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

Year	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	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	0.7
1998	48.3	28.6	19.7
1999	0.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(0.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
2010	13.0	15.1	(2.1)
2011	4.6	2.1	2.5
2012	14.4	16.0	(1.6)
Compounded Annual Gain – 1965-2012	19.7%	9.4%	10.3
Overall Gain – 1964-2012	586,817%	7,433%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

In 2012, Berkshire achieved a total gain for its shareholders of $24.1 billion. We used $1.3 billion of that to repurchase our stock, which left us with an increase in net worth of $22.8 billion for the year. The per-share book value of both our Class A and Class B stock increased by 14.4%. Over the last 48 years (that is, since present management took over), book value has grown from $19 to $114,214, a rate of 19.7% compounded annually.*

A number of good things happened at Berkshire last year, but let's first get the bad news out of the way.

- When the partnership I ran took control of Berkshire in 1965, I could never have dreamed that a year in which we had a gain of $24.1 billion would be subpar, in terms of the comparison we present on the facing page.

  But subpar it was. For the ninth time in 48 years, Berkshire's percentage increase in book value was less than the S&P's percentage gain (a calculation that includes dividends as well as price appreciation). In eight of those nine years, it should be noted, the S&P had a gain of 15% or more. We do better when the wind is in our face.

  To date, we've never had a five-year period of underperformance, having managed 43 times to surpass the S&P over such a stretch. (The record is on page 103.) But the S&P has now had gains in each of the last four years, outpacing us over that period. If the market continues to advance in 2013, our streak of five-year wins will end.

  One thing of which you can be certain: Whatever Berkshire's results, my partner Charlie Munger, the company's Vice Chairman, and I will not change yardsticks. It's our *job* to increase intrinsic business value – for which we use book value as a *significantly understated* proxy – at a faster rate than the market gains of the S&P. If we do so, Berkshire's share price, though unpredictable from year to year, will itself outpace the S&P over time. If we fail, however, our management will bring no value to our investors, who themselves can earn S&P returns by buying a low-cost index fund.

  Charlie and I believe the gain in Berkshire's intrinsic value will over time likely surpass the S&P returns by a small margin. We're confident of that because we have some outstanding businesses, a cadre of terrific operating managers and a shareholder-oriented culture. Our relative performance, however, is almost certain to be better when the market is down or flat. In years when the market is particularly strong, expect us to fall short.

- The second disappointment in 2012 was my inability to make a major acquisition. I pursued a couple of elephants, but came up empty-handed.

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* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

Our luck, however, changed early this year. In February, we agreed to buy 50% of a holding company that will own all of H. J. Heinz. The other half will be owned by a small group of investors led by Jorge Paulo Lemann, a renowned Brazilian businessman and philanthropist.

We couldn't be in better company. Jorge Paulo is a long-time friend of mine and an extraordinary manager. His group and Berkshire will each contribute about $4 billion for common equity in the holding company. Berkshire will also invest $8 billion in preferred shares that pay a 9% dividend. The preferred has two other features that materially increase its value: at some point it will be redeemed at a significant premium price and the preferred also comes with warrants permitting us to buy 5% of the holding company's common stock for a nominal sum.

Our total investment of about $12 billion soaks up much of what Berkshire earned last year. But we still have plenty of cash and are generating more at a good clip. So it's back to work; Charlie and I have again donned our safari outfits and resumed our search for elephants.

Now to some good news from 2012:

- Last year I told you that BNSF, Iscar, Lubrizol, Marmon Group and MidAmerican Energy – our five most profitable non-insurance companies – were likely to earn more than $10 billion pre-tax in 2012. They delivered. Despite tepid U.S. growth and weakening economies throughout much of the world, our "powerhouse five" had aggregate earnings of $10.1 billion, about $600 million more than in 2011.

  Of this group, only MidAmerican, then earning $393 million pre-tax, was owned by Berkshire eight years ago. Subsequently, we purchased another three of the five on an all-cash basis. In acquiring the fifth, BNSF, we paid about 70% of the cost in cash, and for the remainder, issued shares that increased the amount outstanding by 6.1%. Consequently, the $9.7 billion gain in annual earnings delivered Berkshire by the five companies has been accompanied by only minor dilution. That satisfies our goal of not simply growing, but rather increasing *per-share* results.

  Unless the U.S. economy tanks – which we don't expect – our powerhouse five should again deliver higher earnings in 2013. The five outstanding CEOs who run them will see to that.

- Though I failed to land a major acquisition in 2012, the managers of our subsidiaries did far better. We had a record year for "bolt-on" purchases, spending about $2.3 billion for 26 companies that were melded into our existing businesses. These transactions were completed without Berkshire issuing *any* shares.

  Charlie and I love these acquisitions: Usually they are low-risk, burden headquarters not at all, and expand the scope of our proven managers.

- Our insurance operations shot the lights out last year. While giving Berkshire $73 billion of *free* money to invest, they also delivered a $1.6 billion underwriting gain, the tenth consecutive year of profitable underwriting. This is truly having your cake and eating it too.

  GEICO led the way, continuing to gobble up market share without sacrificing underwriting discipline. Since 1995, when we obtained control, GEICO's share of the personal-auto market has grown from 2.5% to 9.7%. Premium volume meanwhile increased from $2.8 billion to $16.7 billion. Much more growth lies ahead.

  The credit for GEICO's extraordinary performance goes to Tony Nicely and his 27,000 associates. And to that cast, we should add our Gecko. Neither rain nor storm nor gloom of night can stop him; the little lizard just soldiers on, telling Americans how they can save big money by going to GEICO.com.

  When I count my blessings, I count GEICO twice.

- Todd Combs and Ted Weschler, our new investment managers, have proved to be smart, models of integrity, helpful to Berkshire in many ways beyond portfolio management, and a perfect cultural fit. We hit the jackpot with these two. In 2012 each outperformed the S&P 500 by double-digit margins. They left me in the dust as well.

  Consequently, we have increased the funds managed by each to almost $5 billion (some of this emanating from the pension funds of our subsidiaries). Todd and Ted are young and will be around to manage Berkshire's massive portfolio long after Charlie and I have left the scene. You can rest easy when they take over.

- Berkshire's yearend employment totaled a record 288,462 (see page 106 for details), up 17,604 from last year. Our headquarters crew, however, remained unchanged at 24. No sense going crazy.

- Berkshire's "Big Four" investments – American Express, Coca-Cola, IBM and Wells Fargo – all had good years. Our ownership interest in each of these companies increased during the year. We purchased additional shares of Wells Fargo (our ownership now is 8.7% versus 7.6% at yearend 2011) and IBM (6.0% versus 5.5%). Meanwhile, stock repurchases at Coca-Cola and American Express raised our percentage ownership. Our equity in Coca-Cola grew from 8.8% to 8.9% and our interest at American Express from 13.0% to 13.7%.

  Berkshire's ownership interest in all four companies is likely to increase in the future. Mae West had it right: "Too much of a good thing can be wonderful."

  The four companies possess marvelous businesses and are run by managers who are both talented and shareholder-oriented. At Berkshire we much prefer owning a non-controlling but substantial portion of a wonderful business to owning 100% of a so-so business. Our flexibility in capital allocation gives us a significant advantage over companies that limit themselves only to acquisitions they can operate.

  Going by our yearend share count, our portion of the "Big Four's" 2012 earnings amounted to $3.9 billion. In the earnings we report to you, however, we include only the dividends we receive – about $1.1 billion. But make no mistake: The $2.8 billion of earnings we do not report is every bit as valuable to us as what we record.

  The earnings that the four companies retain are often used for repurchases – which enhance our share of future earnings – and also for funding business opportunities that are usually advantageous. Over time we expect substantially greater earnings from these four investees. If we are correct, dividends to Berkshire will increase and, even more important, so will our unrealized capital gains (which, for the four, totaled $26.7 billion at yearend).

- There was a lot of hand-wringing last year among CEOs who cried "uncertainty" when faced with capital-allocation decisions (despite many of their businesses having enjoyed record levels of both earnings and cash). At Berkshire, we didn't share their fears, instead spending a record $9.8 billion on plant and equipment in 2012, about 88% of it in the United States. That's 19% more than we spent in 2011, our previous high. Charlie and I love investing large sums in worthwhile projects, whatever the pundits are saying. We instead heed the words from Gary Allan's new country song, "Every Storm Runs Out of Rain."

  We will keep our foot to the floor and will almost certainly set still another record for capital expenditures in 2013. Opportunities abound in America.

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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* – to be far in excess of its historic carrying value. The value of our float is one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

Let me emphasize once again that cost-free float is *not* an outcome to be expected for the P/C industry as a whole: There is very little "Berkshire-quality" float existing in the insurance world. In 37 of the 45 years ending in 2011, the industry's premiums have been inadequate to cover claims plus expenses. Consequently, the industry's overall return on tangible equity has for many decades fallen far short of the average return realized by American industry, a sorry performance almost certain to continue.

A further unpleasant reality adds to the industry's dim prospects: Insurance earnings are now benefitting from "legacy" bond portfolios that deliver much higher yields than will be available when funds are reinvested during the next few years – and perhaps for many years beyond that. Today's bond portfolios are, in effect, wasting assets. Earnings of insurers will be hurt in a significant way as bonds mature and are rolled over.

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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.

			12/31/12	
Shares	*Company*	*Percentage of Company Owned*	*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 oft-stated size requirements for acquisitions.

We can address the second point easily. Charlie and I love newspapers and, *if their economics make sense*, will buy them even when they fall far short of the size threshold we would require for the purchase of, say, a widget company. Addressing the first point requires me to provide a more elaborate explanation, including some history.

