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.*

* 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.

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).

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.

Year	*Per-Share Investments*	*Years*	*Compounded Annual Gain in Per-Share Investments*
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.

Year	*Per Share Pre-Tax Earnings*	*Years*	*Compounded Annual Gain in Per-Share Pre-Tax Earnings*
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."

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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 stockmarket 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.

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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."

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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:

Year	*Underwriting Profit (Loss)*	*Float*
	(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:

Year	*Underwriting Profit (Loss)*	*Float*
	(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.

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2007*	*2006*	*2007*	*2006*
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	279	340*	4,229	4,029*
	$3,374	$3,838	$58,698	$50,887

* 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:

	Earnings (in millions)	
	2007	*2006*
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)	130	245
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	(477)	(426)
Net earnings	$ 1,189	$ 916
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)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 2,080	Notes payable	$ 1,278
Accounts and notes receivable	4,488	Other current liabilities	7,652
Inventory	5,793	Total current liabilities	8,930
Other current assets	470		
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	1,685	Equity	25,485
	$38,322		$38,322

Earnings Statement (in millions)

	2007	*2006*	*2005*
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	127	132	83
Pre-tax earnings	3,947*	3,526*	2,623*
Income taxes and minority interests	1,594	1,395	977
Net income	$ 2,353	$ 2,131	$ 1,646

*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.

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

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.

			12/31/07	
Shares	*Company*	*Percentage of Company Owned*	*Cost**	*Market*
			(in millions)	
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		5,238	7,633
	Total Common Stocks		$39,252	$74,999

*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.

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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.)

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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.

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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 understate 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.”

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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 194,300square-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 1,550square-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 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.*

* 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.

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.

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:

	Earnings (in millions)	
	2008	2007
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	$ 1,850	$ 1,189
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.

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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.

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*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
	$2,792	$3,374	$58,488	$58,698

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)

Assets		*Liabilities and Equity*	
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	752		
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	1,248	Equity	30,779
	$49,897		$49,897

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	$ 2,283	$ 2,353	$ 2,131

*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.

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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.

	Pre-Tax Earnings (in millions)	
	2008	*2007*
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	$787	$1,006

*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.

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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.

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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.

			12/31/08	
Shares	*Company*	*Percentage of Company Owned*	*Cost**	*Market*
			(in millions)	
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 2⅓ 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.

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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-squarefoot 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 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.*

* 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'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.

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.

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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.

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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.

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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.

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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:

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2009*	*2008*	*2009*	*2008*
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
	$1,559	$2,792	$61,911	$58,488

****

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:

	Earnings (in millions)	
	2009	*2008*
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	$ 1,157	$ 1,850
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 cyclicality. 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)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 3,018	Notes payable	$ 1,842
Accounts and notes receivable	5,066	Other current liabilities	7,414
Inventory	6,147	Total current liabilities	9,256
Other current assets	625		
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	2,070	Equity	30,469
	$48,799		$48,799

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	98	139	127
Pre-tax earnings	2,058*	4,023*	3,947*
Income taxes and minority interests	945	1,740	1,594
Net income	$ 1,113	$ 2,283	$ 2,353

*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:

COMPANY	*CEO*
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 cohabitate, 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 5¼%. 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.

	Pre-Tax Earnings (in millions)	
	2009	*2008*
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	$781	$787

*Includes $116 million in 2009 and $92 million in 2008 of fees that Berkshire charges Clayton for the use of Berkshire's credit.

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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.

		12/31/09		
Shares	*Company*	*Percentage of Company Owned*	*Cost **	*Market*
			(in millions)	
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		$34,646	$59,034

*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.

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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:

Quarter	$ Gain (Loss) in Billions
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.

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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 1¼ 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.

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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."

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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-squarefoot 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 Berkyville 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.

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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 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.*

* 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 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.

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)	Annual Percentage Change 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

Yearend	*Per-Share Investments*	*Period*	*Compounded Annual Increase in Per-Share Investments*
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.

Year	*Per-Share Pre-Tax Earnings*	*Period*	*Compounded Annual Increase in Per-Share Pre-Tax Earnings*
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.

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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 (reproduced at the end of this letter) 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).

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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:

Yearend	Float (in $ millions)
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.

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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.

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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.

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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:

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2010*	*2009*	*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
	$2,013	$1,460	$65,832	$63,441

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)

Assets		*Liabilities and Equity*	
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
	$51,146		$51,146

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	$ 2,462	$ 1,113	$ 2,283

*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:

MidAmerican	*Earnings (in millions)*	
	2010	*2009*
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	$1,238	$1,157
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)*	*(in millions)*	
	2010	*2009*
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

Year	*Net Losses as a Percentage of Average Loans*
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.

