create wisdom or ensure business smarts. Nevertheless, I feel better when directors of our portfolio companies have had the experience of purchasing shares with their savings, rather than simply having been the recipients of grants.

* * * * *

Here, a pause is due: I'd like you to know that almost all of the directors I have met over the years have been decent, likable and intelligent. They dressed well, made good neighbors and were fine citizens. I've enjoyed their company. Among the group are some men and women that I would not have met except for our mutual board service and who have become close friends.

Nevertheless, many of these good souls are people whom I would never have chosen to handle money or business matters. It simply was not their game.

They, in turn, would never have asked me for help in removing a tooth, decorating their home or improving their golf swing. Moreover, if I were ever scheduled to appear on *Dancing With the Stars*, I would immediately seek refuge in the Witness Protection Program. We are all duds at one thing or another. For most of us, the list is long. The important point to recognize is that if you are Bobby Fischer, you must play *only* chess for money.

At Berkshire, we will continue to look for business-savvy directors who are owner-oriented and arrive with a strong specific interest in our company. Thought and principles, not robot-like "process," will guide their actions. In representing *your* interests, they will, of course, seek managers whose goals include delighting their customers, cherishing their associates and acting as good citizens of both their communities and our country.

Those objectives are not new. They were the goals of able CEOs sixty years ago and remain so. Who would have it otherwise?

Short Subjects

In past reports, we've discussed both the sense and nonsense of stock repurchases. Our thinking, boiled down: Berkshire will buy back its stock only if a) Charlie and I believe that it is selling for less than it is worth and b) the company, upon completing the repurchase, is left with ample cash.

Calculations of intrinsic value are far from precise. Consequently, neither of us feels any urgency to buy an *estimated* \$1 of value for a very real 95 cents. In 2019, the Berkshire price/value equation was *modestly* favorable at times, and we spent \$5 billion in repurchasing about 1% of the company.

Over time, we want Berkshire's share count to go *down*. If the price-to-value discount (as we estimate it) widens, we will likely become more aggressive in purchasing shares. We will not, however, prop the stock at any level.

Shareholders having at least \$20 million in value of A or B shares and an inclination to sell shares to Berkshire may wish to have their broker contact Berkshire's Mark Millard at 402-346-1400. We request that you phone Mark between 8:00-8:30 a.m. or 3:00-3:30 p.m. Central Time, calling only if you are ready to sell.

* * * * *

In 2019, Berkshire sent \$3.6 billion to the U.S. Treasury to pay its current income tax. The U.S. government collected \$243 billion from corporate income tax payments during the same period. From these statistics, you can take pride that your company delivered 1½% of the federal income taxes paid by *all* of corporate America.

Fifty-five years ago, when Berkshire entered its current incarnation, the company paid *nothing* in federal income tax. (For good reason, too: Over the previous decade, the struggling business had recorded a net loss.) Since then, as Berkshire retained nearly all of its earnings, the beneficiaries of that policy became not only the company's shareholders but also the federal government. In most future years, we both hope and expect to send *far* larger sums to the Treasury.

* * * * *

On pages A-2 – A-3, you will find details about our annual meeting, which will be held on May 2, 2020. Yahoo, as usual, will be streaming the event worldwide. There will be one important change, however, in our format: I've had suggestions from shareholders, media and board members that Ajit Jain and Greg Abel – our two key operating managers – be given more exposure at the meeting. That change makes great sense. They are outstanding individuals, both as managers and as human beings, and you should hear more from them.

Shareholders who this year send a question to be asked by our three long-serving journalists may specify that it be posed to Ajit or Greg. They, like Charlie and me, will not have even a hint of what the questions will be.

The journalists will alternate questions with those from the audience, who also can direct questions to any of the four of us. So polish up your zingers.

* * * * *

On May 2nd, come to Omaha. Meet your fellow capitalists. Buy some Berkshire products. Have fun. Charlie and I – along with the entire Berkshire gang – are looking forward to seeing you.

February 22, 2020

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
Compounded Annual Gain – 1965-2020	20.0%	10.2%
Overall Gain – 1964-2020	2,810,526%	23,454%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire earned \$42.5 billion in 2020 according to generally accepted accounting principles (commonly called “GAAP”). The four components of that figure are \$21.9 billion of operating earnings, \$4.9 billion of realized capital gains, a \$26.7 billion gain from an increase in the amount of net *unrealized* capital gains that exist in the stocks we hold and, finally, an \$11 billion *loss* from a write-down in the value of a few subsidiary and affiliate businesses that we own. All items are stated on an after-tax basis.

Operating earnings are what count most, even during periods when they are *not* the largest item in our GAAP total. Our focus at Berkshire is both to increase this segment of our income and to acquire large and favorably-situated businesses. Last year, however, we met neither goal: Berkshire made no sizable acquisitions and operating earnings *fell 9%*. We did, though, increase Berkshire’s per-share intrinsic value by both retaining earnings and repurchasing about 5% of our shares.

The two GAAP components pertaining to capital gains or losses (whether realized or unrealized) fluctuate capriciously from year to year, reflecting swings in the stock market. Whatever *today’s* figures, Charlie Munger, my long-time partner, and I firmly believe that, over time, Berkshire’s capital gains from its investment holdings will be substantial.

As I’ve emphasized many times, Charlie and I view Berkshire’s holdings of marketable stocks – at yearend worth \$281 billion – as a collection of *businesses*. We don’t control the operations of those companies, but we do share proportionately in their long-term prosperity. From an accounting standpoint, however, our portion of their *earnings* is *not* included in Berkshire’s income. Instead, only what these investees pay us in dividends is recorded on our books. Under GAAP, the huge sums that investees retain on our behalf become invisible.

What’s out of sight, however, should *not* be out of mind: Those unrecorded retained earnings are usually building value – *lots* of value – for Berkshire. Investees use the withheld funds to expand their business, make acquisitions, pay off debt and, often, to repurchase their stock (an act that increases our share of their future earnings). As we pointed out in these pages last year, retained earnings have propelled American business throughout our country’s history. What worked for Carnegie and Rockefeller has, over the years, worked its magic for millions of shareholders as well.

Of course, some of our investees will disappoint, adding little, if anything, to the value of their company by retaining earnings. But others will over-deliver, a few spectacularly. In aggregate, we expect our share of the huge pile of earnings retained by Berkshire’s non-controlled businesses (what others would label our equity portfolio) to eventually deliver us an equal or greater amount of capital gains. Over our 56-year tenure, that expectation has been met.

The final component in our GAAP figure – that ugly \$11 billion write-down – is almost entirely the quantification of a mistake I made in 2016. That year, Berkshire purchased Precision Castparts (“PCC”), and I paid too much for the company.

No one misled me in any way – I was simply too optimistic about PCC’s normalized profit potential. Last year, my miscalculation was laid bare by adverse developments throughout the aerospace industry, PCC’s most important source of customers.

In purchasing PCC, Berkshire bought a fine company – the best in its business. Mark Donegan, PCC’s CEO, is a passionate manager who consistently pours the same energy into the business that he did before we purchased it. We are lucky to have him running things.

I believe I was right in concluding that PCC would, over time, earn good returns on the net tangible assets deployed in its operations. I was wrong, however, in judging the *average* amount of future earnings and, consequently, wrong in my calculation of the proper price to pay for the business.

PCC is far from my first error of that sort. But it’s a big one.

Two Strings to Our Bow

Berkshire is often labeled a conglomerate, a negative term applied to holding companies that own a hodge-podge of unrelated businesses. And, yes, that describes Berkshire – but only in part. To understand how and why we differ from the prototype conglomerate, let’s review a little history.

Over time, conglomerates have generally limited themselves to buying businesses *in their entirety*. That strategy, however, came with two major problems. One was unsolvable: Most of the truly great businesses had no interest in having *anyone* take them over. Consequently, deal-hungry conglomerateurs had to focus on so-so companies that lacked important and durable competitive strengths. That was not a great pond in which to fish.

Beyond that, as conglomerateurs dipped into this universe of mediocre businesses, they often found themselves required to pay staggering “control” premiums to snare their quarry. Aspiring conglomerateurs knew the answer to this “overpayment” problem: They simply needed to manufacture a vastly overvalued stock of their own that could be used as a “currency” for pricey acquisitions. (“I’ll pay you \$10,000 for your dog by giving you two of my \$5,000 cats.”)

Often, the tools for fostering the overvaluation of a conglomerate’s stock involved promotional techniques and “imaginative” accounting maneuvers that were, at best, deceptive and that sometimes crossed the line into fraud. When these tricks were “successful,” the conglomerate pushed its own stock to, say, 3x its business value in order to offer the target 2x *its* value.

Investing illusions can continue for a surprisingly long time. Wall Street loves the fees that deal-making generates, and the press loves the stories that colorful promoters provide. At a point, also, the soaring price of a promoted stock can itself become the “proof” that an illusion is reality.

Eventually, of course, the party ends, and many business “emperors” are found to have no clothes. Financial history is replete with the names of famous conglomerateurs who were initially lionized as business geniuses by journalists, analysts and investment bankers, but whose creations ended up as business junkyards.

Conglomerates *earned* their terrible reputation.

* * * * *

Charlie and I want our conglomerate to *own* all or part of a diverse group of businesses with good economic characteristics and good managers. Whether Berkshire *controls* these businesses, however, is unimportant to us.

It took me a while to wise up. But Charlie – and also my 20-year struggle with the textile operation I inherited at Berkshire – finally convinced me that owning a non-controlling portion of a wonderful business is more profitable, more enjoyable and *far* less work than struggling with 100% of a marginal enterprise.

For those reasons, *our* conglomerate will remain a collection of controlled *and* non-controlled businesses. Charlie and I will simply deploy your capital into whatever we believe makes the most sense, based on a company’s durable competitive strengths, the capabilities and character of its management, and price.

If that strategy requires little or no effort on our part, so much the better. In contrast to the scoring system utilized in diving competitions, you are awarded *no* points in business endeavors for “degree of difficulty.” Furthermore, as Ronald Reagan cautioned: “It’s said that hard work never killed anyone, but *I* say why take the chance?”

The Family Jewels and How We Increase Your Share of These Gems

On page A-1 we list Berkshire’s subsidiaries, a smorgasbord of businesses employing 360,000 at yearend. You can read much more about these controlled operations in the 10-K that fills the back part of this report. Our major positions in companies that we partly own and *don’t* control are listed on page 7 of this letter. That portfolio of businesses, too, is large and diverse.

Most of Berkshire’s value, however, resides in four businesses, three controlled and one in which we have only a 5.4% interest. All four are jewels.

The largest in value is our property/casualty insurance operation, which for 53 years has been the core of Berkshire. Our family of insurers is unique in the insurance field. So, too, is its manager, Ajit Jain, who joined Berkshire in 1986.

Overall, the insurance fleet operates with *far* more capital than is deployed by any of its competitors worldwide. That financial strength, coupled with the huge flow of *cash* Berkshire annually receives from its *non-insurance* businesses, allows our insurance companies to safely follow an equity-heavy investment strategy not feasible for the overwhelming majority of insurers. Those competitors, for both regulatory and credit-rating reasons, *must* focus on bonds.

And bonds are *not* the place to be these days. Can you believe that the income recently available from a 10-year U.S. Treasury bond – the yield was 0.93% at yearend – had fallen 94% from the 15.8% yield available in September 1981? In certain large and important countries, such as Germany and Japan, investors earn a *negative* return on trillions of dollars of sovereign debt. Fixed-income investors worldwide – whether pension funds, insurance companies or retirees – face a bleak future.

Some insurers, as well as other bond investors, may try to juice the pathetic returns now available by shifting their purchases to obligations backed by shaky borrowers. Risky loans, however, are *not* the answer to inadequate interest rates. Three decades ago, the once-mighty savings and loan industry destroyed itself, partly by ignoring that maxim.

Berkshire now enjoys \$138 billion of insurance “float” – funds that do not belong to us, but are nevertheless ours to deploy, whether in bonds, stocks or cash equivalents such as U.S. Treasury bills. Float has some similarities to bank deposits: cash flows in and out daily to insurers, with the total they hold changing very little. The massive sum held by Berkshire is likely to remain near its present level for many years and, on a cumulative basis, has been *costless* to us. That happy result, of course, could change – but, over time, I like our odds.

I have repetitiously – some might say endlessly – explained our insurance operation in my annual letters to you. Therefore, I will this year ask new shareholders who wish to learn more about our insurance business and “float” to read the pertinent section of the 2019 report, reprinted on page A-2. It’s important that you understand the risks, as well as the opportunities, existing in our insurance activities.

Our second and third most valuable assets – it’s pretty much a toss-up at this point – are Berkshire’s 100% ownership of BNSF, America’s largest railroad measured by freight volume, and our 5.4% ownership of Apple. And in the fourth spot is our 91% ownership of Berkshire Hathaway Energy (“BHE”). What we have here is a very unusual utility business, whose annual earnings have grown from \$122 million to *\$3.4 billion* during our 21 years of ownership.

I’ll have more to say about BNSF and BHE later in this letter. For now, however, I would like to focus on a practice Berkshire will periodically use to enhance *your* interest in both its “Big Four” as well as the many other assets Berkshire owns.

* * * * *

Last year we demonstrated our enthusiasm for Berkshire’s spread of properties by repurchasing the equivalent of 80,998 “A” shares, spending \$24.7 billion in the process. That action increased *your* ownership in *all* of Berkshire’s businesses by 5.2% *without* requiring you to so much as touch your wallet.

Following criteria Charlie and I have long recommended, we made those purchases because we believed they would both enhance the intrinsic value per share for continuing shareholders *and* would leave Berkshire with more than ample funds for any opportunities or problems it might encounter.

In no way do we think that Berkshire shares should be repurchased at simply any price. I emphasize that point because American CEOs have an embarrassing record of devoting more company funds to repurchases when prices have risen than when they have tanked. Our approach is exactly the reverse.

Berkshire’s investment in Apple vividly illustrates the power of repurchases. We began buying Apple stock late in 2016 and by early July 2018, owned slightly more than one billion Apple shares (split-adjusted). Saying that, I’m referencing the investment held in Berkshire’s general account and am excluding a very small and separately-managed holding of Apple shares that was subsequently sold. When we finished our purchases in mid-2018, Berkshire’s general account owned 5.2% of Apple.

Our cost for that stake was \$36 billion. Since then, we have both enjoyed regular dividends, averaging about \$775 million annually, and have also – in 2020 – pocketed an additional \$11 billion by selling a small portion of our position.

Despite that sale – voila! – Berkshire now owns 5.4% of Apple. That increase was *costless* to us, coming about because Apple has continuously repurchased its shares, thereby substantially shrinking the number it now has outstanding.

But that's far from all of the good news. Because we also repurchased *Berkshire* shares during the 2½ years, you now indirectly own a full 10% more of Apple's assets and future earnings than you did in July 2018.

This agreeable dynamic continues. Berkshire has repurchased more shares since yearend and is likely to further reduce its share count in the future. Apple has publicly stated an intention to repurchase its shares as well. As these reductions occur, Berkshire shareholders will not only own a greater interest in our insurance group and in BNSF and BHE, but will also find their indirect ownership of Apple increasing as well.

The math of repurchases grinds away slowly, but can be powerful over time. The process offers a simple way for investors to own an ever-expanding portion of exceptional businesses.

And as a sultry Mae West assured us: "Too much of a good thing can be . . . wonderful."

Investments

Below we list our fifteen common stock investments that at yearend were our largest in market value. We exclude our Kraft Heinz holding — 325,442,152 shares — because Berkshire is part of a control group and therefore must account for that investment using the "equity" method. On its balance sheet, Berkshire carries the Kraft Heinz holding at a GAAP figure of \$13.3 billion, an amount that represents Berkshire's share of the audited net worth of Kraft Heinz on December 31, 2020. Please note, though, that the market value of our shares on that date was only \$11.3 billion.

<u>Shares*</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<u>Cost**</u> (in millions)	<u>Market</u>
25,533,082	AbbVie Inc.	1.4	\$ 2,333	\$ 2,736
151,610,700	American Express Company	18.8	1,287	18,331
907,559,761	Apple Inc.	5.4	31,089	120,424
1,032,852,006	Bank of America Corp.	11.9	14,631	31,306
66,835,615	The Bank of New York Mellon Corp.	7.5	2,918	2,837
225,000,000	BYD Co. Ltd.	8.2	232	5,897
5,213,461	Charter Communications, Inc.	2.7	904	3,449
48,498,965	Chevron Corporation	2.5	4,024	4,096
400,000,000	The Coca-Cola Company	9.3	1,299	21,936
52,975,000	General Motors Company	3.7	1,616	2,206
81,304,200	Itochu Corporation	5.1	1,862	2,336
28,697,435	Merck & Co., Inc.	1.1	2,390	2,347
24,669,778	Moody's Corporation	13.2	248	7,160
148,176,166	U.S. Bancorp	9.8	5,638	6,904
146,716,496	Verizon Communications Inc.	3.5	8,691	8,620
Others***			29,458	40,585
Total Equity Investments Carried at Market			<u>\$ 108,620</u>	<u>\$ 281,170</u>

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis.

*** Includes a \$10 billion investment in Occidental Petroleum, consisting of preferred stock and warrants to buy common stock, a combination now being valued at \$9 billion.

A Tale of Two Cities

Success stories abound throughout America. Since our country's birth, individuals with an idea, ambition and often just a pittance of capital have succeeded beyond their dreams by creating something new or by improving the customer's experience with something old.