News, to put it simply, is what people don't know that they want to know. And people will seek their news – what's important to *them* – from whatever sources provide the best combination of immediacy, ease of access, reliability, comprehensiveness and low cost. The relative importance of these factors varies with the nature of the news and the person wanting it.

Before television and the Internet, newspapers were the *primary* source for an incredible variety of news, a fact that made them indispensable to a very high percentage of the population. Whether your interests were international, national, local, sports or financial quotations, your newspaper usually was first to tell you the latest information. Indeed, your paper contained so much you wanted to learn that you received your money's worth, even if only a small number of its pages spoke to your specific interests. Better yet, advertisers typically paid almost all of the product's cost, and readers rode their coattails.

Additionally, the ads themselves delivered information of vital interest to hordes of readers, in effect providing even more "news." Editors would cringe at the thought, but for many readers learning what jobs or apartments were available, what supermarkets were carrying which weekend specials, or what movies were showing where and when was far more important than the views expressed on the editorial page.

In turn, the local paper was indispensable to advertisers. If Sears or Safeway built stores in Omaha, they required a "megaphone" to tell the city's residents why their stores should be visited *today*. Indeed, big department stores and grocers vied to outshout their competition with multi-page spreads, knowing that the goods they advertised would fly off the shelves. With no other megaphone remotely comparable to that of the newspaper, ads sold themselves.

As long as a newspaper was the only one in its community, its profits were certain to be extraordinary; whether it was managed well or poorly made little difference. (As one Southern publisher famously confessed, "I owe my exalted position in life to two great American institutions – nepotism and monopoly.")

Over the years, almost all cities became one-newspaper towns (or harbored two competing papers that joined forces to operate as a single economic unit). This contraction was inevitable because most people wished to read and pay for only one paper. When competition existed, the paper that gained a significant lead in circulation almost automatically received the most ads. That left ads drawing readers and readers drawing ads. This symbiotic process spelled doom for the weaker paper and became known as "survival of the 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% of my Berkshire shares. Through this process, my original position of 712,497,000 B-equivalent shares (split-adjusted) has decreased to 528,525,623 shares. Clearly my ownership *percentage* of the company has significantly decreased.

Yet my investment in the business has actually increased: The book value of my current interest in Berkshire considerably exceeds the book value attributable to my holdings of seven years ago. (The actual figures are $28.2 billion for 2005 and $40.2 billion for 2012.) In other words, I now have *far* more money working for me at Berkshire even though my ownership of the company has materially decreased. It's also true that my share of both Berkshire's intrinsic business value and the company's normal earning power is far greater than it was in 2005. Over time, I expect this accretion of value to continue – albeit in a decidedly irregular fashion – even as I now annually give away more than 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 6 p.m. to 9 p.m. on Friday, May 3rd. The second, the main gala, will be held on Sunday, May 5th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m. In recent years, our three-day volume has far exceeded sales in all of December, normally a jeweler's best month.

Around 1 p.m. on Sunday, I will begin clerking at Borsheims. Last year my sales totaled $1.5 million. This year I won't quit until I hit $2 million. Because I need to leave well before sundown, I will be desperate to do business. Come take advantage of me. Ask for my "Crazy Warren" price.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 29th through Saturday, May 11th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Don't play them for money.

Gorat's and Piccolo's will again be open exclusively for Berkshire shareholders on Sunday, May 5th. Both will be serving until 10 p.m., with Gorat's opening at 1 p.m. and Piccolo's opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*) and at Piccolo's call 402-342-9038. At Piccolo's, order a giant root beer float for dessert. Only sissies get the small one. (I once saw Bill Gates polish off two of the giant variety *after* a full-course dinner; that's when I knew he would make a great director.)

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be emailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any email you send them. (In your email, let the journalist know if you would like your name mentioned if your question is selected.)

Last year we had a second panel of three analysts who follow Berkshire. All were insurance specialists, and shareholders subsequently indicated they wanted a little more variety. Therefore, this year we will have one insurance analyst, Cliff Gallant of Nomura Securities. Jonathan Brandt of Ruane, Cunniff & Goldfarb will join the analyst panel to ask questions that deal with our non-insurance operations.

Finally – to spice things up – we would like to add to the panel a credentialed bear on Berkshire, preferably one who is short the stock. Not yet having a bear identified, we would like to hear from applicants. The only requirement is that you be an investment professional and negative on Berkshire. The three analysts will bring their own Berkshire-specific questions and alternate with the journalists and the audience in asking them.

Charlie and I believe that all shareholders should have access to new Berkshire information simultaneously and should also have adequate time to analyze it, which is why we try to issue financial information after the market close on a Friday and why our annual meeting is held on Saturdays. We do not talk one-on-one to large institutional investors or analysts. Our hope is that the journalists and analysts will ask questions that will further educate shareholders about their investment.

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists and analysts will come up with some tough ones, and that's the way we like it. All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and 18 from the audience. If there is some extra time, we will take more from the audience. Audience questioners will be determined by drawings that will take place at 8:15 a.m. at each of the 11 microphones located in the arena and main overflow room.

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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

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

	Annual Percentage Change		
Year	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	0.7
1998	48.3	28.6	19.7
1999	0.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(0.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
2010	13.0	15.1	(2.1)
2011	4.6	2.1	2.5
2012	14.4	16.0	(1.6)
2013	18.2	32.4	(14.2)
Compounded Annual Gain – 1965-2013	19.7%	9.8%	9.9
Overall Gain – 1964-2013	693,518%	9,841%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2013 was $34.2 billion. That gain was *after* our deducting $1.8 billion of charges – meaningless economically, as I will explain later – that arose from our purchase of the minority interests in Marmon and Iscar. After those charges, the per-share book value of both our Class A and Class B stock increased by 18.2%. Over the last 49 years (that is, since present management took over), book value has grown from $19 to $134,973, a rate of 19.7% compounded annually.*

On the facing page, we show our long-standing performance measurement: The yearly change in Berkshire's per-share book value versus the market performance of the S&P 500. What counts, of course, is per-share *intrinsic* value. But that's a subjective figure, and book value is useful as a rough tracking indicator. (An extended discussion of intrinsic value is included in our Owner-Related Business Principles on pages 103 - 108. Those principles have been included in our reports for 30 years, and we urge new and prospective shareholders to read them.)

As I've long told you, Berkshire's intrinsic value far exceeds its book value. Moreover, the difference has widened considerably in recent years. That's why our 2012 decision to authorize the repurchase of shares at 120% of book value made sense. Purchases at that level benefit continuing shareholders because per-share intrinsic value exceeds that percentage of book value by a meaningful amount. We did not purchase shares during 2013, however, because the stock price did not descend to the 120% level. If it does, we will be aggressive.

Charlie Munger, Berkshire's vice chairman and my partner, and I believe both Berkshire's book value and intrinsic value will outperform the S&P in years when the market is down or moderately up. We expect to fall short, though, in years when the market is strong – as we did in 2013. We have underperformed in ten of our 49 years, with all but one of our shortfalls occurring when the S&P gain exceeded 15%.

Over the stock market cycle between yearends 2007 and 2013, we overperformed the S&P. Through full cycles in future years, we expect to do that again. If we fail to do so, we will not have earned our pay. After all, you could always own an index fund and be assured of S&P results.

The Year at Berkshire

On the operating front, just about everything turned out well for us last year – in certain cases *very* well. Let me count the ways:

- We completed two large acquisitions, spending almost $18 billion to purchase all of NV Energy and a major interest in H. J. Heinz. Both companies fit us well and will be prospering a century from now.

  With the Heinz purchase, moreover, we created a partnership template that may be used by Berkshire in future acquisitions of size. Here, we teamed up with investors at 3G Capital, a firm led by my friend, Jorge Paulo Lemann. His talented associates – Bernardo Hees, Heinz's new CEO, and Alex Behring, its Chairman – are responsible for operations.

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* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

Berkshire is the financing partner. In that role, we purchased $8 billion of Heinz preferred stock that carries a 9% coupon but also possesses other features that should increase the preferred's annual return to 12% or so. Berkshire and 3G each purchased half of the Heinz common stock for $4.25 billion.

Though the Heinz acquisition has some similarities to a "private equity" transaction, there is a crucial difference: Berkshire never intends to sell a share of the company. What we would like, rather, is to buy more, and that could happen: Certain 3G investors may sell some or all of their shares in the future, and we might increase our ownership at such times. Berkshire and 3G could also decide at some point that it would be mutually beneficial if we were to exchange some of our preferred for common shares (at an equity valuation appropriate to the time).

Our partnership took control of Heinz in June, and operating results so far are encouraging. Only minor earnings from Heinz, however, are reflected in those we report for Berkshire this year: One-time charges incurred in the purchase and subsequent restructuring of operations totaled $1.3 billion. Earnings in 2014 will be substantial.

With Heinz, Berkshire now owns 8½ companies that, were they stand-alone businesses, would be in the Fortune 500. Only 491½ to go.

NV Energy, purchased for $5.6 billion by MidAmerican Energy, our utility subsidiary, supplies electricity to about 88% of Nevada's population. This acquisition fits nicely into our existing electric-utility operation and offers many possibilities for large investments in renewable energy. NV Energy will *not* be MidAmerican's last major acquisition.

- MidAmerican is one of our "Powerhouse Five" – a collection of large non-insurance businesses that, in aggregate, had a record $10.8 billion of pre-tax earnings in 2013, up $758 million from 2012. The other companies in this sainted group are BNSF, Iscar, Lubrizol and Marmon.

  Of the five, only MidAmerican, then earning $393 million pre-tax, was owned by Berkshire nine years ago. Subsequently, we purchased another three of the five on an all-cash basis. In acquiring the fifth, BNSF, we paid about 70% of the cost in cash, and, for the remainder, issued shares that increased the number outstanding by 6.1%. In other words, the $10.4 billion gain in annual earnings delivered Berkshire by the five companies over the nine-year span has been accompanied by only minor dilution. That satisfies our goal of not simply growing, but rather increasing *per-share* results.