Shares	Company	12/31/10 Percentage of Company Owned	Cost *	Market
			(in millions)	
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		$33,733	$61,513

*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.

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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 wellbeing. (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.

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-squarefoot 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 72^{nd} 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 anyplace. To obtain the Berkshire discount, you must make your purchases between Tuesday, April 26^{th} and Monday, May 2^{nd} 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 from6p.m.to9p.m.onFriday,April 29^{th}. The second, the main gala, will be held on Sunday, May 1^{st} , 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 25^{th} through Saturday, May 7^{th}. 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 14,097page 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.

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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 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.*

* 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.

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.
- 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:

Year	*Float (in $ millions)*
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 fa*r* 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 w*e* would pay to purchase float o*f* simila*r* qualit*y* — 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 no*t* 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.

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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 almostimpossible-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.)

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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, 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:

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2011*	*2010*	*2011*	*2010*
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
	$ 248	$2,013	$70,571	$65,832

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:

MidAmerican	*Earnings (in millions)*	
	2011	*2010*
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	$1,331	$1,238
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.

BNSF *(Historical accounting through 2/12/10; purchase accounting subsequently)*	*(in millions)*	
	2011	*2010*
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)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 4,241	Notes payable	$ 1,611
Accounts and notes receivable	6,584	Other current liabilities	15,124
Inventory	8,975	Total current liabilities	16,735
Other current assets	631		
Total current assets	20,431		
		Deferred taxes	4,661
Goodwill and other intangibles	24,755	Term debt and other liabilities	6,214
Fixed assets	17,866	Non-controlling interests	2,410
Other assets	3,661	Berkshire equity	36,693
	$66,713		$66,713

Earnings Statement (in millions)

	*2011***	*2010*	*2009*
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	130	111	98
Pre-tax earnings	5,037*	4,274*	2,058*
Income taxes and non-controlling interests	1,998	1,812	945
Net earnings	$ 3,039	$ 2,462	$ 1,113

*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.

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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.

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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	
Shares	*Company*	*Percentage of Company Owned*	*Cost**	*Market*
			(in millions)	
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		$48,209	$76,991

*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.

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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 from10a.m.to9p.m.MondaythroughSaturday,and10a.m.to6p.m.onSunday.On Saturdaythisyear,from5:30p.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.

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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 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 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.*

* 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.

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 mangers 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.

  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.

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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.

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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:

Year	*Float (in $ millions)*
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* —tobe 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.

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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.

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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 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.)

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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 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.

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2012*	*2011*	*2012*	*2011*
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
	$1,625	$ 248	$73,125	$70,571

*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:

MidAmerican (89.8% owned)	Earnings (in millions) 2012	2011
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	$ 1,472	$ 1,331
Earnings applicable to Berkshire	$ 1,323	$ 1,204

BNSF	Earnings (in millions) 2012	2011
Revenues	$20,835	$19,548
Operating expenses	14,835	14,247
Operating earnings before interest and taxes	6,000	5,301
Interest (net)	623	560
Income taxes	2,005	1,769
Net earnings	$ 3,372	$ 2,972

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)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 5,338	Notes payable	$ 1,454
Accounts and notes receivable	7,382	Other current liabilities	8,527
Inventory	9,675	Total current liabilities	9,981
Other current assets	734		
Total current assets	23,129		
		Deferred taxes	4,907
Goodwill and other intangibles	26,017	Term debt and other liabilities	5,826
Fixed assets	18,871	Non-controlling interests	2,062
Other assets	3,416	Berkshire equity	48,657
	$71,433		$71,433

Earnings Statement (in millions)

	2012	*2011**	*2010*
Revenues	$83,255	$72,406	$66,610
Operating expenses	76,978	67,239	62,225
Interest expense	146	130	111
Pre-tax earnings	6,131	5,037	4,274
Income taxes and non-controlling interests	2,432	1,998	1,812
Net earnings	$ 3,699	$ 3,039	$ 2,462

*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:

	2012		2011
		(in millions)	
Berkadia	$ 35		$ 25
Clayton	255		154
CORT	42		29
XTRA	106		126
Net financial income*	410		440
	$848		$774

*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.

Shares	Company	Percentage of Company Owned	12/31/12 Cost*	Market
			(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		7,646	11,330
	Total Common Stocks Carried at Market		$49,796	$87,662

*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.

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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 off-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 fattest."

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.

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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 4¼%ofmyBerkshire 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 4½% 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 *Unbeatable*. 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 6p.m.to9p.m.onFriday,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.

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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 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