Charlie and I journeyed throughout the nation to join with many of these individuals or their families. On the West Coast, we began the routine in 1972 with our purchase of See's Candy. A full century ago, Mary See set out to deliver an age-old product that she had reinvented with special recipes. Added to her business plan were quaint stores staffed by friendly salespeople. Her first small outlet in Los Angeles eventually led to several hundred shops, spread throughout the West.

Today, Mrs. See's creations continue to delight customers while providing life-long employment for thousands of women and men. Berkshire's job is simply not to meddle with the company's success. When a business manufactures and distributes a non-essential consumer product, the *customer* is the boss. And, after 100 years, the customer's message to Berkshire remains clear: "Don't mess with *my candy*." (The website is <https://www.sees.com/>; try the peanut brittle.)

Let's move across the continent to Washington, D.C. In 1936, Leo Goodwin, along with his wife, Lillian, became convinced that auto insurance – a standardized product customarily purchased from agents – could be sold directly at a much lower price. Armed with \$100,000, the pair took on giant insurers possessing 1,000 times or more their capital. Government Employees Insurance Company (later shortened to GEICO) was on its way.

By luck, I was exposed to the company's potential a full 70 years ago. It instantly became my first love (of an investment sort). You know the rest of the story: Berkshire eventually became the 100% owner of GEICO, which at 84 years of age is constantly fine-tuning – but not changing – the vision of Leo and Lillian.

There has been, however, a change in the company's size. In 1937, its first full year of operation, GEICO did \$238,288 of business. Last year the figure was \$35 billion.

* * * * *

Today, with much of finance, media, government and tech located in coastal areas, it's easy to overlook the many miracles occurring in middle America. Let's focus on two communities that provide stunning illustrations of the talent and ambition existing *throughout* our country.

You will not be surprised that I begin with Omaha.

In 1940, Jack Ringwalt, a graduate of Omaha's Central High School (the alma mater as well of Charlie, my dad, my first wife, our three children and two grandchildren), decided to start a property/casualty insurance company funded by \$125,000 in capital.

Jack's dream was preposterous, requiring his pipsqueak operation – somewhat pompously christened as National Indemnity – to compete with giant insurers, all of which operated with abundant capital. Additionally, those competitors were solidly entrenched with nationwide networks of well-funded and long-established local agents. Under Jack's plan, National Indemnity, unlike GEICO, would itself use whatever agencies deigned to accept it and consequently enjoy *no* cost advantage in its acquisition of business. To overcome those formidable handicaps, National Indemnity focused on "odd-ball" risks, which were deemed unimportant by the "big boys." And, improbably, the strategy succeeded.

Jack was honest, shrewd, likeable and a bit quirky. In particular, he disliked regulators. When he periodically became annoyed with their supervision, he would feel an urge to sell his company.

Fortunately, I was nearby on one of those occasions. Jack liked the idea of joining Berkshire, and we made a deal in 1967, taking all of 15 minutes to reach a handshake. I never asked for an audit.

Today National Indemnity is the *only* company in the world prepared to insure certain giant risks. And, yes, it remains based in Omaha, a few miles from Berkshire's home office.

Over the years, we have purchased four additional businesses from Omaha families, the best known among them being Nebraska Furniture Mart ("NFM"). The company's founder, Rose Blumkin ("Mrs. B"), arrived in Seattle in 1915 as a Russian emigrant, unable to read or speak English. She settled in Omaha several years later and by 1936 had saved \$2,500 with which to start a furniture store.

Competitors and suppliers ignored her, and for a time their judgment seemed correct: World War II stalled her business, and at yearend 1946, the company's net worth had grown to only \$72,264. Cash, both in the till and on deposit, totaled \$50 (that's not a typo).

One invaluable asset, however, went unrecorded in the 1946 figures: Louie Blumkin, Mrs. B's only son, had rejoined the store after four years in the U.S. Army. Louie fought at Normandy's Omaha Beach following the D-Day invasion, earned a Purple Heart for injuries sustained in the Battle of the Bulge, and finally sailed home in November 1945.

Once Mrs. B and Louie were reunited, there was no stopping NFM. Driven by their dream, mother and son worked days, nights and weekends. The result was a retailing miracle.

By 1983, the pair had created a business worth \$60 million. That year, on my birthday, Berkshire purchased 80% of NFM, again without an audit. I counted on Blumkin family members to run the business; the third and fourth generation do so today. Mrs. B, it should be noted, worked daily until she was 103 – a ridiculously premature retirement age as judged by Charlie and me.

NFM now owns the three largest home-furnishings stores in the U.S. Each set a sales record in 2020, a feat achieved despite the closing of NFM's stores for more than six weeks because of COVID-19.

A post-script to this story says it all: When Mrs. B's large family gathered for holiday meals, she always asked that they sing a song before eating. Her selection never varied: Irving Berlin's "God Bless America."

* * * * *

Let's move somewhat east to Knoxville, the third largest city in Tennessee. There, Berkshire has ownership in two remarkable companies – Clayton Homes (100% owned) and Pilot Travel Centers (38% owned now, but headed for 80% in 2023).

Each company was started by a young man who had graduated from the University of Tennessee and stayed put in Knoxville. Neither had a meaningful amount of capital nor wealthy parents.

But, so what? Today, Clayton and Pilot each have *annual* pre-tax earnings of more than \$1 billion. Together they employ about 47,000 men and women.

Jim Clayton, after several other business ventures, founded Clayton Homes on a shoestring in 1956, and "Big Jim" Haslam started what became Pilot Travel Centers in 1958 by purchasing a service station for \$6,000. Each of the men later brought into the business a son with the same passion, values and brains as his father. Sometimes there is a magic to genes.

“Big Jim” Haslam, now 90, has recently authored an inspirational book in which he relates how Jim *Clayton*’s son, Kevin, encouraged the Haslams to sell a large portion of Pilot to Berkshire. Every retailer knows that satisfied customers are a store’s best salespeople. That’s true when businesses are changing hands as well.

* * * * *

When you next fly over Knoxville or Omaha, tip your hat to the Claytons, Haslams and Blumkins as well as to the army of successful entrepreneurs who populate every part of our country. These builders needed America’s framework for prosperity – a unique experiment when it was crafted in 1789 – to achieve their potential. In turn, America needed citizens like Jim C., Jim H., Mrs. B and Louie to accomplish the miracles our founding fathers sought.

Today, many people forge similar miracles *throughout* the world, creating a spread of prosperity that benefits *all* of humanity. In its brief 232 years of existence, however, there has been *no* incubator for unleashing human potential like America. Despite some severe interruptions, our country’s economic progress has been breathtaking.

Beyond that, we retain our constitutional aspiration of becoming “a more perfect union.” Progress on that front has been slow, uneven and often discouraging. We have, however, moved forward and will continue to do so.

Our unwavering conclusion: *Never* bet against America.

The Berkshire Partnership

Berkshire is a Delaware corporation, and our directors must follow the state’s laws. Among them is a requirement that board members *must* act in the best interest of the corporation and its stockholders. Our directors embrace that doctrine.

In addition, of course, Berkshire directors want the company to delight its customers, to develop and reward the talents of its 360,000 associates, to behave honorably with lenders and to be regarded as a good citizen of the many cities and states in which we operate. We value these four important constituencies.

None of these groups, however, have a *vote* in determining such matters as dividends, strategic direction, CEO selection, or acquisitions and divestitures. Responsibilities like those fall *solely* on Berkshire’s directors, who must faithfully represent the long-term interests of the corporation and its *owners*.

Beyond legal requirements, Charlie and I feel a special obligation to the many *individual* shareholders of Berkshire. A bit of personal history may help you to understand our unusual attachment and how it shapes our behavior.

* * * * *

Before my Berkshire years, I managed money for many individuals through a series of partnerships, the first three of those formed in 1956. As time passed, the use of multiple entities became unwieldy and, in 1962, we amalgamated 12 partnerships into a single unit, Buffett Partnership Ltd. (“BPL”).

By that year, virtually all of my own money, and that of my wife as well, had become invested alongside the funds of my many limited partners. I received no salary or fees. Instead, as the general partner, I was compensated by my limited partners only after they secured returns above an annual threshold of 6%. If returns failed to meet that level, the shortfall was to be carried forward against my share of future profits. (Fortunately, that never happened: Partnership returns always exceeded the 6% “bogey.”) As the years went by, a large part of the resources of my parents, siblings, aunts, uncles, cousins and in-laws became invested in the partnership.

Charlie formed his partnership in 1962 and operated much as I did. Neither of us had *any* institutional investors, and very few of our partners were financially sophisticated. The people who joined our ventures simply trusted us to treat their money as we treated our own. These individuals – either intuitively or by relying on the advice of friends – correctly concluded that Charlie and I had an extreme aversion to permanent loss of capital and that we would not have accepted their money unless we expected to do reasonably well with it.

I stumbled into *business* management after BPL acquired control of Berkshire in 1965. Later still, in 1969, we decided to dissolve BPL. After yearend, the partnership distributed, pro-rata, all of its cash along with three stocks, the largest by value being BPL’s 70.5% interest in Berkshire.

Charlie, meanwhile, wound up his operation in 1977. Among the assets he distributed to partners was a major interest in Blue Chip Stamps, a company his partnership, Berkshire and I jointly controlled. Blue Chip was also among the three stocks my partnership had distributed upon its dissolution.

In 1983, Berkshire and Blue Chip merged, thereby expanding Berkshire’s base of registered shareholders from 1,900 to 2,900. Charlie and I wanted everyone – old, new and *prospective* shareholders – to be on the same page.

Therefore, the 1983 annual report – up front – laid out Berkshire’s “major business principles.” The *first* principle began: “Although our form is corporate, our attitude is partnership.” That defined our relationship in 1983; it defines it today. Charlie and I – and our directors as well – believe this dictum will serve Berkshire well for many decades to come.

* * * * *

Ownership of Berkshire now resides in five large “buckets,” one occupied by me as a “founder” of sorts. That bucket is certain to empty as the shares I own are annually distributed to various philanthropies.

Two of the remaining four buckets are filled by institutional investors, each handling *other people’s money*. That, however, is where the similarity between those buckets ends: Their investing procedures could not be more different.

In one institutional bucket are index funds, a large and mushrooming segment of the investment world. These funds simply mimic the index that they track. The favorite of index investors is the S&P 500, of which Berkshire is a component. Index funds, it should be emphasized, own Berkshire shares simply because they are *required* to do so. They are on automatic pilot, buying and selling *only* for “weighting” purposes.

In the other institutional bucket are professionals who *manage* their clients’ money, whether those funds belong to wealthy individuals, universities, pensioners or whomever. These professional managers have a mandate to move funds from one investment to another based on their judgment as to valuation and prospects. That is an honorable, though difficult, occupation.

We are happy to work for this “active” group, while they meanwhile search for a better place to deploy the funds of their clientele. Some managers, to be sure, have a long-term focus and trade very infrequently. Others use computers employing algorithms that may direct the purchase or sale of shares in a nano-second. Some professional investors will come and go based upon their macro-economic judgments.

Our fourth bucket consists of individual shareholders who operate in a manner similar to the active institutional managers I’ve just described. These owners, understandably, think of their Berkshire shares as a possible source of funds when they see another investment that excites them. We have no quarrel with that attitude, which is similar to the way we look at *some* of the equities we own at Berkshire.

All of that said, Charlie and I would be less than human if we did not feel a special kinship with our fifth bucket: the million-plus *individual* investors who simply trust us to represent their interests, whatever the future may bring. They have joined us with no intent to leave, adopting a mindset similar to that held by our original partners. Indeed, many investors from our partnership years, and/or their descendants, remain substantial owners of Berkshire.

A prototype of those veterans is Stan Truhlsen, a cheerful and generous Omaha ophthalmologist as well as personal friend, who turned 100 on November 13, 2020. In 1959, Stan, along with 10 other young Omaha doctors, formed a partnership with me. The docs creatively labeled their venture Emdee, Ltd. Annually, they joined my wife and me for a celebratory dinner at our home.

When our partnership distributed its Berkshire shares in 1969, *all* of the doctors kept the stock they received. They may not have known the ins and outs of investing or accounting, but they *did* know that at Berkshire they would be treated as partners.

Two of Stan's comrades from Emdee are now in their high-90s and continue to hold Berkshire shares. This group's startling durability – along with the fact that Charlie and I are 97 and 90, respectively – serves up an interesting question: Could it be that Berkshire ownership fosters longevity?

* * * * *

Berkshire's unusual and valued family of individual shareholders may add to your understanding of our reluctance to court Wall Street analysts and institutional investors. We *already have* the investors we want and don't think that they, on balance, would be upgraded by replacements.

There are only so many seats – that is, shares outstanding – available for Berkshire ownership. And we very much like the people already occupying them.

Of course, some turnover in “partners” will occur. Charlie and I hope, however, that it will be minimal. Who, after all, seeks rapid turnover in friends, neighbors or marriage?

In 1958, Phil Fisher wrote a superb book on investing. In it, he analogized running a public company to managing a restaurant. If you are seeking diners, he said, you can attract a clientele and prosper featuring *either* hamburgers served with a Coke *or* a French cuisine accompanied by exotic wines. But you must not, Fisher warned, capriciously switch from one to the other: Your message to potential customers must be consistent with what they will find upon entering your premises.

At Berkshire, we have been serving hamburgers and Coke for 56 years. We cherish the clientele this fare has attracted.

The tens of millions of other investors and speculators in the United States and elsewhere have a wide variety of equity choices to fit *their* tastes. They will find CEOs and market gurus with enticing ideas. If they want price targets, managed earnings and “stories,” they will not lack suitors. “Technicians” will confidently instruct them as to what some wiggles on a chart portend for a stock’s next move. The calls for action will never stop.

Many of those investors, I should add, will do quite well. After all, ownership of stocks is very much a “positive-sum” game. Indeed, a patient and level-headed monkey, who constructs a portfolio by throwing 50 darts at a board listing all of the S&P 500, will – *over time* – enjoy dividends and capital gains, just as long as it *never* gets tempted to make changes in its original “selections.”

Productive assets such as farms, real estate and, yes, business ownership *produce* wealth – lots of it. Most owners of such properties will be rewarded. All that's required is the passage of time, an inner calm, ample diversification and a minimization of transactions and fees. Still, investors must never forget that their *expenses* are Wall Street's *income*. And, unlike my monkey, Wall Streeters do not work for peanuts.

When seats open up at Berkshire – and we hope they are few – we want them to be occupied by newcomers who understand and desire what we offer. After decades of management, Charlie and I remain unable to promise results. We *can* and *do*, however, pledge to treat you as partners.

And so, too, will our successors.

A Berkshire Number that May Surprise You

Recently, I learned a fact about our company that I had never suspected: Berkshire owns *American-based* property, plant and equipment – the sort of assets that make up the “business infrastructure” of our country – with a GAAP valuation exceeding the amount owned by *any* other U.S. company. Berkshire’s depreciated cost of these *domestic* “fixed assets” is \$154 billion. Next in line on this list is AT&T, with property, plant and equipment of \$127 billion.

Our leadership in fixed-asset ownership, I should add, does *not*, in itself, signal an investment triumph. The *best* results occur at companies that require *minimal* assets to conduct high-margin businesses – *and* offer goods or services that will expand their sales volume with only minor needs for additional capital. We, in fact, own a few of these exceptional businesses, but they are relatively small and, at best, grow slowly.

Asset-heavy companies, however, can be *good* investments. Indeed, we are delighted with our two giants – BNSF and BHE: In 2011, Berkshire’s first full year of BNSF ownership, the two companies had combined earnings of \$4.2 billion. In 2020, a tough year for many businesses, the pair earned \$8.3 billion.

BNSF and BHE will require major capital expenditures for decades to come. The good news is that both are likely to deliver appropriate returns on the incremental investment.

Let’s look first at BNSF. Your railroad carries about 15% of all non-local ton-miles (a ton of freight moved one mile) of goods that move in the United States, whether by rail, truck, pipeline, barge or aircraft. By a significant margin, BNSF’s loads top those of any other carrier.

The history of American railroads is fascinating. After 150 years or so of frenzied construction, skullduggery, overbuilding, bankruptcies, reorganizations and mergers, the railroad industry finally emerged a few decades ago as mature and rationalized.

BNSF began operations in 1850 with a 12-mile line in northeastern Illinois. Today, it has 390 antecedents whose railroads have been purchased or merged. The company’s extensive lineage is laid out at http://www.bnsf.com/bnsf-resources/pdf/about-bnsf/History_and_Legacy.pdf.

Berkshire acquired BNSF early in 2010. Since our purchase, the railroad has invested \$41 billion in fixed assets, an outlay \$20 billion in excess of its depreciation charges. Railroading is an outdoor sport, featuring mile-long trains obliged to reliably operate in both extreme cold and heat, as they all the while encounter every form of terrain from deserts to mountains. Massive flooding periodically occurs. BNSF owns 23,000 miles of track, spread throughout 28 states, and must spend whatever it takes to maximize safety and service throughout its vast system.

Nevertheless, BNSF has paid substantial dividends to Berkshire – \$41.8 billion in total. The railroad pays us, however, only what remains after it both fulfills the needs of its business and maintains a cash balance of about \$2 billion. This conservative policy allows BNSF to borrow at low rates, independent of any guarantee of its debt by Berkshire.