  If the U.S. economy continues to improve in 2014, we can expect earnings of our Powerhouse Five to improve also – perhaps by $1 billion or so pre-tax.

- Our many dozens of smaller non-insurance businesses earned $4.7 billion pre-tax last year, up from $3.9 billion in 2012. Here, too, we expect further gains in 2014.

- Berkshire's extensive insurance operation again operated at an underwriting profit in 2013 – that makes 11 years in a row – and increased its float. During that 11-year stretch, our float – money that doesn't belong to us but that we can invest for Berkshire's benefit – has grown from $41 billion to $77 billion. Concurrently, our underwriting profit has aggregated $22 billion pre-tax, including $3 billion realized in 2013. And all of this all began with our 1967 purchase of National Indemnity for $8.6 *million*.

  We now own a wide variety of exceptional insurance operations. Best known is GEICO, the car insurer Berkshire acquired in full at yearend 1995 (having for many years prior owned a partial interest). GEICO in 1996 ranked number seven among U.S. auto insurers. Now, GEICO is number two, having recently passed Allstate. The reasons for this amazing growth are simple: low prices and reliable service. You can do yourself a favor by calling 1-800-847-7536 or checking Geico.com to see if you, too, can cut your insurance costs. Buy some of Berkshire's other products with the savings.

- While Charlie and I search for elephants, our many subsidiaries are regularly making bolt-on acquisitions. Last year, we contracted for 25 of these, scheduled to cost $3.1 billion in aggregate. These transactions ranged from $1.9 million to $1.1 billion in size.

  Charlie and I encourage these deals. They deploy capital in activities that fit with our existing businesses and that will be managed by our corps of expert managers. The result is no more work for us and more earnings for you. Many more of these bolt-on deals will be made in future years. In aggregate, they will be meaningful.

- Last year we invested $3.5 billion in the surest sort of bolt-on: the purchase of additional shares in two wonderful businesses that we already controlled. In one case – Marmon – our purchases brought us to the 100% ownership we had signed up for in 2008. In the other instance – Iscar – the Wertheimer family elected to exercise a put option it held, selling us the 20% of the business it retained when we bought control in 2006.

  These purchases added about $300 million pre-tax to our current earning power and also delivered us $800 million of cash. Meanwhile, the same nonsensical accounting rule that I described in last year's letter required that we enter these purchases on our books at $1.8 billion less than we paid, a process that reduced Berkshire's book value. (The charge was made to "capital in excess of par value"; figure *that* one out.) This weird accounting, you should understand, instantly increased Berkshire's excess of intrinsic value over book value by the same $1.8 billion.

- Our subsidiaries spent a record $11 billion on plant and equipment during 2013, roughly twice our depreciation charge. About 89% of that money was spent in the United States. Though we invest abroad as well, the mother lode of opportunity resides in America.

- In a year in which most equity managers found it impossible to outperform the S&P 500, both Todd Combs and Ted Weschler handily did so. Each now runs a portfolio exceeding $7 billion. They've earned it.

  I must again confess that their investments outperformed mine. (Charlie says I should add "by a lot.") If such humiliating comparisons continue, I'll have no choice but to cease talking about them.

  Todd and Ted have also created significant value for you in several matters unrelated to their portfolio activities. Their contributions are just beginning: Both men have Berkshire blood in their veins.

- Berkshire's yearend employment – counting Heinz – totaled a record 330,745, up 42,283 from last year. The increase, I must admit, included one person at our Omaha home office. (Don't panic: The headquarters gang still fits comfortably on one floor.)

- Berkshire increased its ownership interest last year in each of its "Big Four" investments – American Express, Coca-Cola, IBM and Wells Fargo. We purchased additional shares of Wells Fargo (increasing our ownership to 9.2% versus 8.7% at yearend 2012) and IBM (6.3% versus 6.0%). Meanwhile, stock repurchases at Coca-Cola and American Express raised our percentage ownership. Our equity in Coca-Cola grew from 8.9% to 9.1% and our interest in American Express from 13.7% to 14.2%. And, if you think tenths of a percent aren't important, ponder this math: For the four companies in aggregate, each increase of one-tenth of a percent in our share of their equity raises Berkshire's share of their annual earnings by $50 million.

The four companies possess excellent businesses and are run by managers who are both talented and shareholder-oriented. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business; it's better to have a partial interest in the Hope diamond than to own all of a rhinestone.

Going by our yearend holdings, our portion of the "Big Four's" 2013 earnings amounted to $4.4 billion. In the earnings we report to you, however, we include only the dividends we receive – about $1.4 billion last year. But make no mistake: The $3 billion of their earnings we don't report is every bit as valuable to us as the portion Berkshire records.

The earnings that these four companies retain are often used for repurchases of their own stock – a move that enhances our share of future earnings – as well as for funding business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees will grow substantially over time. If they do, dividends to Berkshire will increase and, even more important, our unrealized capital gains will, too. (For the four, unrealized gains already totaled $39 billion at yearend.)

Our flexibility in capital allocation – our willingness to invest large sums passively in non-controlled businesses – gives us a significant advantage over companies that limit themselves to acquisitions they can operate. Woody Allen stated the general idea when he said: "The advantage of being bi-sexual is that it doubles your chances for a date on Saturday night." Similarly, our appetite for *either* operating businesses or passive investments doubles our chances of finding sensible uses for our endless gusher of cash.

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Late in 2009, amidst the gloom of the Great Recession, we agreed to buy BNSF, the largest purchase in Berkshire's history. At the time, I called the transaction an "all-in wager on the economic future of the United States."

That kind of commitment was nothing new for us: We've been making similar wagers ever since Buffett Partnership Ltd. acquired control of Berkshire in 1965. For good reason, too. Charlie and I have always considered a "bet" on ever-rising U.S. prosperity to be very close to a sure thing.

Indeed, who has ever benefited during the past 237 years by betting *against* America? If you compare our country's present condition to that existing in 1776, you have to rub your eyes in wonder. And the dynamism embedded in our market economy will continue to work its magic. America's best days lie ahead.

With this tailwind working for us, Charlie and I hope to build Berkshire's per-share intrinsic value by (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. We will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Those building blocks rest on a rock-solid foundation. A century hence, BNSF and MidAmerican Energy will still be playing major roles in our economy. Insurance will concomitantly be essential for both businesses and individuals – and no company brings greater human and financial resources to that business than Berkshire.

Moreover, we will *always* maintain supreme financial strength, operating with at least $20 billion of cash equivalents and never incurring material amounts of short-term obligations. As we view these and other strengths, Charlie and I like your company's prospects. We feel fortunate to be entrusted with its management.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (nor, in fact, for any other stock). In our 2010 annual report, however, we laid out the three elements – one of them qualitative – that we believe are the keys to a sensible estimate of Berkshire's intrinsic value. That discussion is reproduced in full on pages 109 - 110.

Here is an update of the two quantitative factors: In 2013 our per-share investments increased 13.6% to $129,253 and our pre-tax earnings from businesses other than insurance and investments increased 12.8% to $9,116 per share.

Since 1970, our per-share investments have increased at a rate of 19.3% compounded annually, and our earnings figure has grown at a 20.6% clip. It is no coincidence that the price of Berkshire stock over the 43-year period has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both sectors, but we will most strongly focus on building operating earnings.

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Now, let's examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. So we'll present them as four separate businesses, which is how Charlie and I view them (though there are important and *enduring* advantages to having them all under one roof). Our goal is to provide you with the information we would wish to have if our positions were reversed, with you being the reporting manager and we the absentee shareholders. (But don't get any ideas!)

Insurance

> *"Our investment in the insurance companies reflects a first major step in our efforts to achieve a more diversified base of earning power."*
>
> — 1967 Annual Report

Let's look first at insurance, Berkshire's core operation and the engine that has consistently propelled our expansion since that 1967 report was published.

Property-casualty ("P/C") insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

Year	*Float (in $ millions)*
1970	$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2013	77,240

Further gains in float will be tough to achieve. On the plus side, GEICO's float will almost certainly grow. In National Indemnity's reinsurance division, however, we have a number of run-off contracts whose float drifts downward. If we do experience a decline in float at some future time, it will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate demands for sums that are large compared to our cash resources. (In this respect, property-casualty insurance differs in an important way from certain forms of life insurance.)

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous in most years that it causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. For example, State Farm, by far the country's largest insurer and a well-managed company besides, incurred an underwriting loss in nine of the twelve years ending in 2012 (the latest year for which their financials are available, as I write this). Competitive dynamics almost guarantee that the insurance industry – despite the float income all companies enjoy – will continue its dismal record of earning subnormal returns as compared to other businesses.

As noted in the first section of this report, we have now operated at an underwriting profit for eleven consecutive years, our pre-tax gain for the period having totaled $22 billion. Looking ahead, I believe we will continue to underwrite profitably in most years. Doing so is the daily focus of *all* of our insurance managers who know that while float is valuable, it can be drowned by poor underwriting results.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a liability, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as strictly a liability is incorrect; it should instead be viewed as a revolving fund. Daily, we pay old claims – some $17 billion to more than five million claimants in 2013 – and that reduces float. Just as surely, we each day write new business and thereby generate new claims that add to float. If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability.

A counterpart to this overstated liability is $15.5 billion of "goodwill" that is attributable to our insurance companies and included in book value as an asset. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance business sustains large and prolonged underwriting losses, any goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay to purchase an insurance operation possessing float *of similar quality* to that we have – to be far in excess of its historic carrying value. The value of our float is one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

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Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that possess strong, hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources. Indeed, we are *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a $250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because of its many streams of earnings. And we would remain awash in cash, looking for large opportunities if the catastrophe caused markets to go into shock. All other major insurers and reinsurers would meanwhile be far in the red, with some facing insolvency.

From a standing start in 1985, Ajit has created an insurance business with float of $37 billion and a large cumulative underwriting profit, a feat no other insurance CEO has come close to matching. Ajit's mind is an idea factory that is always looking for more lines of business he can add to his current assortment.

One venture materialized last June when he formed Berkshire Hathaway Specialty Insurance ("BHSI"). This initiative took us into commercial insurance, where we were instantly accepted by both major insurance brokers and corporate risk managers throughout America. These professionals recognize that no other insurer can match the financial strength of Berkshire, which guarantees that legitimate claims arising many years in the future will be paid promptly and fully.

BHSI is led by Peter Eastwood, an experienced underwriter who is widely respected in the insurance world. Peter has assembled a spectacular team that is already writing a substantial amount of business with many Fortune 500 companies and with smaller operations as well. BHSI will be a major asset for Berkshire, one that will generate volume in the billions within a few years. Give Peter a Berkshire greeting when you see him at the annual meeting.

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We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been better than cost-free under his leadership, and we expect that, on average, to continue. We are particularly enthusiastic about General Re's international life reinsurance business, which has grown consistently and profitably since we acquired the company in 1998.

It can be remembered that soon after we purchased General Re, the company was beset by problems that caused commentators – and me as well, briefly – to believe I had made a huge mistake. That day is long gone. General Re is now a gem.

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Finally, there is GEICO, the insurer on which I cut my teeth 63 years ago. GEICO is managed by Tony Nicely, who joined the company at 18 and completed 52 years of service in 2013. Tony became CEO in 1993, and since then the company has been flying.

When I was first introduced to GEICO in January 1951, I was blown away by the huge cost advantage the company enjoyed compared to the expenses borne by the giants of the industry. That operational efficiency continues today and is an all-important asset. No one *likes* to buy auto insurance. But almost everyone likes to drive. The insurance needed is a major expenditure for most families. Savings matter to them – and *only* a low-cost operation can deliver these.

GEICO's cost advantage is the factor that has enabled the company to gobble up market share year after year. Its low costs create a moat – an *enduring* one – that competitors are unable to cross. Meanwhile, our little gecko continues to tell Americans how GEICO can save them important money. With our latest reduction in operating costs, his story has become even more compelling.

In 1995, we purchased the half of GEICO that we didn't already own, paying \$1.4 billion more than the net tangible assets we acquired. That's "goodwill," and it will forever remain unchanged on our books. As GEICO's business grows, however, so does its *true* economic goodwill. I believe that figure to be approaching \$20 billion.

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In addition to our three major insurance operations, we own a group of smaller companies, most of them plying their trade in odd corners of the insurance world. In aggregate, these companies are a growing operation that consistently delivers an underwriting profit. Moreover, as the table below shows, they also provide us with substantial float. Charlie and I treasure these companies and their managers.

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2013*	*2012*	*2013*	*2012*
BH Reinsurance	\$1,294	\$ 304	\$37,231	\$34,821
General Re	283	355	20,013	20,128
GEICO	1,127	680	12,566	11,578
Other Primary	385	286	7,430	6,598
	\$3,089	\$1,625	\$77,240	\$73,125

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Simply put, insurance is the sale of promises. The "customer" pays money now; the insurer promises to pay money in the future if certain events occur.

Sometimes, the promise will not be tested for decades. (Think of life insurance bought by those in their 20s.) Therefore, both the ability and willingness of the insurer to pay – even if economic chaos prevails when payment time arrives – is all-important.

Berkshire's promises have no equal, a fact affirmed in recent years by the actions of the world's largest and most sophisticated insurers, some of which have wanted to shed themselves of huge and exceptionally long-lived liabilities, particularly those involving asbestos claims. That is, these insurers wished to "cede" their liabilities to a reinsurer. Choosing the wrong reinsurer, however – one that down the road proved to be financially strapped or a bad actor – would put the original insurer in danger of getting the liabilities right back in its lap.

Almost without exception, the largest insurers seeking aid came to Berkshire. Indeed, in the largest such transaction ever recorded, Lloyd's in 2007 turned over to us both many thousands of known claims arising from policies written before 1993 and an unknown but huge number of claims from that same period sure to materialize in the future. (Yes, we will be receiving claims decades from now that apply to events taking place prior to 1993.)

Berkshire's ultimate payments arising from the Lloyd's transaction are today unknowable. What is certain, however, is that Berkshire will pay all valid claims up to the \$15 billion limit of our policy. No other insurer's promise would have given Lloyd's the comfort provided by its agreement with Berkshire. The CEO of the entity then handling Lloyd's claims said it best: "Names [the original insurers at Lloyd's] wanted to sleep easy at night, and we think we've just bought them the world's best mattress."

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Berkshire's great managers, premier financial strength and a variety of business models possessing wide moats form something unique in the insurance world. The combination is a huge asset for Berkshire shareholders that will only get more valuable with time.

Regulated, Capital-Intensive Businesses

> *"Though there are many regulatory restraints in the utility industry, it's possible that we will make additional commitments in the field. If we do, the amounts involved could be large."*
>
> — 1999 Annual Report

We have two major operations, BNSF and MidAmerican Energy, that share important characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions will far exceed its interest requirements. Last year, for example, BNSF's interest coverage was 9:1. (Our definition of coverage is pre-tax earnings/interest, *not* EBITDA/interest, a commonly-used measure we view as seriously flawed.)

At MidAmerican, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies exclusively offering an essential service. The second is enjoyed by few other utilities: a great diversity of earnings streams, which shield us from being seriously harmed by any single regulatory body. Now, with the acquisition of NV Energy, MidAmerican's earnings base has further broadened. This particular strength, supplemented by Berkshire's ownership, has enabled MidAmerican and its utility subsidiaries to significantly lower their cost of debt. This advantage benefits both us *and* our customers.

Every day, our two subsidiaries power the American economy in major ways:

- BNSF carries about 15% (measured by ton-miles) of *all* inter-city freight, whether it is transported by truck, rail, water, air, or pipeline. Indeed, we move more ton-miles of goods than *anyone* else, a fact establishing BNSF as the most important artery in our economy's circulatory system. Its hold on the number-one position strengthened in 2013.

  BNSF, like all railroads, also moves its cargo in an extraordinarily fuel-efficient and environmentally friendly way, carrying a ton of freight about 500 miles on a single gallon of diesel fuel. Trucks taking on the same job guzzle about four times as much fuel.

- MidAmerican's utilities serve regulated retail customers in eleven states. No utility company stretches further. In addition, we are the leader in renewables: From a standing start nine years ago, MidAmerican now accounts for 7% of the country's wind generation capacity, with more on the way. Our share in solar – most of which is still in construction – is even larger.

  MidAmerican can make these investments because it retains *all* of its earnings. Here's a little known fact: Last year MidAmerican retained more dollars of earnings – by far – than any other American electric utility. We and our regulators see this as an important advantage – one almost certain to exist five, ten and twenty years from now.

When our current projects are completed, MidAmerican's renewables portfolio will have cost $15 billion. We relish making such commitments as long as they promise reasonable returns. And, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need massive investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is meanwhile in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Tangible proof of our dedication to that duty was delivered last year in a poll of customer satisfaction covering 52 holding companies and their 101 operating electric utilities. Our MidAmerican group ranked number one, with 95.3% of respondents giving us a "very satisfied" vote and not a single customer rating us "dissatisfied." The bottom score in the survey, incidentally, was a dismal 34.5%.

All three of our companies were ranked far lower by this measure before they were acquired by MidAmerican. The extraordinary customer satisfaction we have achieved is of great importance as we expand: Regulators in states we hope to enter are glad to see us, knowing we will be responsible operators.

Our railroad has been diligent as well in anticipating the needs of its customers. Whatever you may have heard about our country's crumbling infrastructure in no way applies to BNSF or railroads generally. America's rail system has never been in better shape, a consequence of huge investments by the industry. We are not, however, resting: BNSF spent $4 billion on the railroad in 2013, double its depreciation charge and a single-year record for *any* railroad. And, we will spend considerably more in 2014. Like Noah, who foresaw early on the need for dependable transportation, we know it's our job to plan ahead.

Leading our two capital-intensive companies are Greg Abel, at MidAmerican, and the team of Matt Rose and Carl Ice at BNSF. The three are extraordinary managers who have my gratitude and deserve yours as well. Here are the key figures for their businesses:

MidAmerican (89.8% owned)	*Earnings (in millions)*		
	2013	*2012*	*2011*
U.K. utilities	$ 362	$ 429	$ 469
Iowa utility	230	236	279
Western utilities	982	737	771
Pipelines	385	383	388
HomeServices	139	82	39
Other (net)	4	91	36
Operating earnings before corporate interest and taxes	2,102	1,958	1,982
Interest	296	314	336
Income taxes	170	172	315
Net earnings	$ 1,636	$ 1,472	$ 1,331
Earnings applicable to Berkshire	$ 1,470	$ 1,323	$ 1,204

BNSF	*Earnings (in millions)*		
	2013	*2012*	*2011*
Revenues	$22,014	$20,835	$19,548
Operating expenses	15,357	14,835	14,247
Operating earnings before interest and taxes	6,657	6,000	5,301
Interest (net)	729	623	560
Income taxes	2,135	2,005	1,769
Net earnings	$ 3,793	$ 3,372	$ 2,972

Ron Peltier continues to build HomeServices, MidAmerican's real estate brokerage subsidiary. Last year his operation made four acquisitions, the most significant being Fox & Roach, a Philadelphia-based company that is the largest single-market realtor in the country.