One further word about BNSF: Last year, Carl Ice, its CEO, and his number two, Katie Farmer, did an extraordinary job in controlling expenses while navigating a significant downturn in business. Despite a 7% decline in the volume of goods carried, the two actually increased BNSF's profit margin by 2.9 percentage points. Carl, as long planned, retired at yearend and Katie took over as CEO. Your railroad is in good hands.

BHE, unlike BNSF, pays *no* dividends on its common stock, a highly-unusual practice in the electric-utility industry. That Spartan policy has been the case throughout our 21 years of ownership. Unlike railroads, our country's electric utilities need a massive makeover in which the ultimate costs will be staggering. The effort will absorb all of BHE's earnings for decades to come. We welcome the challenge and believe the added investment will be appropriately rewarded.

Let me tell you about one of BHE's endeavors – its \$18 billion commitment to rework and expand a substantial portion of the outdated grid that now transmits electricity throughout the West. BHE began this project in 2006 and expects it to be completed by 2030 – yes, 2030.

The advent of renewable energy made our project a societal necessity. Historically, the coal-based generation of electricity that long prevailed was located close to huge centers of population. The best sites for the new world of wind and solar generation, however, are often in remote areas. When BHE assessed the situation in 2006, it was no secret that a huge investment in western transmission lines had to be made. Very few companies or governmental entities, however, were in a financial position to raise their hand after they tallied the project's cost.

BHE's decision to proceed, it should be noted, was based upon its trust in America's political, economic and judicial systems. Billions of dollars needed to be invested before meaningful revenue would flow. Transmission lines had to cross the borders of states and other jurisdictions, each with its own rules and constituencies. BHE would also need to deal with hundreds of landowners and execute complicated contracts with both the suppliers that generated renewable power and the far-away utilities that would distribute the electricity to their customers. Competing interests and defenders of the old order, along with unrealistic visionaries desiring an instantly-new world, had to be brought on board.

Both surprises and delays were certain. Equally certain, however, was the fact that BHE had the managerial talent, the institutional commitment and the financial wherewithal to fulfill its promises. Though it will be many years before our western transmission project is completed, we are today searching for other projects of similar size to take on.

Whatever the obstacles, BHE will be a leader in delivering ever-cleaner energy.

The Annual Meeting

Last year, on February 22nd, I wrote you about our plans for a gala annual meeting. Within a month, the schedule was junked.

Our home office group, led by Melissa Shapiro and Marc Hamburg, Berkshire's CFO, quickly regrouped. Miraculously, their improvisations worked. Greg Abel, one of Berkshire's Vice Chairmen, joined me on stage facing a dark arena, 18,000 empty seats and a camera. There was no rehearsal: Greg and I arrived about 45 minutes before "showtime."

Debbie Bosanek, my incredible assistant who joined Berkshire 47 years ago at age 17, had put together about 25 slides displaying various facts and figures that I had assembled at home. An anonymous but highly-capable team of computer and camera operators projected the slides onto the screen in proper order.

Yahoo streamed the proceedings to a record-sized international audience. Becky Quick of CNBC, operating from her home in New Jersey, selected questions from thousands that shareholders had earlier submitted or that viewers had emailed to her during the four hours Greg and I were on stage. See's peanut brittle and fudge, along with Coca-Cola, provided us with nourishment.

This year, on May 1st, we are planning to go one better. Again, we will rely on Yahoo and CNBC to perform flawlessly. Yahoo will go live at 1 p.m. Eastern Daylight Time ("EDT"). Simply navigate to <https://finance.yahoo.com/brklivestream>.

Our formal meeting will commence at 5:00 p.m. EDT and should finish by 5:30 p.m. Earlier, between 1:30-5:00, we will answer your questions as relayed by Becky. As always, we will have no foreknowledge as to what questions will be asked. Send your zingers to BerkshireQuestions@cnbc.com. Yahoo will wrap things up after 5:30.

And now – drum roll, please – a surprise. This year our meeting will be held in Los Angeles . . . and *Charlie will be on stage with me* offering answers and observations throughout the 3 ½-hour question period. I missed him last year and, more important, *you* clearly missed him. Our other invaluable vice-chairmen, Ajit Jain and Greg Abel, will be with us to answer questions relating to their domains.

Join us via Yahoo. Direct your really tough questions to Charlie! We will have fun, and we hope you will as well.

Better yet, of course, will be the day when we see you face to face. I hope and expect that will be in 2022. The citizens of Omaha, our exhibiting subsidiaries and all of us at the home office can't wait to get you back for an honest-to-God annual meeting, *Berkshire-style*.

February 27, 2021

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
2021	29.6	28.7
Compounded Annual Gain – 1965-2021	20.1%	10.5%
Overall Gain – 1964-2021	3,641,613%	30,209%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Charlie Munger, my long-time partner, and I have the job of managing a portion of your savings. We are honored by your trust.

Our position carries with it the responsibility to report to you what we would like to know if *we* were the absentee owner and *you* were the manager. We enjoy communicating directly with you through this annual letter, and through the annual meeting as well.

Our policy is to treat all shareholders equally. Therefore, we do not hold discussions with analysts nor large institutions. Whenever possible, also, we release important communications on Saturday mornings in order to maximize the time for shareholders and the media to absorb the news before markets open on Monday.

A wealth of Berkshire facts and figures are set forth in the annual 10-K that the company regularly files with the S.E.C. and that we reproduce on pages K-1 – K-119. Some shareholders will find this detail engrossing; others will simply prefer to learn what Charlie and I believe is new or interesting at Berkshire.

Alas, there was little action of that sort in 2021. We did, though, make reasonable progress in increasing the intrinsic value of your shares. That task has been my primary duty for 57 years. And it will continue to be.

What You Own

Berkshire owns a wide variety of businesses, some in their entirety, some only in part. The second group largely consists of marketable common stocks of major American companies. Additionally, we own a few non-U.S. equities and participate in several joint ventures or other collaborative activities.

Whatever our form of ownership, our goal is to have meaningful investments in *businesses* with both durable economic advantages and a first-class CEO. Please note particularly that we own stocks based upon our expectations about their long-term *business* performance and *not* because we view them as vehicles for timely market moves. That point is crucial: Charlie and I are *not* stock-pickers; we are business-pickers.

I make many mistakes. Consequently, our extensive collection of businesses includes some enterprises that have truly extraordinary economics, many others that enjoy good economic characteristics, and a few that are marginal. One advantage of our common-stock segment is that – on occasion – it becomes easy to buy *pieces* of wonderful businesses at wonderful prices. That shooting-fish-in-a-barrel experience is *very* rare in negotiated transactions and never occurs *en masse*. It is also far easier to exit from a mistake when it has been made in the marketable arena.

Surprise, Surprise

Here are a few items about your company that often surprise even seasoned investors:

- Many people perceive Berkshire as a large and somewhat strange collection of *financial* assets. In truth, Berkshire owns and *operates* more U.S.-based “infrastructure” assets – classified on our balance sheet as property, plant and equipment – than are owned and operated by *any* other American corporation. That supremacy has never been our goal. It has, however, become a fact.

At yearend, those domestic infrastructure assets were carried on Berkshire’s balance sheet at \$158 billion. That number increased last year and will continue to increase. Berkshire *always* will be building.

- Every year, your company makes substantial federal income tax payments. In 2021, for example, we paid \$3.3 billion while the U.S. Treasury reported *total* corporate income-tax receipts of \$402 billion. Additionally, Berkshire pays substantial state and foreign taxes. “I gave at the office” is an unassailable assertion when made by Berkshire shareholders.

Berkshire’s history vividly illustrates the invisible and often unrecognized financial partnership between government and American businesses. Our tale begins early in 1955, when Berkshire Fine Spinning and Hathaway Manufacturing agreed to merge their businesses. In their requests for shareholder approval, these venerable New England textile companies expressed high hopes for the combination.

The Hathaway solicitation, for example, assured its shareholders that “The combination of the resources and managements will result in one of the strongest and most efficient organizations in the textile industry.” That upbeat view was endorsed by the company’s advisor, Lehman Brothers (yes, *that* Lehman Brothers).

I’m sure it was a joyous day in both Fall River (Berkshire) and New Bedford (Hathaway) when the union was consummated. After the bands stopped playing and the bankers went home, however, the shareholders reaped a disaster.

In the nine years following the merger, Berkshire’s owners watched the company’s net worth crater from \$51.4 million to \$22.1 million. In part, this decline was caused by stock repurchases, ill-advised dividends and plant shutdowns. But nine years of effort by many thousands of employees delivered an operating loss as well. Berkshire’s struggles were not unusual: The New England textile industry had silently entered an extended and non-reversible death march.

During the nine post-merger years, the U.S. Treasury suffered as well from Berkshire’s troubles. All told, the company paid the government only \$337,359 in income tax during that period – a pathetic *\$100 per day*.

Early in 1965, things changed. Berkshire installed new management that redeployed available cash and steered essentially *all* earnings into a variety of good businesses, most of which remained good through the years. Coupling reinvestment of earnings with the power of compounding worked its magic, and shareholders prospered.

Berkshire’s owners, it should be noted, were not the only beneficiary of that course correction. Their “silent partner,” the U.S. Treasury, proceeded to collect many *tens of billions* of dollars from the company in income tax payments. Remember the \$100 daily? Now, Berkshire pays roughly \$9 *million* daily to the Treasury.

In fairness to our governmental partner, our shareholders should acknowledge – indeed trumpet – the fact that Berkshire’s prosperity has been fostered *mightily* because the company has operated in America. Our country would have done splendidly in the years since 1965 *without* Berkshire. Absent our American home, however, Berkshire would never have come close to becoming what it is today. When you see the flag, say thanks.

- From an \$8.6 million purchase of National Indemnity in 1967, Berkshire has become the world leader in insurance “float” – money we hold and can invest but that does *not* belong to us. Including a relatively small sum derived from life insurance, Berkshire’s total float has grown from \$19 *million* when we entered the insurance business to \$147 *billion*.

So far, this float has cost us less than nothing. Though we have experienced a number of years when insurance losses combined with operating expenses exceeded premiums, *overall* we have earned a modest 55-year profit from the underwriting activities that generated our float.

Of equal importance, float is very sticky. Funds attributable to our insurance operations come and go daily, but their aggregate total is immune from precipitous decline. When it comes to investing float, we can therefore think long-term.

If you are not already familiar with the concept of float, I refer you to a long explanation on page A-5. To my surprise, our float increased \$9 billion last year, a buildup of value that is important to Berkshire owners though is *not* reflected in our GAAP (“generally-accepted accounting principles”) presentation of earnings and net worth.

Much of our huge value creation in insurance is attributable to Berkshire’s good luck in my 1986 hiring of Ajit Jain. We first met on a Saturday morning, and I quickly asked Ajit what his insurance experience had been. He replied, “None.”

I said, “Nobody’s perfect,” and hired him. That was my lucky day: Ajit actually *was* as perfect a choice as could have been made. Better yet, he continues to be – 35 years later.

One final thought about insurance: I believe that it is likely – but *far* from assured – that Berkshire’s float can be maintained without our incurring a long-term underwriting loss. I am *certain*, however, that there will be some years when we experience such losses, perhaps involving very large sums.

Berkshire is constructed to handle catastrophic events as no other insurer – and that priority will remain long after Charlie and I are gone.

Our Four Giants

Through Berkshire, our shareholders own many dozens of businesses. Some of these, in turn, have a collection of subsidiaries of their own. For example, Marmon has more than 100 individual business operations, ranging from the leasing of railroad cars to the manufacture of medical devices.

- Nevertheless, operations of our “Big Four” companies account for a very large chunk of Berkshire’s value. Leading this list is our cluster of insurers. Berkshire effectively owns 100% of this group, whose massive float value we earlier described. The invested assets of these insurers are further enlarged by the extraordinary amount of capital we invest to back up their promises.

The insurance business is made to order for Berkshire. The product will never be obsolete, and sales volume will generally increase along with both economic growth and inflation. Also, integrity and capital will forever be important. Our company can and *will* behave well.

There are, of course, other insurers with excellent business models and prospects. Replication of Berkshire's operation, however, would be almost impossible.

- Apple – our runner-up Giant as measured by its yearend market value – is a different sort of holding. Here, our ownership is a mere 5.55%, up from 5.39% a year earlier. That increase sounds like small potatoes. But consider that each *0.1%* of Apple's 2021 earnings amounted to *\$100 million*. We spent *no* Berkshire funds to gain our accretion. Apple's repurchases did the job.

It's important to understand that only *dividends* from Apple are counted in the GAAP earnings Berkshire reports – and last year, Apple paid us \$785 million of those. Yet our "share" of Apple's earnings amounted to a staggering *\$5.6 billion*. Much of what the company retained was used to repurchase Apple shares, an act we applaud. Tim Cook, Apple's brilliant CEO, quite properly regards users of Apple products as his first love, but all of his other constituencies benefit from Tim's managerial touch as well.

- BNSF, our third Giant, continues to be the number one artery of American commerce, which makes it an indispensable asset for America as well as for Berkshire. If the many essential products BNSF carries were instead hauled by truck, America's carbon emissions would soar.

Your railroad had record earnings of \$6 billion in 2021. Here, it should be noted, we are talking about the old-fashioned sort of earnings that we favor: a figure calculated *after* interest, taxes, depreciation, amortization and all forms of compensation. (Our definition suggests a warning: Deceptive "adjustments" to earnings – to use a polite description – have become both more frequent and more fanciful as stocks have risen. Speaking less politely, I would say that bull markets breed bloviated bull . . .)

BNSF trains traveled 143 million miles last year and carried 535 million tons of cargo. Both accomplishments far exceed those of any other American carrier. You can be proud of your railroad.

- BHE, our final Giant, earned a record \$4 billion in 2021. That's up more than 30-fold from the *\$122 million* earned in 2000, the year that Berkshire first purchased a BHE stake. Now, Berkshire owns 91.1% of the company.

BHE's record of societal accomplishment is as remarkable as its financial performance. The company had *no* wind or solar generation in 2000. It was then regarded simply as a relatively new and minor participant in the huge electric utility industry. Subsequently, under David Sokol's and Greg Abel's leadership, BHE has become a utility powerhouse (no groaning, please) and a leading force in wind, solar and transmission throughout much of the United States.

Greg's report on these accomplishments appears on pages A-3 and A-4. The profile you will find there is not in any way one of those currently-fashionable "green-washing" stories. BHE has been faithfully detailing its plans and performance in renewables and transmissions every year since 2007.

To further review this information, visit BHE's website at brkenergy.com. There, you will see that the company has *long* been making climate-conscious moves that soak up *all* of its earnings. More opportunities lie ahead. BHE has the management, the experience, the capital and the appetite for the huge power projects that our country needs.

Investments

Now let's talk about companies we *don't* control, a list that again references Apple. Below we list our fifteen largest equity holdings, several of which are selections of Berkshire's two long-time investment managers, Todd Combs and Ted Weschler. At yearend, this valued pair had *total* authority in respect to \$34 billion of investments, many of which do not meet the threshold value we use in the table. Also, a significant portion of the dollars that Todd and Ted manage are lodged in various pension plans of Berkshire-owned businesses, with the assets of these plans *not* included in this table.

<u>Shares</u>	<u>Company</u>	<u>Percentage of Company Owned</u>	<i>12/31/21</i>	
			<u>Cost*</u>	<u>Market</u> <i>(in millions)</i>
151,610,700	American Express Company	19.9	1,287	24,804
907,559,761	Apple Inc.	5.6	31,089	161,155
1,032,852,006	Bank of America Corp.	12.8	14,631	45,952
66,835,615	The Bank of New York Mellon Corp.	8.3	2,918	3,882
225,000,000	BYD Co. Ltd.**	7.7	232	7,693
3,828,941	Charter Communications, Inc.	2.2	643	2,496
38,245,036	Chevron Corporation	2.0	3,420	4,488
400,000,000	The Coca-Cola Company	9.2	1,299	23,684
52,975,000	General Motors Company	3.6	1,616	3,106
89,241,000	ITOCHU Corporation	5.6	2,099	2,728
81,714,800	Mitsubishi Corporation	5.5	2,102	2,593
93,776,200	Mitsui & Co., Ltd.	5.7	1,621	2,219
24,669,778	Moody's Corporation	13.3	248	9,636
143,456,055	U.S. Bancorp	9.7	5,384	8,058
158,824,575	Verizon Communications Inc.	3.8	9,387	8,253
	Others***		26,629	39,972
	Total Equity Investments Carried at Market		<u>\$ 104,605</u>	<u>\$ 350,719</u>

* This is our actual purchase price and also our tax basis.

** Held by BHE; consequently, Berkshire shareholders have only a 91.1% interest in this position.

*** Includes a \$10 billion investment in Occidental Petroleum, consisting of preferred stock and warrants to buy common stock, a combination now being valued at \$10.7 billion.

In addition to the footnoted Occidental holding and our various common-stock positions, Berkshire also owns a 26.6% interest in Kraft Heinz (accounted for on the "equity" method, *not* market value, and carried at \$13.1 billion) and 38.6% of Pilot Corp., a leader in travel centers that had revenues last year of \$45 billion.

Since we purchased our Pilot stake in 2017, this holding has warranted "equity" accounting treatment. Early in 2023, Berkshire will purchase an additional interest in Pilot that will raise our ownership to 80% and lead to our fully consolidating Pilot's earnings, assets and liabilities in our financial statements.