HomeServices now has 22,114 agents (listed by geography on page 112), up 38% from 2012. HomeServices also owns 67% of the Prudential and Real Living franchise operations, which are in the process of rebranding their franchisees as Berkshire Hathaway HomeServices. If you haven't yet, many of you will soon be seeing our name on "for sale" signs.

Manufacturing, Service and Retailing Operations

> *"See that store," Warren says, pointing at Nebraska Furniture Mart. "That's a really good business."*
> *"Why don't you buy it?" I said.*
> *"It's privately held," Warren said.*
> *"Oh," I said.*
> *"I might buy it anyway," Warren said. "Someday."*
> — *Supermoney* by Adam Smith (1972)

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

Balance Sheet 12/31/13 (in millions)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 6,625	Notes payable	$ 1,615
Accounts and notes receivable	7,749	Other current liabilities	8,965
Inventory	9,945	Total current liabilities	10,580
Other current assets	716		
Total current assets	25,035		
		Deferred taxes	5,184
Goodwill and other intangibles	25,617	Term debt and other liabilities	4,405
Fixed assets	19,389	Non-controlling interests	456
Other assets	4,274	Berkshire equity	53,690
	$74,315		$74,315

Earnings Statement (in millions)

	2013	*2012*	*2011*
Revenues	$95,291	$83,255	$72,406
Operating expenses	88,414	76,978	67,239
Interest expense	135	146	130
Pre-tax earnings	6,742	6,131	5,037
Income taxes and non-controlling interests	2,512	2,432	1,998
Net earnings	$ 4,230	$ 3,699	$ 3,039

Our income and expense data conforming to Generally Accepted Accounting Principles ("GAAP") is on page 29. In contrast, the operating expense figures above are non-GAAP and exclude some purchase-accounting items (primarily the amortization of certain intangible assets). We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the true economic expenses and profits of the businesses aggregated in the table than do GAAP figures.

I won't explain all of the adjustments – some are tiny and arcane – but serious investors should understand the disparate nature of intangible assets: Some truly deplete over time while others in no way lose value. With software, for example, amortization charges are very real expenses. Charges against other intangibles such as the amortization of customer relationships, however, arise through purchase-accounting rules and are clearly not real costs. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when earnings are calculated – even though from an investor's viewpoint they could not be more different.

In the GAAP-compliant figures we show on page 29, amortization charges of $648 million for the companies included in this section are deducted as expenses. We would call about 20% of these "real," the rest not. This difference has become significant because of the many acquisitions we have made. It will almost certainly rise further as we acquire more companies.

Eventually, of course, the non-real charges disappear when the assets to which they're related become fully amortized. But this usually takes 15 years and – alas – it will be my successor whose reported earnings get the benefit of their expiration.

Every dime of depreciation expense we report, however, is a real cost. And that's true at almost all other companies as well. When Wall Streeters tout EBITDA as a valuation guide, button your wallet.

Our public reports of earnings will, of course, continue to conform to GAAP. To embrace reality, however, remember to add back most of the amortization charges we report.

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The crowd of companies in this section sells products ranging from lollipops to jet airplanes. Some of these businesses, measured by earnings on unleveraged net *tangible* assets, enjoy terrific economics, producing profits that run from 25% after-tax to far more than 100%. Others generate good returns in the area of 12% to 20%. A few, however, have very poor returns, a result of some serious mistakes I made in my job of capital allocation. I was not misled: I simply was wrong in my evaluation of the economic dynamics of the company or the industry in which it operated.

Fortunately, my blunders usually involved relatively small acquisitions. Our large buys have generally worked out well and, in a few cases, more than well. I have not, however, made my last mistake in purchasing either businesses or stocks. Not everything works out as planned.

Viewed as a single entity, the companies in this group are an excellent business. They employed an average of $25 billion of net tangible assets during 2013 and, with large quantities of excess cash and little leverage, earned 16.7% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if the purchase price is excessive. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for goodwill. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Furthermore, the intrinsic value of these businesses, in aggregate, exceeds their carrying value by a good margin. Even so, the difference between intrinsic value and carrying value in the insurance and regulated-industry segments is *far* greater. It is there that the truly big winners reside.

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We have far too many companies in this group to comment on them individually. Moreover, both current and potential competitors read this report. In a few of our businesses we might be disadvantaged if they knew our numbers. So, in some of our operations that are not of a size material to an evaluation of Berkshire, we only disclose what is required. You can find a good bit of detail about many of our operations, however, on pages 80-84.

I can't resist, however, giving you an update on Nebraska Furniture Mart's expansion into Texas. I'm not covering this event because of its *economic* importance to Berkshire – it takes more than a new store to move the needle on Berkshire's $225 billion equity base. But I've now worked 30 years with the marvelous Blumkin family, and I'm excited about the remarkable store – truly Texas-sized – it is building at The Colony, in the northern part of the Dallas metropolitan area.

When the store is completed next year, NFM will have – under one roof, and on a 433-acre site – 1.8 million square feet of retail and supporting warehouse space. View the project's progress at www.nfm.com/texas. NFM already owns the two highest-volume home furnishings stores in the country (in Omaha and Kansas City, Kansas), each doing about $450 million annually. I predict the Texas store will blow these records away. If you live anywhere near Dallas, come check us out.

I think back to August 30, 1983 – my birthday – when I went to see Mrs. B (Rose Blumkin), carrying a 1 ¼-page purchase proposal for NFM that I had drafted. (It's reproduced on pages 114 - 115.) Mrs. B accepted my offer without changing a word, and we completed the deal without the involvement of investment bankers or lawyers (an experience that can only be described as heavenly). Though the company's financial statements were unaudited, I had no worries. Mrs. B simply told me what was what, and her word was good enough for me.

Mrs. B was 89 at the time and worked until 103 – definitely my kind of woman. Take a look at NFM's financial statements from 1946 on pages 116 - 117. Everything NFM now owns comes from (a) that $72,264 of net worth and $50 – *no* zeros omitted – of cash the company then possessed, and (b) the incredible talents of Mrs. B, her son, Louie, and his sons Ron and Irv.

The punch line to this story is that Mrs. B never spent a day in school. Moreover, she emigrated from Russia to America knowing not a word of English. But she loved her adopted country: At Mrs. B's request, the family always sang *God Bless America* at its gatherings.

Aspiring business managers should look hard at the plain, but rare, attributes that produced Mrs. B's incredible success. Students from 40 universities visit me every year, and I have them start the day with a visit to NFM. If they absorb Mrs. B's lessons, they need none from me.

Finance and Financial Products

> *"Clayton's loan portfolio will likely grow to at least $5 billion in not too many years and, with sensible credit standards in place, should deliver significant earnings."*
>
> *— 2003 Annual Report*

This sector, our smallest, includes two rental companies, XTRA (trailers) and CORT (furniture), as well as Clayton Homes, the country's leading producer and financer of manufactured homes. Aside from these 100%-owned subsidiaries, we also include in this category a collection of financial assets and our 50% interest in Berkadia Commercial Mortgage.

Clayton is placed in this section because it owns and services 326,569 mortgages, totaling $13.6 billion. In recent years, as manufactured home sales plummeted, a high percentage of Clayton's earnings came from this mortgage business.

In 2013, however, the sale of new homes began to pick up and earnings from both manufacturing and retailing are again becoming significant. Clayton remains America's number one homebuilder: Its 2013 output of 29,547 homes accounted for about 4.7% of all single-family residences built in the country. Kevin Clayton, Clayton's CEO, has done a magnificent job of guiding the company through the severe housing depression. Now, his job – definitely more fun these days – includes the prospect of another earnings gain in 2014.

CORT and XTRA are leaders in their industries as well. And Jeff Pederson and Bill Franz will keep them on top. We are backing their plans through purchases of equipment that enlarge their rental potential.

Here's the pre-tax earnings recap for this sector:

	2013	*2012*	*2011*
		(in millions)	
Berkadia	$ 80	$ 35	$ 25
Clayton	416	255	154
CORT	40	42	29
XTRA	125	106	126
Net financial income*	324	410	440
	$985	$848	$ 774

* Excludes capital gains or losses

Investments

"Our stock portfolio . . . was worth approximately $17 million less than its carrying value [cost] . . . it is our belief that, over a period of years, the overall portfolio will prove to be worth more than its cost."

— 1974 Annual Report

Below we list our fifteen common stock investments that at yearend had the largest market value.

*Shares***	*Company*	*Percentage of Company Owned*	*12/31/13 Cost**	*12/31/13 Market*
			(in millions)	
151,610,700	American Express Company	14.2	$ 1,287	$ 13,756
400,000,000	The Coca-Cola Company	9.1	1,299	16,524
22,238,900	DIRECTV	4.2	1,017	1,536
41,129,643	Exxon Mobil Corp.	0.9	3,737	4,162
13,062,594	The Goldman Sachs Group, Inc.	2.8	750	2,315
68,121,984	International Business Machines Corp.	6.3	11,681	12,778
24,669,778	Moody's Corporation	11.5	248	1,936
20,060,390	Munich Re	11.2	2,990	4,415
20,668,118	Phillips 66	3.4	660	1,594
52,477,678	The Procter & Gamble Company	1.9	336	4,272
22,169,930	Sanofi	1.7	1,747	2,354
301,046,076	Tesco plc	3.7	1,699	1,666
96,117,069	U.S. Bancorp	5.3	3,002	3,883
56,805,984	Wal-Mart Stores, Inc.	1.8	2,976	4,470
483,470,853	Wells Fargo & Company	9.2	11,871	21,950
	Others		11,281	19,894
	Total Common Stocks Carried at Market		$56,581	$117,505

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

**Excludes shares held by Berkshire subsidiary pension funds.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for $5 billion. At yearend these shares were worth $10.9 billion. We are likely to purchase the shares just before expiration of our option. In the meantime, it is important for you to realize that Bank of America is, in effect, our fifth largest equity investment and one we value highly.