U.S. Treasury Bills

Berkshire's balance sheet includes \$144 billion of cash and cash equivalents (excluding the holdings of BNSF and BHE). Of this sum, \$120 billion is held in U.S. Treasury bills, all maturing in less than a year. That stake leaves Berkshire financing about $\frac{1}{2}$ of 1% of the publicly-held national debt.

Charlie and I have pledged that Berkshire (along with our subsidiaries other than BNSF and BHE) will always hold more than \$30 billion of cash and equivalents. We want your company to be financially impregnable and *never* dependent on the kindness of strangers (or even that of friends). Both of us like to sleep soundly, and we want our creditors, insurance claimants and *you* to do so as well.

But \$144 billion?

That imposing sum, I assure you, is not some deranged expression of patriotism. Nor have Charlie and I lost our overwhelming preference for *business* ownership. Indeed, I first manifested my enthusiasm for that 80 years ago, on March 11, 1942, when I purchased three shares of Cities Services preferred stock. Their cost was \$114.75 and required *all* of my savings. (The Dow Jones Industrial Average that day closed at 99, a fact that should scream to you: *Never bet against America.*)

After my initial plunge, I always kept at least 80% of my net worth in equities. My *favored* status throughout that period was 100% – and still is. Berkshire's current 80%-or-so position in businesses is a consequence of my failure to find entire companies or small portions thereof (that is, marketable stocks) which meet our criteria for long-term holding.

Charlie and I have endured similar cash-heavy positions from time to time in the past. These periods are never pleasant; they are also never permanent. And, fortunately, we have had a mildly attractive alternative during 2020 and 2021 for deploying capital. Read on.

Share Repurchases

There are three ways that we can increase the value of your investment. The first is *always* front and center in our minds: Increase the long-term earning power of Berkshire's controlled businesses through internal growth or by making acquisitions. Today, internal opportunities deliver far better returns than acquisitions. The size of those opportunities, however, is small compared to Berkshire's resources.

Our second choice is to buy non-controlling part-interests in the many good or great businesses that are publicly traded. From time to time, such possibilities are both numerous and blatantly attractive. Today, though, we find little that excites us.

That's largely because of a truism: Long-term interest rates that are low push the prices of *all* productive investments upward, whether these are stocks, apartments, farms, oil wells, whatever. Other factors influence valuations as well, but interest rates will always be important.

Our final path to value creation is to repurchase Berkshire shares. Through that simple act, we increase *your* share of the many controlled *and* non-controlled businesses Berkshire owns. When the price/value equation is right, this path is the easiest and most certain way for us to increase *your* wealth. (Alongside the accretion of value to continuing shareholders, a couple of other parties gain: Repurchases are modestly beneficial to the seller of the repurchased shares and to society as well.)

Periodically, as alternative paths become unattractive, repurchases make good sense for Berkshire's owners. During the past two years, we therefore repurchased 9% of the shares that were outstanding at yearend 2019 for a total cost of \$51.7 billion. That expenditure left our continuing shareholders owning about 10% more of *all* Berkshire businesses, whether these are wholly-owned (such as BNSF and GEICO) or partly-owned (such as Coca-Cola and Moody's).

I want to underscore that for Berkshire repurchases to make sense, our shares *must* offer appropriate value. We don't want to overpay for the shares of other companies, and it would be *value-destroying* if we were to overpay when we are buying Berkshire. As of February 23, 2022, since yearend we repurchased additional shares at a cost of \$1.2 billion. Our appetite remains large but will always remain price-dependent.

It should be noted that Berkshire's buyback opportunities are limited *because* of its high-class investor base. If our shares were heavily held by short-term speculators, both price volatility and transaction volumes would materially increase. That kind of reshaping would offer us far greater opportunities for creating value by making repurchases. Nevertheless, Charlie and I far prefer the owners we have, even though their admirable buy-and-keep attitudes limit the extent to which long-term shareholders can profit from opportunistic repurchases.

Finally, one easily-overlooked value calculation specific to Berkshire: As we've discussed, insurance "float" of the right sort is of great value to us. As it happens, repurchases automatically increase the amount of "float" *per share*. That figure has increased during the past two years by 25% – going from \$79,387 per "A" share to \$99,497, a meaningful gain that, as noted, owes some thanks to repurchases.

A Wonderful Man and a Wonderful Business

Last year, Paul Andrews died. Paul was the founder and CEO of TTI, a Fort Worth-based subsidiary of Berkshire. Throughout his life – in both his business *and* his personal pursuits – Paul quietly displayed all the qualities that Charlie and I admire. His story should be told.

In 1971, Paul was working as a purchasing agent for General Dynamics when the roof fell in. After losing a huge defense contract, the company fired thousands of employees, including Paul.

With his first child due soon, Paul decided to bet on himself, using \$500 of his savings to found Tex-Tronics (later renamed TTI). The company set itself up to distribute small electronic components, and first-year sales totaled \$112,000. Today, TTI markets more than one million different items with annual volume of \$7.7 billion.

But back to 2006: Paul, at 63, then found himself happy with his family, his job, and his associates. But he had one nagging worry, heightened because he had recently witnessed a friend's early death and the disastrous results that followed for that man's family and business. What, Paul asked himself in 2006, would happen to the many people depending on *him* if he should unexpectedly die?

For a year, Paul wrestled with his options. Sell to a competitor? From a strictly economic viewpoint, that course made the most sense. After all, competitors could envision lucrative "synergies" – savings that would be achieved as the acquirer slashed duplicated functions at TTI.

But . . . Such a purchaser would most certainly also retain *its* CFO, *its* legal counsel, *its* HR unit. Their TTI counterparts would therefore be sent packing. And ugh! If a new distribution center were to be needed, the acquirer's home city would certainly be favored over Fort Worth.

Whatever the financial benefits, Paul quickly concluded that selling to a competitor was not for him. He next considered seeking a financial buyer, a species once labeled – aptly so – a leveraged buyout firm. Paul knew, however, that such a purchaser would be focused on an “exit strategy.” And who could know what that would be? Brooding over it all, Paul found himself having no interest in handing his 35-year-old creation over to a reseller.

When Paul met me, he explained why he had eliminated these two alternatives as buyers. He then summed up his dilemma by saying – in far more tactful phrasing than this – “After a year of pondering the alternatives, I want to sell to Berkshire because you are the only guy left.” So, I made an offer and Paul said “Yes.” One meeting; one lunch; one deal.

To say we both lived happily ever after is an understatement. When Berkshire purchased TTI, the company employed 2,387. Now the number is 8,043. A large percentage of that growth took place in Fort Worth and environs. Earnings have increased 673%.

Annually, I would call Paul and tell him his salary should be substantially increased. Annually, he would tell me, “We can talk about that next year, Warren; I’m too busy now.”

When Greg Abel and I attended Paul’s memorial service, we met children, grandchildren, long-time associates (including TTI’s first employee) and John Roach, the former CEO of a Fort Worth company Berkshire had purchased in 2000. John had steered his friend Paul to Omaha, instinctively knowing we would be a match.

At the service, Greg and I heard about the multitudes of people and organizations that Paul had silently supported. The breadth of his generosity was extraordinary – geared always to improving the lives of others, particularly those in Fort Worth.

In all ways, Paul was a class act.

* * * * *

Good luck – occasionally *extraordinary* luck – has played its part at Berkshire. If Paul and I had not enjoyed a mutual friend – John Roach – TTI would not have found its home with us. But that ample serving of luck was only the beginning. TTI was soon to lead Berkshire to its most important acquisition.

Every fall, Berkshire directors gather for a presentation by a few of our executives. We sometimes choose the site based upon the location of a recent acquisition, by that means allowing directors to meet the new subsidiary’s CEO and learn more about the acquiree’s activities.

In the fall of 2009, we consequently selected Fort Worth so that we could visit TTI. At that time, BNSF, which also had Fort Worth as its hometown, was the third-largest holding among our marketable equities. Despite that large stake, I had never visited the railroad’s headquarters.

Deb Bosanek, my assistant, scheduled our board’s opening dinner for October 22. Meanwhile, I arranged to arrive earlier that day to meet with Matt Rose, CEO of BNSF, whose accomplishments I had long admired. When I made the date, I had no idea that our get-together would coincide with BNSF’s third-quarter earnings report, which was released late on the 22nd.

The market reacted badly to the railroad’s results. The Great Recession was in full force in the third quarter, and BNSF’s earnings reflected that slump. The economic outlook was also bleak, and Wall Street wasn’t feeling friendly to railroads – or much else.

On the following day, I again got together with Matt and suggested that Berkshire would offer the railroad a better long-term home than it could expect as a public company. I also told him the maximum price that Berkshire would pay.

Matt relayed the offer to his directors and advisors. Eleven busy days later, Berkshire and BNSF announced a firm deal. And here I'll venture a rare prediction: BNSF will be a key asset for Berkshire *and* our country a century from now.

The BNSF acquisition would never have happened if Paul Andrews hadn't sized up Berkshire as the right home for TTI.

Thanks

I taught my first investing class 70 years ago. Since then, I have enjoyed working almost every year with students of all ages, finally "retiring" from that pursuit in 2018.

Along the way, my toughest audience was my grandson's fifth-grade class. The 11-year-olds were squirming in their seats and giving me blank stares until I mentioned Coca-Cola and its famous secret formula. Instantly, every hand went up, and I learned that "secrets" are catnip to kids.

Teaching, like writing, has helped me develop and clarify my own thoughts. Charlie calls this phenomenon the orangutan effect: If you sit down with an orangutan and carefully explain to it one of your cherished ideas, you may leave behind a puzzled primate, but will yourself exit thinking more clearly.

Talking to university students is far superior. I have urged that they seek employment in (1) the field and (2) with the kind of people they would select, if they had *no need* for money. Economic realities, I acknowledge, may interfere with that kind of search. Even so, I urge the students never to give up the quest, for when they find that sort of job, they will no longer be "working."

Charlie and I, ourselves, followed that liberating course after a few early stumbles. We both started as part-timers at my grandfather's grocery store, Charlie in 1940 and I in 1942. We were each assigned boring tasks and paid little, definitely not what we had in mind. Charlie later took up law, and I tried selling securities. Job satisfaction continued to elude us.

Finally, at Berkshire, we found what we love to do. With very few exceptions, we have now "worked" for many decades with people whom we like and trust. It's a joy in life to join with managers such as Paul Andrews or the Berkshire families I told you about last year. In our home office, we employ decent and talented people – no jerks. Turnover averages, perhaps, one person per year.

I would like, however, to emphasize a further item that turns our jobs into fun and satisfaction - - - - working for you. There is nothing more rewarding to Charlie and me than enjoying the trust of *individual* long-term shareholders who, for many decades, have joined us with the expectation that we would be a reliable custodian of their funds.

Obviously, we can't select our owners, as we could do if our *form* of operation were a partnership. Anyone can buy shares of Berkshire today with the intention of soon reselling them. For sure, we get a few of that type of shareholder, just as we get index funds that own huge amounts of Berkshire simply because they are required to do so.

To a truly unusual degree, however, Berkshire has as owners a very large corps of individuals and families that have elected to join us with an intent approaching “til death do us part.” Often, they have trusted us with a large – some might say *excessive* – portion of their savings.

Berkshire, these shareholders would sometimes acknowledge, might be far from the *best* selection they could have made. But they would add that Berkshire would rank high among those with which they would be most comfortable. And people who are comfortable with their investments will, on average, achieve better results than those who are motivated by ever-changing headlines, chatter and promises.

Long-term individual owners are both the “partners” Charlie and I have always sought and the ones we constantly have in mind as we make decisions at Berkshire. To them we say, “It feels good to ‘work’ for you, and you have our thanks for your trust.”

The Annual Meeting

Clear your calendar! Berkshire will have its annual gathering of capitalists in Omaha on Friday, April 29th through Sunday, May 1st. The details regarding the weekend are laid out on pages A-1 and A-2. Omaha eagerly awaits you, as do I.

I will end this letter with a sales pitch. “Cousin” Jimmy Buffett has designed a pontoon “party” boat that is now being manufactured by Forest River, a Berkshire subsidiary. The boat will be introduced on April 29 at our Berkshire Bazaar of Bargains. And, for two days only, shareholders will be able to purchase Jimmy’s masterpiece at a 10% discount. Your bargain-hunting chairman will be buying a boat for his family’s use. Join me.

February 26, 2022

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
2021	29.6	28.7
2022	4.0	(18.1)
Compounded Annual Gain – 1965-2022	19.8%	9.9%
Overall Gain – 1964-2022	3,787,464%	24,708%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Charlie Munger, my long-time partner, and I have the job of managing the savings of a great number of *individuals*. We are grateful for their enduring trust, a relationship that often spans much of their adult lifetime. It is those dedicated savers that are forefront in my mind as I write this letter.

A common belief is that people choose to save when young, expecting thereby to maintain their living standards after retirement. Any assets that remain at death, this theory says, will usually be left to their families or, possibly, to friends and philanthropy.

Our experience has differed. We believe Berkshire's individual holders largely to be of the once-a-saver, always-a-saver variety. Though these people live well, they eventually dispense most of their funds to philanthropic organizations. These, in turn, redistribute the funds by expenditures intended to improve the lives of a great many people who are unrelated to the original benefactor. Sometimes, the results have been spectacular.

The disposition of money unmasks humans. Charlie and I watch with pleasure the vast flow of Berkshire-generated funds to public needs and, alongside, the infrequency with which our shareholders opt for look-at-me assets and dynasty-building.

Who *wouldn't* enjoy working for shareholders like ours?

What We Do

Charlie and I allocate your savings at Berkshire between two related forms of ownership. First, we invest in businesses that we control, usually buying 100% of each. Berkshire directs capital allocation at these subsidiaries and selects the CEOs who make day-by-day operating decisions. When large enterprises are being managed, both trust and rules are essential. Berkshire emphasizes the former to an unusual – some would say extreme – degree. Disappointments are inevitable. We are understanding about *business* mistakes; our tolerance for personal misconduct is zero.

In our second category of ownership, we buy publicly-traded stocks through which we passively own *pieces* of businesses. Holding *these* investments, we have no say in management.

Our goal in both forms of ownership is to make meaningful investments in *businesses* with both long-lasting favorable economic characteristics and trustworthy managers. Please note particularly that we own publicly-traded stocks based on our expectations about their long-term *business* performance, not because we view them as vehicles for adroit purchases and sales. That point is crucial: Charlie and I are *not* stock-pickers; we are business-pickers.

Over the years, I have made many mistakes. Consequently, our extensive collection of businesses currently consists of a few enterprises that have truly extraordinary economics, many that enjoy very good economic characteristics, and a large group that are marginal. Along the way, other businesses in which I have invested have died, their products unwanted by the public. Capitalism has two sides: The system creates an ever-growing pile of losers while concurrently delivering a gusher of improved goods and services. Schumpeter called this phenomenon “creative destruction.”

One advantage of our publicly-traded segment is that – episodically – it becomes easy to buy *pieces* of wonderful businesses at wonderful prices. It’s crucial to understand that stocks often trade at truly foolish prices, both high and low. “Efficient” markets exist only in textbooks. In truth, marketable stocks and bonds are baffling, their behavior usually understandable only in retrospect.

Controlled businesses are a different breed. They sometimes command ridiculously *higher* prices than justified but are almost never available at bargain valuations. Unless under duress, the owner of a controlled business gives no thought to selling at a panic-type valuation.

* * * * *

At this point, a report card from me is appropriate: In 58 years of Berkshire management, most of my capital-allocation decisions have been no better than so-so. In some cases, also, bad moves by me have been rescued by very large doses of luck. (Remember our escapes from near-disasters at USAir and Salomon? I certainly do.)

Our satisfactory results have been the product of about a dozen truly good decisions – that would be about one every five years – *and* a sometimes-forgotten advantage that favors long-term investors such as Berkshire. Let’s take a peek behind the curtain.

The Secret Sauce

In August 1994 – yes, 1994 – Berkshire *completed* its seven-year purchase of the 400 million shares of Coca-Cola we now own. The total cost was \$1.3 billion – then a very meaningful sum at Berkshire.

The cash dividend we received from Coke in 1994 was \$75 million. By 2022, the dividend had increased to \$704 million. Growth occurred every year, just as certain as birthdays. All Charlie and I were required to do was cash Coke’s quarterly dividend checks. We expect that those checks are highly likely to grow.

American Express is much the same story. Berkshire's purchases of Amex were essentially completed in 1995 and, coincidentally, also cost \$1.3 billion. Annual dividends received from this investment have grown from \$41 million to \$302 million. Those checks, too, seem highly likely to increase.

These dividend gains, though pleasing, are *far* from spectacular. But they bring with them important gains in stock prices. At yearend, our Coke investment was valued at \$25 billion while Amex was recorded at \$22 billion. Each holding now accounts for roughly 5% of Berkshire's net worth, akin to its weighting long ago.

Assume, for a moment, I had made a similarly-sized investment mistake in the 1990s, one that flat-lined and simply retained its \$1.3 billion value in 2022. (An example would be a high-grade 30-year bond.) That disappointing investment would now represent an insignificant 0.3% of Berkshire's net worth and would be delivering to us an unchanged \$80 million or so of annual income.

The lesson for investors: The weeds wither away in significance as the flowers bloom. Over time, it takes just a few winners to work wonders. And, yes, it helps to start early and live into your 90s as well.

The Past Year in Brief

Berkshire had a good year in 2022. The company's *operating earnings* – our term for income calculated using Generally Accepted Accounting Principles ("GAAP"), *exclusive* of capital gains or losses from equity holdings – set a record at \$30.8 billion. Charlie and I focus on this operational figure and urge you to do so as well. The GAAP figure, *absent our adjustment*, fluctuates wildly and capriciously at every reporting date. Note its acrobatic behavior in 2022, which is in no way unusual:

2022 Quarter	Earnings in \$ billions	
	"Operating Earnings"	GAAP Earnings We are Required to Report
1	7.0	5.5
2	9.3	(43.8)
3	7.8	(2.7)
4	6.7	18.2

The GAAP earnings are 100% misleading when viewed quarterly or even annually. Capital gains, to be sure, have been hugely important to Berkshire over past decades, and we expect them to be meaningfully positive in future decades. But their quarter-by-quarter gyrations, regularly and mindlessly headlined by media, totally misinform investors.

A second positive development for Berkshire last year was our purchase of Alleghany Corporation, a property-casualty insurer captained by Joe Brandon. I've worked with Joe in the past, and he understands both Berkshire and insurance. Alleghany delivers special value to us because Berkshire's unmatched financial strength allows its insurance subsidiaries to follow valuable and enduring investment strategies unavailable to virtually all competitors.

Aided by Alleghany, our insurance float increased during 2022 from \$147 billion to \$164 billion. With disciplined underwriting, these funds have a decent chance of being *cost-free* over time. Since purchasing our first property-casualty insurer in 1967, Berkshire's float has increased 8,000-fold through acquisitions, operations and innovations. Though *not* recognized in our financial statements, this float has been an extraordinary asset for Berkshire. New shareholders can get an understanding of its value by reading our annually updated explanation of float on page A-2.

* * * * *

A *very* minor gain in per-share intrinsic value took place in 2022 through Berkshire share repurchases as well as similar moves at Apple and American Express, both significant investees of ours. At Berkshire, we directly increased your interest in our unique collection of businesses by repurchasing 1.2% of the company's outstanding shares. At Apple and Amex, repurchases increased Berkshire's ownership a bit without any cost to us.

The math isn't complicated: When the share count goes down, *your* interest in our many businesses goes *up*. Every small bit helps *if repurchases are made at value-accretive prices*. Just as surely, when a company overpays for repurchases, the continuing shareholders *lose*. At such times, gains flow only to the *selling* shareholders and to the friendly, but expensive, investment banker who recommended the foolish purchases.

Gains from value-accretive repurchases, it should be emphasized, benefit *all* owners – in *every* respect. Imagine, if you will, three fully-informed shareholders of a local auto dealership, one of whom manages the business. Imagine, further, that one of the passive owners wishes to sell his interest back to the company at a price attractive to the two continuing shareholders. When completed, has this transaction harmed anyone? Is the manager somehow favored over the continuing passive owners? Has the public been hurt?

When you are told that *all* repurchases are harmful to shareholders *or* to the country, *or* particularly beneficial to CEOs, you are listening to either an economic illiterate or a silver-tongued demagogue (characters that are *not* mutually exclusive).

Almost endless details of Berkshire's 2022 operations are laid out on pages K-33 – K-66. Charlie and I, along with many Berkshire shareholders, enjoy poring over the many facts and figures laid out in that section. These pages are *not*, however, required reading. There are many Berkshire centimillionaires and, yes, billionaires who have never studied our financial figures. They simply know that Charlie and I – along with our families and close friends – continue to have very significant investments in Berkshire, and they trust us to treat their money as we do our own.

And *that* is a promise we can make.

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Finally, an important warning: Even the *operating* earnings figure that we favor can easily be manipulated by managers who wish to do so. Such tampering is often thought of as sophisticated by CEOs, directors and their advisors. Reporters and analysts embrace its existence as well. Beating “expectations” is heralded as a managerial triumph.

That activity is disgusting. It requires no talent to manipulate numbers: Only a deep desire to deceive is required. “Bold imaginative accounting,” as a CEO once described his deception to me, has become one of the shames of capitalism.

58 Years – and a Few Figures

In 1965, Berkshire was a one-trick pony, the owner of a venerable – but doomed – New England textile operation. With that business on a death march, Berkshire needed an immediate fresh start. Looking back, I was slow to recognize the severity of its problems.

And then came a stroke of good luck: National Indemnity became available in 1967, and we shifted our resources toward insurance and other non-textile operations.

Thus began our journey to 2023, a bumpy road involving a combination of *continuous* savings by our owners (that is, by their retaining earnings), the power of compounding, our avoidance of *major* mistakes and – most important of all – the American Tailwind. America would have done fine without Berkshire. The reverse is *not* true.

Berkshire now enjoys major ownership in an unmatched collection of huge and diversified businesses. Let's first look at the 5,000 or so publicly-held companies that trade daily on NASDAQ, the NYSE and related venues. Within this group is housed the members of the S&P 500 Index, an elite collection of large and well-known American companies.

In aggregate, the 500 earned \$1.8 trillion in 2021. I don't yet have the final results for 2022. Using, therefore, the 2021 figures, only 128 of the 500 (including Berkshire itself) earned \$3 billion or more. Indeed, 23 lost money.

At yearend 2022, Berkshire was the largest owner of *eight* of these giants: American Express, Bank of America, Chevron, Coca-Cola, HP Inc., Moody's, Occidental Petroleum and Paramount Global.

In addition to those eight investees, Berkshire owns 100% of BNSF and 92% of BH Energy, each with earnings that exceed the \$3 billion mark noted above (\$5.9 billion at BNSF and \$4.3 billion at BHE). Were these companies publicly-owned, they would replace two present members of the 500. All told, our ten controlled and non-controlled behemoths leave Berkshire more broadly aligned with the country's economic future than is the case at any other U.S. company. (This calculation leaves aside "fiduciary" operations such as pension funds and investment companies.) In addition, Berkshire's insurance operation, though conducted through many individually-managed subsidiaries, has a value comparable to BNSF or BHE.

As for the future, Berkshire will always hold a boatload of cash and U.S. Treasury bills along with a wide array of businesses. We will also avoid behavior that could result in *any* uncomfortable cash needs at inconvenient times, including financial panics and unprecedented insurance losses. Our CEO will always be the Chief Risk Officer – a task it is irresponsible to delegate. Additionally, our future CEOs will have a significant part of their net worth in Berkshire shares, bought with their own money. *And* yes, our shareholders will continue to save and prosper by retaining earnings.

At Berkshire, there will be no finish line.

Some Surprising Facts About Federal Taxes

During the decade ending in 2021, the United States Treasury received about \$32.3 trillion in taxes while it spent \$43.9 trillion.

Though economists, politicians and many of the public have opinions about the consequences of that huge imbalance, Charlie and I plead ignorance and firmly believe that near-term economic and market forecasts are worse than useless. Our job is to manage Berkshire's operations and finances in a manner that will achieve an acceptable result over time and that will preserve the company's unmatched staying power when financial panics or severe worldwide recessions occur. Berkshire also offers some modest protection from runaway inflation, but this attribute is *far* from perfect. Huge and entrenched fiscal deficits have consequences.

The \$32 trillion of revenue was garnered by the Treasury through individual income taxes (48%), social security and related receipts (34½%), corporate income tax payments (8½%) and a wide variety of lesser levies. Berkshire's contribution via the corporate income tax was \$32 billion during the decade, almost exactly a tenth of 1% of *all* money that the Treasury collected.

And that means – brace yourself – had there been roughly 1,000 taxpayers in the U.S. matching Berkshire’s payments, no other businesses nor any of the country’s 131 million households would have needed to pay *any* taxes to the federal government. Not a dime.

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Millions, billions, trillions – we all know the words, but the sums involved are almost impossible to comprehend. Let’s put physical dimensions to the numbers:

- If you convert \$1 million into newly-printed \$100 bills, you will have a stack that reaches your chest.
- Perform the same exercise with \$1 *billion* – this is getting exciting! – and the stack reaches about ¾ of a mile into the sky.
- Finally, imagine piling up \$32 billion, the total of Berkshire’s 2012-21 federal income tax payments. Now the stack grows to more than 21 miles in height, about three times the level at which commercial airplanes usually cruise.

When it comes to federal taxes, individuals who own Berkshire can unequivocally state “I gave at the office.”

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At Berkshire we hope *and expect* to pay much more in taxes during the next decade. We owe the country no less: America’s dynamism has made a huge contribution to whatever success Berkshire has achieved – a contribution Berkshire will always need. We *count* on the American Tailwind and, though it has been becalmed from time to time, its propelling force has always returned.

I have been investing for 80 years – more than one-third of our country’s lifetime. Despite our citizens’ penchant – almost enthusiasm – for self-criticism and self-doubt, I have yet to see a time when it made sense to make a long-term bet against America. And I doubt very much that any reader of this letter will have a different experience in the future.

Nothing Beats Having a Great Partner

Charlie and I think pretty much alike. But what it takes me a page to explain, he sums up in a sentence. His version, moreover, is always more clearly reasoned and also more artfully – some might add bluntly – stated.

Here are a few of his thoughts, many lifted from a very recent podcast:

- The world is full of foolish gamblers, and they will not do as well as the patient investor.
- If you don’t see the world the way it is, it’s like judging something through a distorted lens.
- All I want to know is where I’m going to die, so I’ll never go there. And a related thought: Early on, write your desired obituary – and then behave accordingly.
- If you don’t care whether you are rational or not, you won’t work on it. Then you will stay irrational and get lousy results.

- Patience can be learned. Having a long attention span and the ability to concentrate on one thing for a long time is a huge advantage.
- You can learn a lot from dead people. Read of the deceased you admire and detest.
- Don't bail away in a sinking boat if you can swim to one that is seaworthy.
- A great company keeps working after you are not; a mediocre company won't do that.
- Warren and I don't focus on the froth of the market. We seek out good long-term investments and stubbornly hold them for a long time.
- Ben Graham said, "Day to day, the stock market is a voting machine; in the long term it's a weighing machine." If you keep making something more valuable, then some wise person is going to notice it and start buying.
- There is no such thing as a 100% sure thing when investing. Thus, the use of leverage is dangerous. A string of wonderful numbers times zero will always equal zero. Don't count on getting rich twice.
- You don't, however, need to own a lot of things in order to get rich.
- You have to keep learning if you want to become a great investor. When the world changes, *you must change*.
- Warren and I hated railroad stocks for decades, but the world changed and finally the country had four huge railroads of vital importance to the American economy. We were slow to recognize the change, but better late than never.
- Finally, I will add two short sentences by Charlie that have been his decision-clinchers for decades: "Warren, think more about it. You're smart and I'm right."

And so it goes. I never have a phone call with Charlie without learning something. And, while he makes me think, he also makes me laugh.

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I will add to Charlie's list a rule of my own: Find a very smart high-grade partner – preferably slightly older than you – and then listen *very* carefully to what he says.

A Family Gathering in Omaha

Charlie and I are shameless. Last year, at our first shareholder get-together in three years, we greeted you with our usual commercial hustle.

From the opening bell, we went straight for your wallet. In short order, our See's kiosk sold you *eleven tons* of nourishing peanut brittle and chocolates. In our P.T. Barnum pitch, we promised you longevity. After all, what else but candy from See's could account for Charlie and me making it to 99 and 92?

I know you can't wait to hear the specifics of last year's hustle.

On Friday, the doors were open from noon until 5 p.m., and our candy counters rang up 2,690 individual sales. On Saturday, See's registered an additional 3,931 transactions between 7 a.m. and 4:30 p.m., despite the fact that 6 ½ of the 9 ½ operating hours occurred while our movie and the question-and-answer session were limiting commercial traffic.

Do the math: See's rang up about 10 sales per minute during its prime operating time (racking up \$400,309 of volume during the two days), with all the goods purchased at a single location selling products that haven't been materially altered in 101 years. What worked for See's in the days of Henry Ford's model T works now.

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Charlie, I, and the entire Berkshire bunch look forward to seeing you in Omaha on May 5-6. We will have a good time and so will you.

February 25, 2023

Warren E. Buffett
Chairman of the Board

Charlie Munger – The Architect of Berkshire Hathaway

Charlie Munger died on November 28, just 33 days before his 100th birthday.

Though born and raised in Omaha, he spent 80% of his life domiciled elsewhere. Consequently, it was not until 1959 when he was 35 that I first met him. In 1962, he decided that he should take up money management.

Three years later he told me – correctly! – that I had made a dumb decision in buying control of Berkshire. **But**, he assured me, since I had already made the move, he would tell me how to correct my mistake.

In what I next relate, bear in mind that Charlie and his family did not have a dime invested in the small investing partnership that I was then managing and whose money I had used for the Berkshire purchase. Moreover, neither of us expected that Charlie would **ever** own a share of Berkshire stock.

Nevertheless, Charlie, in 1965, promptly advised me: “Warren, forget about ever buying another company like Berkshire. But now that you control Berkshire, add to it wonderful businesses purchased at fair prices and give up buying fair businesses at wonderful prices. In other words, abandon everything you learned from your hero, Ben Graham. It works but only when practiced at small scale.” With much back-sliding I subsequently followed his instructions.

Many years later, Charlie became my partner in running Berkshire and, repeatedly, jerked me back to sanity when my old habits surfaced. Until his death, he continued in this role and together we, along with those who early on invested with us, ended up far better off than Charlie and I had ever dreamed possible.

In reality, Charlie was the “architect” of the present Berkshire, and I acted as the “general contractor” to carry out the day-by-day construction of his vision.

Charlie never sought to take credit for his role as creator but instead let me take the bows and receive the accolades. In a way his relationship with me was part older brother, part loving father. Even when he knew he was right, he gave me the reins, and when I blundered he never – **never** – reminded me of my mistake.

In the physical world, great buildings are linked to their architect while those who had poured the concrete or installed the windows are soon forgotten. Berkshire has become a great company. Though I have long been in charge of the construction crew; **Charlie** should **forever** be credited with being the architect.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire has more than three million shareholder accounts. I am charged with writing a letter every year that will be useful to this diverse and ever-changing group of owners, many of whom wish to learn more about their investment.

Charlie Munger, for decades my partner in managing Berkshire, viewed this obligation identically and would expect me to communicate with you this year in the regular manner. He and I were of one mind regarding our responsibilities to Berkshire shareholders.

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Writers find it useful to picture the reader they seek, and often they are hoping to attract a mass audience. At Berkshire, we have a more limited target: investors who trust Berkshire with their savings without any expectation of resale (resembling in attitude people who save in order to buy a farm or rental property rather than people who prefer using their excess funds to purchase lottery tickets or “hot” stocks).

Over the years, Berkshire has attracted an unusual number of such “lifetime” shareholders and their heirs. We cherish their presence and believe they are entitled to hear every year both the good and bad news, delivered directly from their CEO and *not* from an investor-relations officer or communications consultant forever serving up optimism and syrupy mush.

In visualizing the owners that *Berkshire* seeks, I am lucky to have the perfect mental model, my sister, Bertie. Let me introduce her.

For openers, Bertie is smart, wise and likes to challenge my thinking. We have never, however, had a shouting match or anything close to a ruptured relationship. We never will.

Furthermore, Bertie, and her three daughters as well, have a large portion of their savings in Berkshire shares. Their ownership spans decades, and every year Bertie will read what I have to say. My job is to anticipate her questions and give her honest answers.

Bertie, like most of you, understands many accounting terms, but she is not ready for a CPA exam. She follows business news – reading four newspapers daily – but doesn’t consider herself an economic expert. She is sensible – *very* sensible – instinctively knowing that pundits should *always* be ignored. After all, if *she* could reliably predict tomorrow’s winners, would she freely share her valuable insights and thereby increase competitive buying? That would be like finding gold and then handing a map to the neighbors showing its location.

Bertie understands the power – for good or bad – of incentives, the weaknesses of humans, the “tells” that can be recognized when observing human behavior. She knows who is “selling” and who can be trusted. In short, she is nobody’s fool.

So, what would interest Bertie this year?

Operating Results, Fact and Fiction

Let’s begin with the numbers. The *official* annual report begins on K-1 and extends for 124 pages. It is filled with a vast amount of information – some important, some trivial.

Among its disclosures many owners, along with financial reporters, will focus on page K-72. There, they will find the proverbial “bottom line” labeled “Net earnings (loss).” The numbers read \$90 billion for 2021, (\$23 billion) for 2022 and \$96 billion for 2023.

What in the world is going on?

You seek guidance and are told that the procedures for calculating these “earnings” are promulgated by a sober and credentialed Financial Accounting Standards Board (“FASB”), mandated by a dedicated and hard-working Securities and Exchange Commission (“SEC”) and audited by the world-class professionals at Deloitte & Touche (“D&T”). On page K-67, D&T pulls no punches: “In our opinion, the financial statements present fairly, *in all material respects* (italics mine), the financial position of the Company and the results of its operations for each of the three years in the period ended December 31, 2023”

So sanctified, this worse-than-useless “net income” figure quickly gets transmitted throughout the world via the internet and media. All parties believe they have done their job – and, legally, they have.

We, however, are left uncomfortable. At Berkshire, *our* view is that “earnings” should be a sensible concept that Bertie will find somewhat useful – *but only as a starting point* – in evaluating a business. Accordingly, Berkshire *also* reports to Bertie and you what we call “operating earnings.” Here is the story *they* tell: \$27.6 billion for 2021; \$30.9 billion for 2022 and \$37.4 billion for 2023.