In addition to our equity holdings, we also invest substantial sums in bonds. Usually, we've done well in these. But not always.

Most of you have never heard of Energy Future Holdings. Consider yourselves lucky; I certainly wish I hadn't. The company was formed in 2007 to effect a giant leveraged buyout of electric utility assets in Texas. The equity owners put up $8 billion and borrowed a massive amount in addition. About $2 billion of the debt was purchased by Berkshire, pursuant to a decision I made without consulting with Charlie. That was a *big* mistake.

Unless natural gas prices soar, EFH will almost certainly file for bankruptcy in 2014. Last year, we sold our holdings for $259 million. While owning the bonds, we received $837 million in cash interest. Overall, therefore, we suffered a pre-tax loss of $873 million. Next time I'll call Charlie.

A few of our subsidiaries – primarily electric and gas utilities – use derivatives in their operations. Otherwise, we have not entered into any derivative contracts for some years, and our existing positions continue to run off. The contracts that have expired have delivered large profits as well as several billion dollars of medium-term float. Though there are no guarantees, we expect a similar result from those remaining on our books.

Some Thoughts About Investing

Investment is most intelligent when it is most businesslike.
— *The Intelligent Investor* by Benjamin Graham

It is fitting to have a Ben Graham quote open this discussion because I owe so much of what I know about investing to him. I will talk more about Ben a bit later, and I will even sooner talk about common stocks. But let me first tell you about two small non-stock investments that I made long ago. Though neither changed my net worth by much, they are instructive.

This tale begins in Nebraska. From 1973 to 1981, the Midwest experienced an explosion in farm prices, caused by a widespread belief that runaway inflation was coming and fueled by the lending policies of small rural banks. Then the bubble burst, bringing price declines of 50% or more that devastated both leveraged farmers and their lenders. Five times as many Iowa and Nebraska banks failed in that bubble's aftermath than in our recent Great Recession.

In 1986, I purchased a 400-acre farm, located 50 miles north of Omaha, from the FDIC. It cost me $280,000, considerably less than what a failed bank had lent against the farm a few years earlier. I knew nothing about operating a farm. But I have a son who loves farming and I learned from him both how many bushels of corn and soybeans the farm would produce and what the operating expenses would be. From these estimates, I calculated the normalized return from the farm to then be about 10%. I also thought it was likely that productivity would improve over time and that crop prices would move higher as well. Both expectations proved out.

I needed no unusual knowledge or intelligence to conclude that the investment had no downside and potentially had substantial upside. There would, of course, be the occasional bad crop and prices would sometimes disappoint. But so what? There would be some unusually good years as well, and I would never be under any pressure to sell the property. Now, 28 years later, the farm has tripled its earnings and is worth five times or more what I paid. I still know nothing about farming and recently made just my second visit to the farm.

In 1993, I made another small investment. Larry Silverstein, Salomon's landlord when I was the company's CEO, told me about a New York retail property adjacent to NYU that the Resolution Trust Corp. was selling. Again, a bubble had popped – this one involving commercial real estate – and the RTC had been created to dispose of the assets of failed savings institutions whose optimistic lending practices had fueled the folly.

Here, too, the analysis was simple. As had been the case with the farm, the unleveraged current yield from the property was about 10%. But the property had been undermanaged by the RTC, and its income would increase when several vacant stores were leased. Even more important, the largest tenant – who occupied around 20% of the project's space – was paying rent of about $5 per foot, whereas other tenants averaged $70. The expiration of this bargain lease in nine years was certain to provide a major boost to earnings. The property's location was also superb: NYU wasn't going anywhere.

I joined a small group, including Larry and my friend Fred Rose, that purchased the parcel. Fred was an experienced, high-grade real estate investor who, with his family, would manage the property. And manage it they did. As old leases expired, earnings tripled. Annual distributions now exceed 35% of our original equity investment. Moreover, our original mortgage was refinanced in 1996 and again in 1999, moves that allowed several special distributions totaling more than 150% of what we had invested. I've yet to view the property.

Income from both the farm and the NYU real estate will probably increase in the decades to come. Though the gains won't be dramatic, the two investments will be solid and satisfactory holdings for my lifetime and, subsequently, for my children and grandchildren.

I tell these tales to illustrate certain fundamentals of investing:

- You don't need to be an expert in order to achieve satisfactory investment returns. But if you aren't, you must recognize your limitations and follow a course certain to work reasonably well. Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick "no."

- Focus on the future productivity of the asset you are considering. If you don't feel comfortable making a rough estimate of the asset's future earnings, just forget it and move on. No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you undertake.

- If you instead focus on the prospective price change of a contemplated purchase, you are speculating. There is nothing improper about that. I know, however, that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first toss; *none* of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is *never* a reason to buy it.

- With my two small investments, I thought *only* of what the properties would produce and cared not at all about their daily valuations. Games are won by players who focus on the playing field – not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.

- Forming macro opinions or listening to the macro or market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: "You don't know how easy this game is until you get into that broadcasting booth.")

- My two purchases were made in 1986 and 1993. What the economy, interest rates, or the stock market might do in the years immediately following – 1987 and 1994 – was of no importance to me in making those investments. I can't remember what the headlines or pundits were saying at the time. Whatever the chatter, corn would keep growing in Nebraska and students would flock to NYU.

There is one major difference between my two small investments and an investment in stocks. Stocks provide you minute-to-minute valuations for your holdings whereas I have yet to see a quotation for either my farm or the New York real estate.

It should be an enormous advantage for investors in stocks to have those wildly fluctuating valuations placed on their holdings – and for some investors, it is. After all, if a moody fellow with a farm bordering my property yelled out a price every day to me at which he would either buy my farm or sell me his – and those prices varied widely over short periods of time depending on his mental state – how in the world could I be other than benefited by his erratic behavior? If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming.

Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments.

Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of "Don't just sit there, *do* something." For these investors, liquidity is transformed from the unqualified benefit it should be to a curse.

A "flash crash" or some other extreme market fluctuation can't hurt an investor any more than an erratic and mouthy neighbor can hurt my farm investment. Indeed, tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your *friend* when investing; a euphoric world is your enemy.

During the extraordinary financial panic that occurred late in 2008, I never gave a thought to selling my farm or New York real estate, even though a severe recession was clearly brewing. And, if I had owned 100% of a solid business with good long-term prospects, it would have been foolish for me to even consider dumping it. So why would I have sold my stocks that were small participations in wonderful businesses? True, any one of them might eventually disappoint, but as a group they were certain to do well. Could anyone really believe the earth was going to swallow up the incredible productive assets and unlimited human ingenuity existing in America?

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When Charlie and I buy stocks – which we think of as small portions of businesses – our analysis is very similar to that which we use in buying entire businesses. We first have to decide whether we can sensibly estimate an earnings range for five years out, or more. If the answer is yes, we will buy the stock (or business) if it sells at a reasonable price in relation to the bottom boundary of our estimate. If, however, we lack the ability to estimate future earnings – which is usually the case – we simply move on to other prospects. In the 54 years we have worked together, we have *never* foregone an attractive purchase because of the macro or political environment, or the views of other people. In fact, these subjects never come up when we make decisions.

It's vital, however, that we recognize the perimeter of our "circle of competence" and stay well inside of it. Even then, we will make some mistakes, both with stocks and businesses. But they will not be the disasters that occur, for example, when a long-rising market induces purchases that are based on anticipated price behavior and a desire to be where the action is.

Most investors, of course, have not made the study of business prospects a priority in their lives. If wise, they will conclude that they do not know enough about specific businesses to predict their future earning power.

I have good news for these non-professionals: The typical investor doesn't need this skill. In aggregate, American business has done wonderfully over time and will continue to do so (though, most assuredly, in *unpredictable* fits and starts). In the 20th Century, the Dow Jones Industrials index advanced from 66 to 11,497, paying a rising stream of dividends to boot. The 21st Century will witness further gains, almost certain to be substantial. The goal of the non-professional should not be to pick winners – neither he nor his "helpers" can do that – but should rather be to own a cross-section of businesses that in aggregate are bound to do well. A low-cost S&P 500 index fund will achieve this goal.

That's the "what" of investing for the non-professional. The "when" is also important. The main danger is that the timid or beginning investor will enter the market at a time of extreme exuberance and then become disillusioned when paper losses occur. (Remember the late Barton Biggs' observation: "A bull market is like sex. It feels best just before it ends.") The antidote to that kind of mistiming is for an investor to accumulate shares over a long period and never to sell when the news is bad and stocks are well off their highs. Following those rules, the "know-nothing" investor who both diversifies and *keeps his costs minimal* is virtually certain to get satisfactory results. Indeed, the unsophisticated investor who is realistic about his shortcomings is likely to obtain better long-term results than the knowledgeable professional who is blind to even a single weakness.

If "investors" frenetically bought and sold farmland to each other, neither the yields nor prices of their crops would be increased. The only consequence of such behavior would be decreases in the overall earnings realized by the farm-owning population because of the substantial costs it would incur as it sought advice and switched properties.

Nevertheless, both individuals and institutions will constantly be urged to be active by those who profit from giving advice or effecting transactions. The resulting frictional costs can be huge and, for investors in aggregate, devoid of benefit. So ignore the chatter, keep your costs minimal, and invest in stocks as you would in a farm.

My money, I should add, is where my mouth is: What I advise here is essentially identical to certain instructions I've laid out in my will. One bequest provides that cash will be delivered to a trustee for my wife's benefit. (I have to use cash for individual bequests, because *all* of my Berkshire shares will be fully distributed to certain philanthropic organizations over the ten years following the closing of my estate.) My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's.) I believe the trust's long-term results from this policy will be superior to those attained by most investors – whether pension funds, institutions or individuals – who employ high-fee managers.