The *primary* difference between the mandated figures and the ones Berkshire prefers is that we exclude unrealized capital gains or losses that at times can exceed \$5 billion *a day*. Ironically, our preference was pretty much the rule until 2018, when the “improvement” was mandated. Galileo’s experience, several centuries ago, should have taught us not to mess with mandates from on high. But, at Berkshire, we can be stubborn.

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Make no mistake about the significance of capital gains: I expect them to be a *very* important component of Berkshire’s value accretion during the decades ahead. Why else would we commit huge dollar amounts of your money (and Bertie’s) to marketable equities just as I have been doing with my own funds throughout my investing lifetime?

I can’t remember a period since March 11, 1942 – the date of my first stock purchase – that I have *not* had a majority of my net worth in equities, *U.S.-based* equities. And so far, so good. The Dow Jones Industrial Average fell below 100 on that fateful day in 1942 when I “pulled the trigger.” I was down about \$5 by the time school was out. Soon, things turned around and now that index hovers around 38,000. America has been a terrific country for investors. All they have needed to do is sit quietly, listening to no one.

It is more than silly, however, to make judgments about Berkshire’s investment value based on “earnings” that incorporate the capricious *day-by-day* and, yes, even year-by-year movements of the stock market. As Ben Graham taught me, “In the short run the market acts as a voting machine; in the long run it becomes a weighing machine.”

What We Do

Our goal at Berkshire is simple: We want to own either all or a portion of businesses that enjoy good economics that are fundamental and enduring. Within capitalism, some businesses will flourish for a very long time while others will prove to be sinkholes. It’s harder than you would think to predict which will be the winners and losers. And those who tell you they know the answer are usually either self-delusional or snake-oil salesmen.

At Berkshire, we particularly favor the rare enterprise that can deploy *additional* capital at high returns in the future. Owning only one of these companies – and simply sitting tight – can deliver wealth almost beyond measure. Even heirs to such a holding can – ugh! – sometimes live a lifetime of leisure.

We also hope these favored businesses are run by able and trustworthy managers, though that is a more difficult judgment to make, however, and Berkshire has had its share of disappointments.

In 1863, Hugh McCulloch, the first Comptroller of the United States, sent a letter to all national banks. His instructions included this warning: “Never deal with a rascal under the expectation that you can prevent him from cheating you.” Many bankers who thought they could “manage” the rascal problem have learned the wisdom of Mr. McCulloch’s advice – and I have as well. People are not that easy to read. Sincerity and empathy can easily be faked. That is as true now as it was in 1863.

This combination of the two necessities I’ve described for acquiring businesses has for long been our goal in purchases and, for a while, we had an abundance of candidates to evaluate. If I missed one – and I missed plenty – another always came along.

Those days are long behind us; *size* did us in, though increased competition for purchases was also a factor.

Berkshire now has – *by far* – the largest GAAP net worth recorded by *any* American business. Record operating income and a strong stock market led to a yearend figure of \$561 billion. The *total* GAAP net worth for the other 499 S&P companies – a who’s who of American business – was \$8.9 trillion in 2022. (The 2023 number for the S&P has not yet been tallied but is unlikely to materially exceed \$9.5 trillion.)

By this measure, Berkshire now occupies nearly 6% of the universe in which it operates. Doubling our huge base is simply not possible within, say, a five-year period, particularly because we are highly averse to issuing shares (an act that immediately juices net worth).

There remain only a handful of companies in this country capable of truly moving the needle at Berkshire, and they have been endlessly picked over by us and by others. Some we can value; some we can’t. And, if we can, they have to be attractively priced. Outside the U.S., there are essentially no candidates that are *meaningful* options for capital deployment at Berkshire. All in all, we have *no* possibility of eye-popping performance.

Nevertheless, managing Berkshire is mostly fun and always interesting. On the positive side, after 59 years of assemblage, the company now owns either a portion or 100% of various businesses that, on a weighted basis, have somewhat better prospects than exist at most large American companies. By both luck and pluck, a few huge winners have emerged from a great many dozens of decisions. And we now have a small cadre of long-time managers who never muse about going elsewhere and who regard 65 as just another birthday.

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Berkshire benefits from an unusual constancy and clarity of purpose. While we emphasize treating our employees, communities and suppliers well – who *wouldn’t* wish to do so? – our allegiance will *always* be to our country and our shareholders. We never forget that, though your money is *commingled* with ours, it does not *belong* to us.

With that focus, and with our present mix of businesses, Berkshire *should* do a bit better than the average American corporation and, more important, *should* also operate with materially less risk of permanent loss of capital. Anything beyond “slightly better,” though, is wishful thinking. This modest aspiration wasn’t the case when Bertie went all-in on Berkshire – but it is now.

Our Not-So-Secret Weapon

Occasionally, markets and/or the economy will cause stocks and bonds of some large and fundamentally good businesses to be strikingly mispriced. Indeed, markets can – and will – unpredictably seize up or even *vanish* as they did for four months in 1914 and for a few days in 2001. If you believe that American investors are now more stable than in the past, think back to September 2008. Speed of communication and the wonders of technology *facilitate* instant worldwide paralysis, and we have come a long way since smoke signals. Such instant panics won’t happen often – but they *will* happen.

Berkshire’s ability to immediately respond to market seizures with both huge sums and certainty of performance *may* offer us an occasional large-scale opportunity. Though the stock market is massively larger than it was in our early years, today’s *active* participants are neither more emotionally stable nor better taught than when I was in school. For whatever reasons, markets now exhibit far more casino-like behavior than they did when I was young. The casino now resides in many homes and daily tempts the occupants.

One fact of financial life should never be forgotten. Wall Street – to use the term in its figurative sense – would *like* its customers to make money, but what truly causes its denizens’ juices to flow is feverish activity. At such times, whatever foolishness can be marketed *will* be vigorously marketed – not by everyone but always by someone.

Occasionally, the scene turns ugly. The politicians then become enraged; the most flagrant perpetrators of misdeeds slip away, rich and unpunished; and your friend next door becomes bewildered, poorer and sometimes vengeful. Money, he learns, has trumped morality.

One investment rule at Berkshire has not and will not change: *Never* risk permanent loss of capital. Thanks to the American tailwind and the power of compound interest, the arena in which we operate has been – and will be – rewarding *if* you make a couple of good decisions during a lifetime *and* avoid serious mistakes.

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I believe Berkshire can handle *financial* disasters of a magnitude beyond any heretofore experienced. This ability is one we will not relinquish. When economic upsets occur, as they will, Berkshire’s goal will be to function as an *asset* to the country – just as it was in a very minor way in 2008-9 – and to help *extinguish* the financial fire rather than to be among the many companies that, inadvertently or otherwise, ignited the conflagration.

Our goal is realistic. Berkshire's strength comes from its Niagara of diverse earnings delivered *after* interest costs, taxes and substantial charges for depreciation and amortization ("EBITDA" is a banned measurement at Berkshire). We also operate with minimal requirements for cash, even if the country encounters a prolonged period of global economic weakness, fear and near-paralysis.

Berkshire does not currently pay dividends, and its share repurchases are 100% discretionary. Annual debt maturities are never material.

Your company also holds a *cash* and *U.S. Treasury bill* position far in excess of what conventional wisdom deems necessary. During the 2008 panic, Berkshire *generated* cash from operations and did not rely in any manner on commercial paper, bank lines or debt markets. We did *not* predict the time of an economic paralysis but we were always *prepared* for one.

Extreme fiscal conservatism is a corporate pledge we make to those who have joined us in ownership of Berkshire. In most years – indeed in most decades – our caution will likely prove to be unneeded behavior – akin to an insurance policy on a fortress-like building *thought* to be fireproof. But Berkshire does not want to inflict *permanent* financial damage – quotational shrinkage for extended periods can't be avoided – on Bertie or *any* of the individuals who have trusted us with their savings.

Berkshire is built to last.

Non-controlled Businesses That Leave Us Comfortable

Last year I mentioned two of Berkshire's long-duration partial-ownership positions – Coca-Cola and American Express. These are not huge commitments like our Apple position. Each only accounts for 4-5% of Berkshire's GAAP net worth. But they are meaningful assets and also illustrate our thought processes.

American Express began operations in 1850, and Coca-Cola was launched in an Atlanta drug store in 1886. (Berkshire is *not* big on newcomers.) Both companies tried expanding into unrelated areas over the years and both found little success in these attempts. In the past – but *definitely* not now – both were even mismanaged.

But each was hugely successful in its base business, reshaped here and there as conditions called for. And, crucially, their products "traveled." Both Coke and AMEX became recognizable names worldwide as did their core products, *and* the consumption of liquids and the need for unquestioned financial trust are timeless essentials of our world.

During 2023, we did not buy or sell a share of either AMEX or Coke – extending our own Rip Van Winkle slumber that has now lasted well over two decades. Both companies again rewarded our inaction last year by increasing their earnings and dividends. Indeed, our share of AMEX *earnings* in 2023 considerably exceeded the \$1.3 billion *cost* of our long-ago purchase.

Both AMEX and Coke will almost certainly increase their dividends in 2024 – about 16% in the case of AMEX – and we *will* most certainly leave our holdings untouched throughout the year. Could *I* create a better worldwide business than these two enjoy? As Bertie will tell you: “No way.”

Though Berkshire did not purchase shares of either company in 2023, *your* indirect ownership of both Coke and AMEX increased a bit last year because of share repurchases we made at Berkshire. Such repurchases work to increase your participation in *every* asset that Berkshire owns. To this obvious but often overlooked truth, I add my usual caveat: *All* stock repurchases should be price-dependent. What is sensible at a discount to business-value becomes stupid if done at a premium.

The lesson from Coke and AMEX? When you find a truly wonderful business, stick with it. *Patience* pays, and one wonderful business can offset the many mediocre decisions that are inevitable.

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This year, I would like to describe two other investments that we expect to maintain indefinitely. Like Coke and AMEX, these commitments are not huge relative to our resources. They are worthwhile, however, and we were able to increase both positions during 2023.

At yearend, Berkshire owned 27.8% of Occidental Petroleum’s common shares and also owned warrants that, for more than five years, give us the *option* to materially increase our ownership at a fixed price. Though we very much like our ownership, as well as the option, Berkshire has no interest in purchasing or managing Occidental. We particularly like its vast oil and gas holdings in the United States, as well as its leadership in carbon-capture initiatives, though the economic feasibility of this technique has yet to be proven. Both of these activities are very much in our country’s interest.

Not so long ago, the U.S. was woefully dependent on foreign oil, and carbon capture had no meaningful constituency. Indeed, in 1975, U.S. production was eight million barrels of oil-equivalent per day (“BOEPD”), a level far short of the country’s needs. From the favorable energy position that facilitated the U.S. mobilization in World War II, the country had retreated to become heavily dependent on foreign – potentially unstable – suppliers. Further declines in oil production were predicted along with future increases in usage.

For a long time, the pessimism appeared to be correct, with production falling to five million BOEPD by 2007. Meanwhile, the U.S. government created a Strategic Petroleum Reserve (“SPR”) in 1975 to alleviate – though not come close to eliminating – this erosion of American self-sufficiency.

And then – Hallelujah! – shale economics became feasible in 2011, and our energy dependency ended. Now, U.S. production is more than 13 million BOEPD, and OPEC no longer has the upper hand. Occidental itself has annual U.S. oil production that each year comes close to matching the entire inventory of the SPR. Our country would be very – *very* – nervous today if domestic production had remained at five million BOEPD, and it found itself hugely dependent on non-U.S. sources. At that level, the SPR would have been emptied within months if foreign oil became unavailable.

Under Vicki Hollub’s leadership, Occidental is doing the right things for both its country and its owners. No one knows what oil prices will do over the next month, year, or decade. But Vicki does know how to separate oil from rock, and that’s an uncommon talent, valuable to her shareholders and to her country.

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Additionally, Berkshire continues to hold its passive and long-term interest in five very large Japanese companies, each of which operates in a highly-diversified manner somewhat similar to the way Berkshire itself is run. We increased our holdings in all five last year after Greg Abel and I made a trip to Tokyo to talk with their managements.

Berkshire now owns about 9% of each of the five. (A minor point: Japanese companies calculate outstanding shares in a manner different from the practice in the U.S.) Berkshire has also pledged to each company that it will not purchase shares that will take our holdings beyond 9.9%. Our cost for the five totals ¥1.6 trillion, and the yearend market value of the five was ¥2.9 trillion. However, the yen has weakened in recent years and our yearend unrealized gain in dollars was 61% or \$8 billion.

Neither Greg nor I believe we can forecast market prices of major currencies. We also don’t believe we can hire anyone with this ability. Therefore, Berkshire has financed most of its Japanese position with the proceeds from ¥1.3 trillion of bonds. This debt has been very well-received in Japan, and I believe Berkshire has more yen-denominated debt outstanding than any other American company. The weakened yen has produced a yearend gain for Berkshire of \$1.9 billion, a sum that, pursuant to GAAP rules, has periodically been recognized in income over the 2020-23 period.

In certain important ways, all five companies – Itochu, Marubeni, Mitsubishi, Mitsui and Sumitomo – follow shareholder-friendly policies that are much superior to those customarily practiced in the U.S. Since we began our Japanese purchases, *each* of the five has reduced the number of its outstanding shares *at attractive prices*.

Meanwhile, the managements of all five companies have been *far* less aggressive about their own compensation than is typical in the United States. Note as well that each of the five is applying only about $\frac{1}{3}$ of its earnings to dividends. The large sums the five retain are used both to build their many businesses and, to a lesser degree, to repurchase shares. Like Berkshire, the five companies are reluctant to *issue* shares.

An additional benefit for Berkshire is the possibility that our investment may lead to opportunities for us to partner around the world with five large, well-managed and well-respected companies. Their interests are far more broad than ours. And, on their side, the Japanese CEOs have the comfort of knowing that Berkshire will always possess huge liquid resources that can be instantly available for such partnerships, whatever their size may be.

Our Japanese purchases began on July 4, 2019. Given Berkshire's present size, building positions through open-market purchases takes a lot of patience and an extended period of "friendly" prices. The process is like turning a battleship. That is an important disadvantage which we did not face in our early days at Berkshire.

The Scorecard in 2023

Every quarter we issue a press release that reports our summarized operating earnings (or loss) in a manner similar to what is shown below. Here is the full-year compilation:

	(in \$ millions)	
	<u>2023</u>	<u>2022</u>
Insurance-underwriting	\$ 5,428	\$ (30)
Insurance-investment income	9,567	6,484
Railroad	5,087	5,946
Utilities and energy	2,331	3,904
Other businesses and miscellaneous items	<u>14,937</u>	<u>14,549</u>
Operating earnings	<u><u>\$37,350</u></u>	<u><u>\$30,853</u></u>

At Berkshire's annual gathering on May 6, 2023, I presented the first quarter's results which had been released early that morning. I followed with a short summary of the outlook for the full year: (1) most of our *non-insurance* businesses faced lower earnings in 2023; (2) that decline would be cushioned by decent results at our two largest non-insurance businesses, BNSF and Berkshire Hathaway Energy ("BHE") which, combined, had accounted for more than 30% of operating earnings in 2022; (3) our investment income was *certain* to materially grow because the huge U.S. Treasury bill position held by Berkshire had finally begun to pay us far more than the pittance we had been receiving and (4) insurance would likely do well, both because its underwriting earnings are not correlated to earnings elsewhere in the economy and, beyond that, property-casualty insurance prices had strengthened.

Insurance came through as expected. I erred, however, in my expectations for both BNSF and BHE. Let's take a look at each.

* * * * *

Rail is essential to America's economic future. It is clearly the most efficient way – measured by cost, fuel usage and carbon intensity – of moving heavy materials to distant destinations. Trucking wins for short hauls, but many goods that Americans need *must* travel to customers many hundreds or even several thousands of miles away. The country can't run without rail, and the industry's capital needs will always be huge. Indeed, compared to most American businesses, railroads *eat* capital.

BNSF is the largest of six major rail systems that blanket North America. Our railroad carries its 23,759 miles of main track, 99 tunnels, 13,495 bridges, 7,521 locomotives and assorted other fixed assets at \$70 billion on its balance sheet. But my guess is that it would cost at least \$500 billion to replicate those assets and *decades* to complete the job.

BNSF must annually spend more than its depreciation charge to simply *Maintain* its present level of business. This reality is bad for owners, whatever the industry in which they have invested, but it is particularly disadvantageous in capital-intensive industries.

At BNSF, the outlays in *excess* of GAAP depreciation charges since our purchase 14 years ago have totaled a staggering \$22 billion or more than \$1½ billion annually. Ouch! That sort of gap means BNSF dividends paid to Berkshire, its owner, will regularly fall *considerably short* of BNSF's reported earnings unless we regularly increase the railroad's debt. And that we do not intend to do.

Consequently, Berkshire is receiving an acceptable return on its purchase price, though less than it might appear, and also a pittance on the replacement value of the property. That's no surprise to me or Berkshire's board of directors. It explains why we could buy BNSF in 2010 at a small fraction of its replacement value.

North America's rail system moves huge quantities of coal, grain, autos, imported and exported goods, etc. *one-way* for long distances and those trips often create a revenue problem for back-hauls. Weather conditions are extreme and frequently hamper or even stymie the utilization of track, bridges and equipment. Flooding can be a nightmare. None of this is a surprise. While I sit in an always-comfortable office, railroading is an outdoor activity with many employees working under trying and sometimes dangerous conditions.