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And now back to Ben Graham. I learned most of the thoughts in this investment discussion from Ben's book *The Intelligent Investor*, which I bought in 1949. My financial life changed with that purchase.

Before reading Ben's book, I had wandered around the investing landscape, devouring everything written on the subject. Much of what I read fascinated me: I tried my hand at charting and at using market indicia to predict stock movements. I sat in brokerage offices watching the tape roll by, and I listened to commentators. All of this was fun, but I couldn't shake the feeling that I wasn't getting anywhere.

In contrast, Ben's ideas were explained logically in elegant, easy-to-understand prose (without Greek letters or complicated formulas). For me, the key points were laid out in what later editions labeled Chapters 8 and 20. (The original 1949 edition numbered its chapters differently.) These points guide my investing decisions today.

A couple of interesting sidelights about the book: Later editions included a postscript describing an unnamed investment that was a bonanza for Ben. Ben made the purchase in 1948 when he was writing the first edition and – brace yourself – the mystery company was GEICO. If Ben had not recognized the special qualities of GEICO when it was still in its infancy, my future and Berkshire's would have been far different.

The 1949 edition of the book also recommended a railroad stock that was then selling for $17 and earning about $10 per share. (One of the reasons I admired Ben was that he had the guts to use current examples, leaving himself open to sneers if he stumbled.) In part, that low valuation resulted from an accounting rule of the time that required the railroad to exclude from its reported earnings the substantial retained earnings of affiliates.

The recommended stock was Northern Pacific, and its most important affiliate was Chicago, Burlington and Quincy. These railroads are now important parts of BNSF (Burlington Northern Santa Fe), which is today fully owned by Berkshire. When I read the book, Northern Pacific had a market value of about $40 million. Now its successor (having added a great many properties, to be sure) *earns* that amount every four days.

I can't remember what I paid for that first copy of *The Intelligent Investor*. Whatever the cost, it would underscore the truth of Ben's adage: Price is what you pay, value is what you get. Of all the investments I ever made, buying Ben's book was the best (except for my purchase of two marriage licenses).

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Local and state financial problems are accelerating, in large part because public entities promised pensions they couldn't afford. Citizens and public officials typically under-appreciated the gigantic financial tapeworm that was born when promises were made that conflicted with a willingness to fund them. Unfortunately, pension mathematics today remain a mystery to most Americans.

Investment policies, as well, play an important role in these problems. In 1975, I wrote a memo to Katharine Graham, then chairman of The Washington Post Company, about the pitfalls of pension promises and the importance of investment policy. That memo is reproduced on pages 118 - 136.

During the next decade, you will read a lot of news – *bad* news – about public pension plans. I hope my memo is helpful to you in understanding the necessity for prompt remedial action where problems exist.

The Annual Meeting

The annual meeting will be held on Saturday, May 3rd at the CenturyLink Center. Carrie Sova, our talented ringmaster, will be in charge, and all of our headquarters group will pitch in to help her. Our gang both does a better job than professional event planners would and – yes – saves us money.

CenturyLink's doors will open at 7 a.m., and at 7:30 we will have our third International Newspaper Tossing Challenge. Our target will be a Clayton Home porch, precisely 35 feet from the throwing line. I tossed about 500,000 papers when I was a teenager, so I think I'm pretty good. Challenge me: I'll buy a Dilly Bar for anyone who lands his or her throw closer to the doorstep than I do. The papers will be 36 to 42 pages, and you must fold them yourself (no rubber bands allowed).

At 8:30, a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (with a break for lunch at CenturyLink's stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course, is to *shop*. We'll assist you by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. In a nine-hour period, we sold 1,062 pairs of Justin boots (that's a pair every 32 seconds), 12,792 pounds of See's candy, 11,162 Quikut knives (21 knives per minute) and 6,344 pairs of Wells Lamont gloves, always a hot item. This year, Charlie and I will have competing ketchup bottles for sale. Naturally, the one with Charlie's picture will be heavily discounted. But, if you help, my bottle will outsell his. This is important, so don't let me down.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them the next day at our second annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that you will receive with your tickets for the meeting. Entrants will find themselves running alongside many of Berkshire's managers, directors and associates.

GEICO will have a booth in the shopping area, staffed by a number of its top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least half of you, I believe we can.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, among them a couple of new titles. One is Max Olson's compilation of Berkshire letters going back to 1965. The book includes an index that I find particularly useful, specifying page numbers for individuals, companies and subject matter. I also recommend *Forty Chances* by my son, Howard. You'll enjoy it.

If you are a big spender – or aspire to become one – visit Signature Flight Support on the east side of the Omaha airport between noon and 5 p.m. on Saturday. There, we will have a fleet of NetJets aircraft sure to set your pulse racing. Come by bus; leave by private jet. Live a little.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City versus Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money, particularly if you had planned to rent a car in Omaha. Spend the savings with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. Last year in the week surrounding the meeting, the store did $40.2 million of business, breaking its previous record by 12%. It also set a single day record of $8.2 million on Saturday, selling nearly $1 million of mattresses alone.

To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, April 29th and Monday, May 5th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 2nd. The second, the main gala, will be held on Sunday, May 4th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m. In recent years, our three-day volume has far exceeded sales in all of December, normally a jeweler's best month.

About 1:15 p.m. on Sunday, I will begin clerking at Borsheims. Ask for my "Crazy Warren" quote on the item of your choice. As I get older, my pricing gets ever more ridiculous. Come take advantage of me.

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

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Don't play them for money.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. Last year, she made Americans – and especially me – proud with her performance at the Olympics.

I met Ariel when she was nine and even then I was unable to score a point against her. Now, she's a freshman at Princeton and the U.S. Women's Champion. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates and I will lead off and try to soften her up.

Gorat's and Piccolo's will again be open exclusively for Berkshire shareholders on Sunday, May 4th. Both will be serving until 10 p.m., with Gorat's opening at 1 p.m. and Piccolo's opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*) and for Piccolo's call 402-342-9038. At Piccolo's order a giant root beer float for dessert. Only sissies get the small one.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be e-mailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is selected.)

We will also have a panel of three analysts who follow Berkshire. This year the insurance specialist will be Jay Gelb of Barclays. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb.

And we will again have a credentialed bear on Berkshire. We would like to hear from applicants who are short Berkshire (please include evidence of your position). The three analysts will bring their own Berkshire-specific questions and alternate with the journalists and the audience in asking them.

Charlie and I believe that all shareholders should have access to new Berkshire information simultaneously and should also have adequate time to analyze it. That's why we try to issue financial information late on Fridays or early on Saturdays and why our annual meeting is held on Saturdays. We do not talk one-on-one to large institutional investors or analysts, but rather treat *all* shareholders the same. Our hope is that the journalists and analysts will ask questions that further educate our owners about their investment.

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists and analysts will come up with some tough ones, and that's the way we like it. All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and 18 from the audience. If there is some extra time, we will take more from the audience. Audience questioners will be determined by drawings that will take place at 8:15 a.m. at each of the 15 microphones located in the arena and main overflow room.

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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 the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most have no financial need to work; the joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 24 men and women who work with me at our corporate office. This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 23,000-page Federal income tax return as well as state and foreign returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and French fries (smothered in ketchup, of course) for lunch. No CEO has it better; I truly do feel like tap dancing to work every day.

In closing, I think it's become appropriate to ignore our "no pictures" policy and let you view our remarkable home-office crew. Below is a photo from our Christmas lunch. Two people couldn't make it; otherwise you are looking at all of those who staff Berkshire's headquarters. They are truly miracle-workers.

Next year's letter will review our 50 years at Berkshire and speculate a bit about the next 50. In the meantime, come to Omaha on May 3rd and enjoy our Woodstock for Capitalists.

February 28, 2014

Warren E. Buffett
Chairman of the Board

A power lunch, Berkshire-style

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
Compounded Annual Gain – 1965-2014	19.4%	21.6%	9.9%
Overall Gain – 1964-2014	751,113%	1,826,163%	11,196%

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

A note to readers: Fifty years ago, today's management took charge at Berkshire. For this Golden Anniversary, Warren Buffett and Charlie Munger each wrote his views of what has happened at Berkshire during the past 50 years and what each expects during the next 50. Neither changed a word of his commentary after reading what the other had written. Warren's thoughts begin on page 24 and Charlie's on page 39. Shareholders, particularly new ones, may find it useful to read those letters before reading the report on 2014, which begins below.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2014 was $18.3 billion, which increased the per-share book value of both our Class A and Class B stock by 8.3%. Over the last 50 years (that is, since present management took over), per-share book value has grown from $19 to $146,186, a rate of 19.4% compounded annually.*

During our tenure, we have consistently compared the yearly performance of the S&P 500 to the change in Berkshire's per-share book value. We've done that because book value has been a crude, but useful, *tracking device* for the number that really counts: intrinsic business value.

In our early decades, the relationship between book value and intrinsic value was much closer than it is now. That was true because Berkshire's assets were then largely securities whose values were continuously restated to reflect their current market prices. In Wall Street parlance, most of the assets involved in the calculation of book value were "marked to market."

Today, our emphasis has shifted in a major way to owning and operating large businesses. Many of these are worth far more than their cost-based carrying value. But that amount is *never* revalued upward no matter how much the value of these companies has increased. Consequently, the gap between Berkshire's intrinsic value and its book value has materially widened.

With that in mind, we have added a new set of data – the historical record of Berkshire's stock price – to the performance table on the facing page. Market prices, let me stress, have their limitations in the short term. Monthly or yearly movements of stocks are often erratic and not indicative of changes in intrinsic value. Over time, however, stock prices and intrinsic value almost invariably converge. Charlie Munger, Berkshire Vice Chairman and my partner, and I believe that has been true at Berkshire: In our view, the increase in Berkshire's per-share intrinsic value over the past 50 years is roughly equal to the 1,826,163% gain in market price of the company's shares.