An evolving problem is that a growing percentage of Americans are not looking for the difficult, and often lonely, employment conditions inherent in some rail operations. Engineers must deal with the fact that among an American population of 335 million, some forlorn or mentally-disturbed Americans are going to elect suicide by lying in front of a 100-car, extraordinarily heavy train that can't be stopped in less than a mile or more. Would *you* like to be the helpless engineer? This trauma happens about once a day in North America; it is far more common in Europe and will always be with us.

Wage negotiations in the rail industry can end up in the hands of the President and Congress. Additionally, American railroads are *required* to carry many dangerous products every day that the industry would much rather avoid. The words “common carrier” define railroad responsibilities.

Last year BNSF’s earnings declined more than I expected, as revenues fell. Though fuel costs also fell, wage increases, promulgated in Washington, were far beyond the country’s inflation goals. This differential may recur in future negotiations.

Though BNSF carries more freight and spends more on capital expenditures than any of the five other major North American railroads, its profit margins have slipped relative to all five since our purchase. I believe that our vast service territory is second to none and that therefore our margin comparisons can and should improve.

I am particularly proud of both BNSF’s contribution to the country and the people who work in sub-zero outdoor jobs in North Dakota and Montana winters to keep America’s commercial arteries open. Railroads don’t get much attention when they are working but, were they unavailable, the void would be noticed immediately throughout America.

A century from now, BNSF will continue to be a major asset of the country and of Berkshire. You can count on that.

* * * * *

Our second and even more severe earnings disappointment last year occurred at BHE. *Most* of its large electric-utility businesses, as well as its extensive gas pipelines, performed about as expected. But the regulatory climate in a few states has raised the specter of zero profitability or even bankruptcy (an actual outcome at California’s largest utility and a current threat in Hawaii). In such jurisdictions, it is difficult to project both earnings and asset values in what was once regarded as among the most stable industries in America.

For more than a century, electric utilities raised huge sums to finance their growth through a state-by-state promise of a fixed return on equity (sometimes with a small bonus for superior performance). With this approach, massive investments were made for capacity that would likely be required a few years down the road. That forward-looking regulation reflected the reality that utilities build generating and transmission assets that often take many years to construct. BHE’s extensive multi-state transmission project in the West was initiated in 2006 and remains some years from completion. Eventually, it will serve 10 states comprising 30% of the acreage in the continental United States.

With this model employed by both private and public-power systems, the lights stayed on, even if population growth or industrial demand exceeded expectations. The “margin of safety” approach seemed sensible to regulators, investors and the public. Now, the fixed-but-satisfactory-return pact has been broken in a few states, and investors are becoming apprehensive that such ruptures may spread. Climate change adds to their worries. Underground transmission may be required but who, a few decades ago, wanted to pay the staggering costs for such construction?

At Berkshire, we have made a best estimate for the amount of losses that have occurred. These costs arose from forest fires, whose frequency and intensity have increased – and will likely continue to increase – if convective storms become more frequent.

It will be many years until we know the final tally from BHE's forest-fire losses and can intelligently make decisions about the desirability of future investments in vulnerable western states. It remains to be seen whether the regulatory environment will change elsewhere.

Other electric utilities may face survival problems resembling those of Pacific Gas and Electric and Hawaiian Electric. A confiscatory resolution of our present problems would obviously be a negative for BHE, but both that company and Berkshire itself are structured to survive negative surprises. We regularly get these in our insurance business, where our basic product is risk assumption, and they will occur elsewhere. Berkshire can sustain financial surprises but we will not *knowingly* throw good money after bad.

Whatever the case at Berkshire, the final result for the utility industry may be ominous: Certain utilities might no longer attract the savings of American citizens and will be forced to adopt the public-power model. Nebraska made this choice in the 1930s and there are many public-power operations throughout the country. Eventually, voters, taxpayers and users will decide which model they prefer.

When the dust settles, America's power needs and the consequent capital expenditure will be staggering. I did not anticipate or even consider the adverse developments in regulatory returns and, along with Berkshire's two partners at BHE, I made a costly mistake in not doing so.

* * * * *

Enough about problems: Our insurance business performed exceptionally well last year, setting records in sales, float and underwriting profits. Property-casualty insurance ("P/C") provides the core of Berkshire's well-being and growth. We have been in the business for 57 years and despite our nearly *5,000-fold* increase in volume – from \$17 million to \$83 billion – we have much room to grow.

Beyond that, we have learned – too often, painfully – a good deal about what types of insurance business and what sort of people to *avoid*. The most important lesson is that our underwriters can be thin, fat, male, female, young, old, foreign or domestic. But they *can't* be optimists at the office, however desirable that quality may generally be in life.

Surprises in the P/C business – which can occur decades after six-month or one-year policies have expired – are almost always negative. The industry's accounting is designed to recognize this reality, but estimation mistakes can be huge. And when charlatans are involved, detection is often both slow and costly. Berkshire will always attempt to be accurate in its estimates of future loss payments but inflation – both monetary and the "legal" variety – is a wild card.

I've told the story of our insurance operations so many times that I will simply direct newcomers to page 18. Here, I will only repeat that our position would not be what it is if Ajit Jain had not joined Berkshire in 1986. Before that lucky day – aside from an almost unbelievably wonderful experience with GEICO that began early in 1951 and will never end – I was largely wandering in the wilderness, as I struggled to build our insurance operation.

Ajit's achievements since joining Berkshire have been supported by a large cast of hugely-talented insurance executives in our various P/C operations. Their names and faces are unknown to most of the press and the public. Berkshire's lineup of managers, however, is to P/C insurance what Cooperstown's honorees are to baseball.

Bertie, you can feel good about the fact that you own a piece of an incredible P/C operation that now operates worldwide with unmatched financial resources, reputation and talent. It carried the day in 2023.

What is it with Omaha?

Come to Berkshire's annual gathering on May 4, 2024. On stage you will see the three managers who now bear the prime responsibilities for steering your company. What, you may wonder, do the three have in common? They certainly don't look alike. Let's dig deeper.

Greg Abel, who runs all non-insurance operations for Berkshire – and in *all* respects is ready to be CEO of Berkshire tomorrow – was born and raised in Canada (he still plays hockey). In the 1990s, however, Greg lived for six years in Omaha just a few blocks away from me. During that period, I never met him.

A decade or so earlier, Ajit Jain, who was born, raised and educated in India, lived with his family in Omaha only a mile or so from my home (where I've lived since 1958). Both Ajit and his wife, Tinku, have many Omaha friends, though it's been more than three decades since they moved to New York (in order to be where much of the action in reinsurance takes place).

Missing from the stage this year will be Charlie. He and I were both born in Omaha about two miles from where you will sit at our May get-together. In his first ten years, Charlie lived about a half-mile from where Berkshire has long maintained its office. Both Charlie and I spent our early years in Omaha public schools and were indelibly shaped by our Omaha childhood. We didn't meet, however, until much later. (A footnote that may surprise you: Charlie lived under 15 of America's 45 presidents. People refer to President Biden as #46, but that numbering counts Grover Cleveland as both #22 and #24 because his terms were not consecutive. America is a very young country.)

Moving to the corporate level, Berkshire itself relocated in 1970 from its 81 years of residence in New England to settle in Omaha, leaving its troubles behind and blossoming in its new home.

As a final punctuation point to the “Omaha Effect,” Bertie – yes *that* Bertie – spent her early formative years in a middle-class neighborhood in Omaha and, many decades later, emerged as one of the country’s great investors.

You may be thinking that she put all of her money in Berkshire and then simply sat on it. But that’s not true. After starting a family in 1956, Bertie was active financially for 20 years: holding bonds, putting $\frac{1}{3}$ of her funds in a publicly-held mutual fund and trading stocks with some frequency. Her potential remained unnoticed.

Then, in 1980, when 46, and independent of any urgings from her brother, Bertie decided to make her move. Retaining only the mutual fund and Berkshire, she made *no* new trades during the next 43 years. During that period, she became very rich, even after making large philanthropic gifts (think nine figures).

Millions of American investors *could* have followed her reasoning which involved only the common sense she had somehow absorbed as a child in Omaha. And, taking no chances, Bertie returns to Omaha *every* May to be re-energized.

* * * * *

So what is going on? Is it Omaha’s water? Is it Omaha’s air? Is it some strange planetary phenomenon akin to that which has produced Jamaica’s sprinters, Kenya’s marathon runners, or Russia’s chess experts? Must we wait until AI someday yields the answer to this puzzle?

Keep an open mind. Come to Omaha in May, inhale the air, drink the water and say “hi” to Bertie and her good-looking daughters. Who knows? There is no downside, and, in any event, you will have a good time and meet a huge crowd of friendly people.

To top things off, we will have available the new 4th edition of Poor Charlie’s Almanack. Pick up a copy. Charlie’s wisdom will improve your life as it has mine.

February 24, 2024

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
2021	29.6	28.7
2022	4.0	(18.1)
2023	15.8	26.3
Compounded Annual Gain – 1965-2023	19.8%	10.2%
Overall Gain – 1964-2023	4,384,748%	31,223%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

This letter comes to you as part of Berkshire's annual *report*. As a public company, we are required to periodically tell you many specific facts and figures.

"Report," however, implies a greater responsibility. In addition to the mandated data, we believe we owe you additional commentary about what you own and how we think. Our goal is to communicate with you in a manner that we would wish you to use if our positions were reversed – that is, if you were Berkshire's CEO while I and my family were passive investors, trusting *you* with our savings.

This approach leads us to an annual recitation of both good and bad developments at the many businesses you indirectly own through your Berkshire shares. When discussing problems at specific subsidiaries, we do, however, try to follow the advice Tom Murphy gave to me 60 years ago: "praise by name, criticize by category."

Mistakes – Yes, We Make Them at Berkshire

Sometimes I've made mistakes in assessing the future economics of a business I've purchased for Berkshire – each a case of capital allocation gone wrong. That happens with both judgments about marketable equities – we view these as *partial* ownership of businesses – and the 100% acquisitions of companies.

At other times, I've made mistakes when assessing the abilities or fidelity of the managers Berkshire is hiring. The fidelity disappointments can hurt beyond their financial impact, a pain that can approach that of a failed marriage.

A decent batting average in personnel decisions is all that can be hoped for. The cardinal sin is delaying the correction of mistakes or what Charlie Munger called "thumb-sucking." Problems, he would tell me, cannot be wished away. They require action, however uncomfortable that may be.

* * * * *

During the 2019-23 period, I have used the words "mistake" or "error" 16 times in my letters to you. Many other huge companies have *never* used either word over that span. Amazon, I should acknowledge, made some brutally candid observations in its 2021 letter. Elsewhere, it has generally been happy talk and pictures.

I have also been a director of large public companies at which “mistake” or “wrong” were forbidden words at board meetings or analyst calls. That taboo, implying managerial perfection, always made me nervous (though, at times, there could be legal issues that make limited discussion advisable. We live in a very litigious society.)

* * * * *

At 94, it won’t be long before Greg Abel replaces me as CEO and will be writing the annual letters. Greg shares the Berkshire creed that a “report” is what a Berkshire CEO annually owes to owners. And he also understands that if you start fooling your shareholders, you will soon believe your own baloney and be fooling yourself as well.

Pete Liegl – One of a Kind

Let me pause to tell you the remarkable story of Pete Liegl, a man unknown to most Berkshire shareholders but one who contributed many billions to their aggregate wealth. Pete died in November, still working at 80.

I first heard of Forest River – the Indiana company Pete founded and managed – on June 21, 2005. On that day I received a letter from an intermediary detailing relevant data about the company, a recreational vehicle (“RV”) manufacturer. The writer said that Pete, the 100% owner of Forest River, specifically wanted to sell to Berkshire. He also told me the price that Pete expected to receive. I liked this no-nonsense approach.

I did some checking with RV dealers, liked what I learned and arranged a June 28th meeting in Omaha. Pete brought along his wife, Sharon, and daughter, Lisa. When we met, Pete assured me that he wanted to keep running the business but would feel more comfortable if he could assure financial security for his family.

Pete next mentioned that he owned some real estate that was leased to Forest River and had not been covered in the June 21 letter. Within a few minutes, we arrived at a price for those assets as I expressed no need for appraisal by Berkshire but would simply accept his valuation.

Then we arrived at the other point that needed clarity. I asked Pete what his compensation should be, adding that whatever he said, I would accept. (This, I should add, is *not* an approach I recommend for general use.)

Pete paused as his wife, daughter and I leaned forward. Then he surprised us: “Well, I looked at Berkshire’s proxy statement and I wouldn’t want to make more than my boss, so pay me \$100,000 per year.” After I picked myself off the floor, Pete added: “But we will earn X (he named a number) this year, and I would like an annual bonus of 10% of any earnings above what the company is now delivering.” I replied: “OK Pete, but if Forest River makes any significant acquisitions we will make an appropriate adjustment for the additional capital thus employed.” I didn’t define “appropriate” or “significant,” but those vague terms never caused a problem.

The four of us then went to dinner at Omaha's Happy Hollow Club and lived happily ever after. During the next 19 years, Pete shot the lights out. No competitor came close to his performance.

* * * * *

Every company doesn't have an easy-to-understand business and there are *very* few owners or managers like Pete. And, of course, I expect to make my share of mistakes about the businesses Berkshire buys and sometimes err in evaluating the sort of person with whom I'm dealing.

But I've also had many pleasant surprises in both the potential of the business as well as the ability and fidelity of the manager. And our experience is that a *single* winning decision can make a breathtaking difference over time. (Think GEICO as a business decision, Ajit Jain as a managerial decision and my luck in finding Charlie Munger as a one-of-a-kind partner, personal advisor and steadfast friend.) Mistakes fade away; winners can forever blossom.

* * * * *

One further point in our CEO selections: I never look at where a candidate has gone to school. Never!

Of course, there are great managers who attended the most famous schools. But there are plenty such as Pete who may have benefitted by attending a less prestigious institution or even by not bothering to finish school. Look at my friend, Bill Gates, who decided that it was far more important to get underway in an exploding industry that would change the world than it was to stick around for a parchment that he could hang on the wall. (Read his new book, *Source Code*.)

Not long ago, I met – by phone – Jessica Toonkel, whose step-grandfather, Ben Rosner, long ago ran a business for Charlie and me. Ben was a retailing genius and, in preparing for this report, I checked with Jessica to confirm Ben's schooling, which I remembered as limited. Jessica's reply: "Ben never went past 6th grade."

I was lucky enough to get an education at three fine universities. And I avidly believe in lifelong learning. I've observed, however, that a very large portion of business talent is innate with nature swamping nurture.

Pete Liegl was a natural.

Last Year's Performance

In 2024, Berkshire did better than I expected though 53% of our 189 operating businesses reported a *decline* in earnings. We were aided by a predictable large gain in investment income as Treasury Bill yields improved and we substantially increased our holdings of these highly-liquid short-term securities.

Our insurance business also delivered a major increase in earnings, led by the performance of GEICO. In five years, Todd Combs has reshaped GEICO in a major way, increasing efficiency and bringing underwriting practices up to date. GEICO was a long-held gem that needed major repolishing, and Todd has worked tirelessly in getting the job done. Though not yet complete, the 2024 improvement was spectacular.

In general, property-casualty (“P/C”) insurance pricing strengthened during 2024, reflecting a major increase in damage from convective storms. Climate change may have been announcing its arrival. However, no “monster” event occurred during 2024. Someday, *any* day, a truly staggering insurance loss will occur – and there is no guarantee that there will be only one per annum.

The P/C business is so central to Berkshire that it warrants a further discussion that appears later in this letter.

Berkshire’s railroad and utility operations, our two largest businesses outside of insurance, improved their aggregate earnings. Both, however, have much left to accomplish.

Late in the year we increased our ownership of the utility operation from about 92% to 100% at a cost of roughly \$3.9 billion, of which \$2.9 billion was paid in cash with a balance in Berkshire “B” shares.

* * * * *

All told, we recorded *operating earnings* of \$47.4 billion in 2024. We regularly – endlessly, some readers may groan – emphasize this measure rather than the GAAP-mandated earnings that are reported on page K-68.

Our measure excludes capital gains or losses on the stocks and bonds we own, whether realized or unrealized. Over time, we think it highly likely that gains will prevail – why else would we buy these securities? – though the year-by-year numbers will swing wildly and unpredictably. Our horizon for such commitments is almost always far longer than a single year. In many, our thinking involves decades. These long-termers are the purchases that sometimes make the cash register ring like church bells.

Here's a breakdown of the 2023-24 earnings as we see them. All calculations are *after* depreciation, amortization and income tax. EBITDA, a flawed favorite of Wall Street, is not for us.

	(in \$ millions)	
	<u>2024</u>	<u>2023</u>
Insurance-underwriting	\$ 9,020	\$ 5,428
Insurance-investment income	13,670	9,567
BNSF	5,031	5,087
Berkshire Hathaway Energy	3,730	2,331
Other controlled businesses	13,072	13,362
Non-controlled businesses*	1,519	1,750
Other**	1,395	(175)
Operating earnings	<u>\$47,437</u>	<u>\$37,350</u>

* *Includes certain businesses in which Berkshire had between a 20% and 50% ownership such as Kraft Heinz, Occidental Petroleum and Berkadia.*

** *Includes foreign currency exchange gains of approximately \$1.1 billion in 2024 and approximately \$211 million in 2023 produced by our usage of non-U.S. dollar-denominated debt.*

Surprise, Surprise! An Important American Record is Smashed

Sixty years ago, present management took control of Berkshire. That move was a mistake – *my* mistake – and one that plagued us for *two decades*. Charlie, I should emphasize, spotted my obvious error immediately: Though the price I paid for Berkshire *looked* cheap, its business – a large northern textile operation – was headed for extinction.

The U.S. Treasury, of all places, had already received silent warnings of Berkshire's destiny. In 1965, the company did not pay a dime of income tax, an embarrassment that had generally prevailed at the company for *a decade*. That sort of economic behavior may be understandable for glamorous startups, but it's a blinking yellow light when it happens at a venerable pillar of American industry. Berkshire was headed for the ash can.

Fast forward 60 years and imagine the surprise at the Treasury when that same company – still operating under the name of Berkshire Hathaway – paid *far* more in corporate income tax than the U.S. government had *ever* received from *any* company – even the American tech titans that commanded market values in the *trillions*.

To be precise, Berkshire last year made four payments to the IRS that totaled \$26.8 billion. That's about 5% of what *all* of corporate America paid. (In addition, we paid sizable amounts for income taxes to foreign governments and to 44 states.)

Note one crucial factor allowing this record-shattering payment: Berkshire shareholders during the same 1965-2024 period received only one cash dividend. On January 3, 1967, we disbursed our sole payment – \$101,755 or 10¢ per A share. (I can't remember why I suggested this action to Berkshire's board of directors. Now it seems like a bad dream.)

For *sixty years*, Berkshire shareholders endorsed continuous reinvestment and that enabled the company to build its taxable income. Cash income-tax payments to the U.S. Treasury, minuscule in the first decade, now aggregate more than \$101 *billion* . . . and counting.

* * * * *

Huge numbers can be hard to visualize. Let me recast the \$26.8 billion that we paid last year.

If Berkshire had sent the Treasury a \$1 million check *every 20 minutes* throughout all of 2024 – visualize *366 days and nights* because 2024 was a leap year – we still would have owed the federal government a significant sum at yearend. Indeed, it would be well into January before the Treasury would tell us that we could take a short breather, get some sleep, and prepare for our 2025 tax payments.

Where Your Money Is

Berkshire's equity activity is ambidextrous. In one hand we own control of many businesses, holding at least 80% of the investee's shares. Generally, we own 100%. These 189 subsidiaries have similarities to marketable common stocks but are far from identical. The collection is worth many hundreds of billions and includes a few rare gems, many good-but-far-from-fabulous businesses and some laggards that have been disappointments. We own nothing that is a major drag, but we have a number that I should not have purchased.

In the *other* hand, we own a small percentage of a dozen or so very large and highly profitable businesses with household names such as Apple, American Express, Coca-Cola and Moody's. Many of these companies earn very high returns on the net tangible equity required for their operations. At yearend, our partial-ownership holdings were valued at \$272 billion. Understandably, really outstanding businesses are *very* seldom offered in their entirety, but small fractions of these gems can be purchased Monday through Friday on Wall Street and, very occasionally, they sell at bargain prices.

We are impartial in our choice of equity vehicles, investing in either variety based upon where we can best deploy your (and my family's) savings. Often, nothing looks compelling; *very* infrequently we find ourselves knee-deep in opportunities. Greg has vividly shown his ability to act at such times as did Charlie.

With marketable equities, it is easier to change course when I make a mistake.

Berkshire's present size, it should be underscored, *diminishes* this valuable option. We can't come and go on a dime. Sometimes a year or more is required to establish or divest an investment. Additionally, with ownership of minority positions we can't change management if that action is needed or control what is done with capital flows if we are unhappy with the decisions being made.

With controlled companies, we can dictate these decisions, *but* we have far less flexibility in the disposition of mistakes. In reality, Berkshire almost never sells controlled businesses unless we face what we believe to be unending problems. An offset is that some business owners seek out Berkshire because of our steadfast behavior. Occasionally, that can be a decided plus for us.

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Despite what some commentators currently view as an extraordinary cash position at Berkshire, the great majority of your money remains in equities. That preference won't change. While our ownership in *marketable* equities moved downward last year from \$354 billion to \$272 billion, the value of our non-quoted controlled equities increased somewhat and remains *far* greater than the value of the *marketable* portfolio.

Berkshire shareholders can rest assured that we will forever deploy a substantial majority of their money in equities – mostly American equities although many of these will have international operations of significance. Berkshire will *never* prefer ownership of cash-equivalent assets over the ownership of good businesses, whether controlled or only partially owned.

Paper money can see its value evaporate if fiscal folly prevails. In some countries, this reckless practice has become habitual, and, in our country's short history, the U.S. has come close to the edge. Fixed-coupon bonds provide no protection against runaway currency.

Businesses, as well as individuals with desired talents, however, will usually find a way to cope with monetary instability as long as their goods or services are desired by the country's citizenry. So, too, with personal skills. Lacking such assets as athletic excellence, a wonderful voice, medical or legal skills or, for that matter, *any* special talents, I have had to rely on equities throughout my life. In effect, I have depended on the success of American businesses and I will continue to do so.

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One way or another, the sensible – better yet imaginative – deployment of savings by citizens is required to propel an ever-growing societal output of desired goods and services. This system is called capitalism. It has its faults and abuses – in certain respects more egregious now than ever – but it also can work wonders unmatched by other economic systems.

America is Exhibit A. Our country's progress over its mere 235 years of existence could not have been imagined by even the most optimistic colonists in 1789, when the Constitution was adopted and the country's energies were unleashed.

True, our country in its infancy sometimes borrowed abroad to supplement our own savings. But, concurrently, we needed many Americans to consistently save and then needed those savers or other Americans to wisely deploy the capital thus made available. If America had consumed all that it produced, the country would have been spinning its wheels.

The American process has *not* always been pretty – our country has forever had many scoundrels and promoters who seek to take advantage of those who mistakenly trust them with their savings. But even with such malfeasance – which remains in full force today – and also much deployment of capital that eventually floundered because of brutal competition or disruptive innovation, the savings of Americans has delivered a quantity and quality of output beyond the dreams of any colonist.

From a base of only four million people – and despite a brutal internal war early on, pitting one American against another – America changed the world in the blink of a celestial eye.

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In a *very* minor way, Berkshire shareholders have participated in the American miracle by foregoing dividends, thereby electing to reinvest rather than consume. Originally, this reinvestment was tiny, almost meaningless, but over time, it mushroomed, reflecting the mixture of a sustained culture of savings, combined with the magic of long-term compounding.

Berkshire's activities now impact all corners of our country. And we are not finished. Companies die for many reasons but, unlike the fate of humans, old age itself is not lethal. Berkshire today is far more youthful than it was in 1965.

However, as Charlie and I have always acknowledged, Berkshire would not have achieved its results in any locale except America whereas America would have been every bit the success it has been if Berkshire had never existed.

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So thank you, Uncle Sam. Someday your nieces and nephews at Berkshire hope to send you even larger payments than we did in 2024. Spend it wisely. Take care of the many who, for no fault of their own, get the short straws in life. They deserve better. And never forget that we need you to maintain a stable currency and that result *requires* both wisdom and vigilance on your part.

Property-Casualty Insurance

P/C insurance continues to be Berkshire's core business. The industry follows a financial model that is rare – very rare – among giant businesses.

Customarily, companies incur costs for labor, materials, inventories, plant and equipment, etc. *before* – or concurrently with – the sale of their products or services. Consequently, their CEOs have a good fix on knowing the *cost* of their product *before* they sell it. If the selling price is less than its cost, managers soon learn they have a problem. Hemorrhaging cash is hard to ignore.

When writing P/C insurance, we receive payment upfront and *much later* learn what our product has cost us – sometimes a moment of truth that is delayed as much as 30 or more years. (We are still making substantial payments on asbestos exposures that occurred 50 or more years ago.)

This mode of operations has the desirable effect of giving P/C insurers cash before they incur most expenses but carries with it the risk that the company can be losing money – sometimes mountains of money – before the CEO and directors realize what is happening.

Certain lines of insurance minimize this mismatch, such as crop insurance or hail damage in which losses are quickly reported, evaluated and paid. Other lines, however, can lead to executive and shareholder bliss as the company is going broke. Think coverages such as medical malpractice or product liability. In “long-tail” lines, a P/C insurer may report large but fictitious profits to its owners and regulators for many years – even decades. The accounting can be particularly dangerous if the CEO is an optimist or a crook. These possibilities are not fanciful: History reveals a large number of each species.

In recent decades, this “money-up-front, loss-payments-later” model has allowed Berkshire to invest large sums (“float”) while generally delivering what we believe to be a small underwriting profit. We make estimates for “surprises” and, so far, these estimates have been sufficient.

We are not deterred by the dramatic and growing loss payments sustained by our activities. (As I write this, think wildfires.) It’s our job to price to absorb these and unemotionally take our lumps when surprises develop. It’s also our job to contest “runaway” verdicts, spurious litigation and outright fraudulent behavior.

Under Ajit, our insurance operation has blossomed from an obscure Omaha-based company into a world leader, renowned for both its taste for risk and its Gibraltar-like financial strength. Moreover, Greg, our directors and I all have a *very* large investment in Berkshire in relation to any compensation we receive. We do *not* use options or other one-sided forms of compensation; if *you* lose money, so do we. This approach encourages caution but does *not* ensure foresight.

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P/C insurance *growth* is dependent on increased economic risk. No risk – no need for insurance.

Think back only 135 years when the world had no autos, trucks or airplanes. Now there are 300 million vehicles in the U.S. alone, a massive fleet causing huge damage daily. Property damage arising from hurricanes, tornadoes and wildfires is massive, growing and increasingly unpredictable in their patterns and eventual costs.

It would be foolish – make that madness – to write ten-year policies for these coverages, but we believe one-year assumption of such risks is generally manageable. If we change our minds, we will change the contracts we offer. During my lifetime, auto insurers have generally abandoned one-year policies and switched to the six-month variety. This change *reduced* float but allowed more intelligent underwriting.

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No private insurer has the willingness to take on the amount of risk that Berkshire can provide. At times, this advantage can be important. But we also need to *shrink* when prices are inadequate. We must *never* write inadequately-priced policies in order to stay in the game. That policy is corporate suicide.

Properly pricing P/C insurance is part art, part science and is definitely not a business for optimists. Mike Goldberg, the Berkshire executive who recruited Ajit, said it best: “We want our underwriters to daily come to work nervous, but not paralyzed.”

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All things considered, we like the P/C insurance business. Berkshire can financially and psychologically handle extreme losses without blinking. We are also not dependent on reinsurers and that gives us a material and enduring cost advantage. Finally, we have outstanding managers (*no* optimists) and are particularly well-situated to utilize the substantial sums P/C insurance delivers for investment.

Over the past two decades, our insurance business has generated \$32 billion of after-tax profits from underwriting, about 3.3 cents per dollar of sales after income tax. Meanwhile, our float has grown from \$46 billion to \$171 billion. The float is likely to grow a bit over time and, with intelligent underwriting (and some luck), has a reasonable prospect of being costless.

Berkshire Increases its Japanese Investments

A small but important exception to our U.S.-based focus is our growing investment in Japan.

It's been almost six years since Berkshire began purchasing shares in five Japanese companies that very successfully operate in a manner somewhat similar to Berkshire itself. The five are (alphabetically) ITOCHU, Marubeni, Mitsubishi, Mitsui and Sumitomo. Each of these large enterprises, in turn, owns interests in a vast array of businesses, many based in Japan but others that operate throughout the world.

Berkshire made its first purchases involving the five in July 2019. We simply looked at their financial records and were amazed at the low prices of their stocks. As the years have passed, our admiration for these companies has consistently grown. Greg has met many times with them, and I regularly follow their progress. Both of us like their capital deployment, their managements and their attitude in respect to their investors.

Each of the five companies increase dividends when appropriate, they repurchase their shares when it is sensible to do so, and their top managers are far less aggressive in their compensation programs than their U.S. counterparts.

Our holdings of the five are for the very long term, and we are *committed* to supporting their boards of directors. From the start, we also agreed to keep Berkshire's holdings below 10% of each company's shares. But, as we approached this limit, the five companies agreed to moderately relax the ceiling. *Over time*, you will likely see Berkshire's ownership of all five increase somewhat.

At yearend, Berkshire's aggregate cost (in dollars) was \$13.8 billion and the market value of our holdings totaled \$23.5 billion.

Meanwhile, Berkshire has consistently – but *not* pursuant to any formula – increased its yen-denominated borrowings. All are at fixed rates, no “floaters.” Greg and I have *no* view on future foreign exchange rates and therefore seek a position approximating currency-neutrality. We are required, however, under GAAP rules to regularly recognize in our earnings a calculation of any gains or losses in the yen we have borrowed and, at yearend, had included \$2.3 billion of after-tax gains due to dollar strength of which \$850 million occurred in 2024.

I expect that Greg and his eventual successors will be holding this Japanese position for many decades and that Berkshire will find other ways to work productively with the five companies in the future.

We like the current math of our yen-balanced strategy as well. As I write this, the annual dividend income expected from the Japanese investments in 2025 will total about \$812 million and the interest cost of our yen-denominated debt will be about \$135 million.

The Annual Gathering in Omaha

I hope you will join us in Omaha on May 3rd. We are following a somewhat changed schedule this year, but the basics remain the same. Our goal is that you get many of your questions answered, that you connect with friends, and that you leave with a good impression of Omaha. The city looks forward to your visits.

We will have much the same group of volunteers to offer you a wide variety of Berkshire products that will lighten your wallet and brighten your day. As usual, we will be open on Friday from noon until 5 p.m. with lovable Squishmallows, underwear from Fruit of the Loom, Brooks running shoes and a host of other items to tempt you.

Again, we will have only one book for sale. Last year we featured *Poor Charlie's Almanack* and sold out – 5,000 copies disappeared before the close of business on Saturday.

This year we will offer *60 Years of Berkshire Hathaway*. In 2015, I asked Carrie Sova, who among her many duties managed much of the activity at the annual meeting, to try her hand at putting together a light-hearted history of Berkshire. I gave her full reign to use her imagination, and she quickly produced a book that blew me away with its ingenuity, contents and design.

Subsequently, Carrie left Berkshire to raise a family and now has three children. But each summer, the Berkshire office force gets together to watch the Omaha Storm Chasers play baseball against a Triple A opponent. I ask a few alums to join us, and Carrie usually comes with her family. At this year's event, I brazenly asked her if she would do a 60th Anniversary issue, featuring Charlie's photos, quotes and stories that have seldom been made public.

Even with three young children to manage, Carrie immediately said "yes." Consequently, we will have 5,000 copies of the new book available for sale on Friday afternoon and from 7 a.m. to 4 p.m. on Saturday.

Carrie refused any payment for her extensive work on the new "Charlie" edition. I suggested she and I co-sign 20 copies to be given to any shareholder contributing \$5,000 to the Stephen Center that serves homeless adults and children in South Omaha. The Kizer family, beginning with Bill Kizer, Sr., my long-time friend and Carrie's grandfather, have for decades been assisting this worthy institution. Whatever is raised through the sale of the 20 autographed books, I will match.

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Becky Quick will cover our somewhat re-engineered gathering on Saturday. Becky knows Berkshire like a book and always arranges interesting interviews with managers, investors, shareholders and an occasional celebrity. She and her CNBC crew do a great job of both transmitting our meetings worldwide and archiving much Berkshire-related material. Give our director, Steve Burke, credit for the archive idea.

We will not have a movie this year but rather will convene a bit earlier at 8 a.m. I will make a few introductory remarks, and we will promptly get to the Q&A, alternating questions between Becky and the audience.

Greg and Ajit will join me in answering questions and we will take a half-hour break at 10:30 a.m. When we reconvene at 11:00 a.m., only Greg will join me on stage. This year we will disband at 1:00 p.m. but stay open for shopping in the exhibit area until 4:00 p.m.

You can find the full details regarding weekend activities on page 16. Note particularly the always-popular Brooks run on Sunday morning. (I will be sleeping.)

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My wise and good-looking sister, Bertie, of whom I wrote last year, will be attending the meeting along with two of her daughters, both good-looking as well. Observers all agree that the genes producing this dazzling result flow down *only* the female side of the family. (Sob.)

Bertie is now 91 and we talk regularly on Sundays using old-fashion telephones for communications. We cover the joys of old age and discuss such exciting topics as the relative merits of our canes. In my case, the utility is limited to the avoidance of falling flat on my face.

But Bertie regularly one-ups me by asserting that she enjoys an additional benefit: When a woman uses a cane, she tells me, men quit “hitting” on her. Bertie’s explanation is that the male ego is such that little old ladies with canes simply aren’t an appropriate target. Presently, I have no data to counter her assertion.

But I have suspicions. At the meeting I can’t see much from the stage, and I would appreciate it if attendees would keep an eye on Bertie. Let me know if the cane is really doing its job. My bet is that she will be *surrounded* by males. For those of a certain age, the scene will bring back memories of Scarlett O’Hara and her horde of male admirers in *Gone with the Wind*.

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The Berkshire directors and I immensely enjoy having you come to Omaha, and I predict that you will have a good time and likely make some new friends.

February 22, 2025

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	49.5%	10.0%
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change	
	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1995	57.4%	37.6%
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
2021	29.6	28.7
2022	4.0	(18.1)
2023	15.8	26.3
2024	25.5	25.0
Compounded Annual Gain – 1965-2024	19.9%	10.4%
Overall Gain – 1964-2024	5,502,284%	39,054%