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* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

The Year at Berkshire

It was a good year for Berkshire on all major fronts, except one. Here are the important developments:

- Our "Powerhouse Five" – a collection of Berkshire's largest non-insurance businesses – had a record $12.4 billion of pre-tax earnings in 2014, up $1.6 billion from 2013.* The companies in this sainted group are Berkshire Hathaway Energy (formerly MidAmerican Energy), BNSF, IMC (I've called it Iscar in the past), Lubrizol and Marmon.

  Of the five, only Berkshire Hathaway Energy, then earning $393 million, was owned by us a decade ago. Subsequently we purchased another three of the five on an all-cash basis. In acquiring the fifth, BNSF, we paid about 70% of the cost in cash and, for the remainder, issued Berkshire shares that increased the number outstanding by 6.1%. In other words, the $12 billion gain in annual earnings delivered Berkshire by the five companies over the ten-year span has been accompanied by only minor dilution. That satisfies our goal of not simply increasing earnings, but making sure we also increase *per-share* results.

  If the U.S. economy continues to improve in 2015, we expect earnings of our Powerhouse Five to improve as well. The gain could reach $1 billion, in part because of bolt-on acquisitions by the group that have already closed or are under contract.

- Our bad news from 2014 comes from our group of five as well and is unrelated to earnings. During the year, BNSF disappointed many of its customers. These shippers depend on us, and service failures can badly hurt their businesses.

  BNSF is, by far, Berkshire's most important non-insurance subsidiary and, to improve its performance, we will spend $6 billion on plant and equipment in 2015. That sum is nearly 50% more than any other railroad has spent in a single year and is a truly extraordinary amount, whether compared to revenues, earnings or depreciation charges.

  Though weather, which was particularly severe last year, will always cause railroads a variety of operating problems, our responsibility is to do *whatever it takes* to restore our service to industry-leading levels. That can't be done overnight: The extensive work required to increase system capacity sometimes disrupts operations while it is underway. Recently, however, our outsized expenditures are beginning to show results. During the last three months, BNSF's performance metrics have materially improved from last year's figures.

- Our many dozens of smaller non-insurance businesses earned $5.1 billion last year, up from $4.7 billion in 2013. Here, as with our Powerhouse Five, we expect further gains in 2015. Within this group, we have two companies that last year earned between $400 million and $600 million, six that earned between $250 million and $400 million, and seven that earned between $100 million and $250 million. This collection of businesses will increase in both number and earnings. Our ambitions have no finish line.

- Berkshire's huge and growing insurance operation again operated at an underwriting profit in 2014 – that makes 12 years in a row – and increased its float. During that 12-year stretch, our float – money that doesn't belong to us but that we can invest for Berkshire's benefit – has grown from $41 billion to $84 billion. Though neither that gain nor the size of our float is reflected in Berkshire's earnings, float generates significant investment income because of the assets it allows us to hold.

* Throughout this letter, as well as in the "Golden Anniversary" letters included later in this report, all earnings are stated on a pre-tax basis unless otherwise designated.

Meanwhile, our underwriting profit totaled $24 billion during the twelve-year period, including $2.7 billion earned in 2014. And all of this began with our 1967 purchase of National Indemnity for $8.6 *million*.

- While Charlie and I search for new businesses to buy, our many subsidiaries are regularly making bolt-on acquisitions. Last year was particularly fruitful: We contracted for 31 bolt-ons, scheduled to cost $7.8 billion in aggregate. The size of these transactions ranged from $400,000 to $2.9 billion. However, the largest acquisition, Duracell, will not close until the second half of this year. It will then be placed under Marmon's jurisdiction.

  Charlie and I encourage bolt-ons, *if* they are sensibly-priced. (Most deals offered us aren't.) They deploy capital in activities that fit with our existing businesses and that will be managed by our corps of expert managers. This means no more work for us, yet more earnings, a combination we find particularly appealing. We will make many more of these bolt-on deals in future years.

- Two years ago my friend, Jorge Paulo Lemann, asked Berkshire to join his 3G Capital group in the acquisition of Heinz. My affirmative response was a no-brainer: I knew immediately that this partnership would work well from both a personal and financial standpoint. And it most definitely has.

  I'm not embarrassed to admit that Heinz is run far better under Alex Behring, Chairman, and Bernardo Hees, CEO, than would be the case if I were in charge. They hold themselves to extraordinarily high performance standards and are never satisfied, even when their results far exceed those of competitors.

  We expect to partner with 3G in more activities. Sometimes our participation will only involve a financing role, as was the case in the recent acquisition of Tim Hortons by Burger King. Our favored arrangement, however, will usually be to link up as a *permanent* equity partner (who, in some cases, contributes to the financing of the deal as well). Whatever the structure, we feel good when working with Jorge Paulo.

  Berkshire also has fine partnerships with Mars and Leucadia, and we may form new ones with them or with other partners. Our participation in any joint activities, whether as a financing or equity partner, will be limited to friendly transactions.

- In October, we contracted to buy Van Tuyl Automotive, a group of 78 automobile dealerships that is exceptionally well-run. Larry Van Tuyl, the company's owner, and I met some years ago. He then decided that if he were ever to sell his company, its home should be Berkshire. Our purchase was recently completed, and we are now "car guys."

  Larry and his dad, Cecil, spent 62 years building the group, following a strategy that made owner-partners of all local managers. Creating this mutuality of interests proved over and over to be a winner. Van Tuyl is now the fifth-largest automotive group in the country, with per-dealership sales figures that are outstanding.

  In recent years, Jeff Rachor has worked alongside Larry, a successful arrangement that will continue. There are about 17,000 dealerships in the country, and ownership transfers always require approval by the relevant auto manufacturer. Berkshire's job is to perform in a manner that will cause manufacturers to welcome further purchases by us. If we do this – and if we can buy dealerships at sensible prices – we will build a business that before long will be multiples the size of Van Tuyl's $9 billion of sales.

  With the acquisition of Van Tuyl, Berkshire now owns 9½ companies that would be listed on the Fortune 500 were they independent (Heinz is the ½). That leaves 490½ fish in the sea. Our lines are out.

- Our subsidiaries spent a record $15 billion on plant and equipment during 2014, well over twice their depreciation charges. About 90% of that money was spent in the United States. Though we will always invest abroad as well, the mother lode of opportunities runs through America. The treasures that have been uncovered up to now are dwarfed by those still untapped. Through dumb luck, Charlie and I were born in the United States, and we are forever grateful for the staggering advantages this accident of birth has given us.

- Berkshire's yearend employees – including those at Heinz – totaled a record 340,499, up 9,754 from last year. The increase, I am proud to say, included no gain at headquarters (where 25 people work). No sense going crazy.

- Berkshire increased its ownership interest last year in each of its "Big Four" investments – American Express, Coca-Cola, IBM and Wells Fargo. We purchased additional shares of IBM (increasing our ownership to 7.8% versus 6.3% at yearend 2013). Meanwhile, stock repurchases at Coca-Cola, American Express and Wells Fargo raised our percentage ownership of each. Our equity in Coca-Cola grew from 9.1% to 9.2%, our interest in American Express increased from 14.2% to 14.8% and our ownership of Wells Fargo grew from 9.2% to 9.4%. And, if you think tenths of a percent aren't important, ponder this math: For the four companies in aggregate, each increase of one-tenth of a percent in our ownership raises Berkshire's portion of their annual earnings by $50 million.

  These four investees possess excellent businesses and are run by managers who are both talented and shareholder-oriented. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business. It's better to have a partial interest in the Hope Diamond than to own all of a rhinestone.

  If Berkshire's yearend holdings are used as the marker, our portion of the "Big Four's" 2014 earnings before discontinued operations amounted to $4.7 billion (compared to $3.3 billion only three years ago). In the earnings we report to you, however, we include only the dividends we receive – about $1.6 billion last year. (Again, three years ago the dividends were $862 million.) But make no mistake: The $3.1 billion of these companies' earnings we don't report are every bit as valuable to us as the portion Berkshire records.

  The earnings these investees retain are often used for repurchases of their own stock – a move that enhances Berkshire's share of future earnings without requiring us to lay out a dime. Their retained earnings also fund business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees, in aggregate, will grow substantially over time (though 2015 will be a tough year for the group, in part because of the strong dollar). If the expected gains materialize, dividends to Berkshire will increase and, even more important, so will our unrealized capital gains. (For the package of four, our unrealized gains already totaled $42 billion at yearend.)

  Our flexibility in capital allocation – our willingness to invest large sums passively in non-controlled businesses – gives us a significant advantage over companies that limit themselves to acquisitions they can operate. Our appetite for *either* operating businesses or passive investments doubles our chances of finding sensible uses for Berkshire's endless gusher of cash.

- I've mentioned in the past that my experience in business helps me as an investor and that my investment experience has made me a better businessman. Each pursuit teaches lessons that are applicable to the other. And some truths can only be fully learned through experience. (In Fred Schwed's wonderful book, *Where Are the Customers' Yachts?*, a Peter Arno cartoon depicts a puzzled Adam looking at an eager Eve, while a caption says, "There are certain things that cannot be adequately explained to a virgin either by words or pictures." If you haven't read Schwed's book, buy a copy at our annual meeting. Its wisdom and humor are truly priceless.)

Among Arno's "certain things," I would include two separate skills, the evaluation of investments and the management of businesses. I therefore think it's worthwhile for Todd Combs and Ted Weschler, our two investment managers, to each have oversight of at least one of our businesses. A sensible opportunity for them to do so opened up a few months ago when we agreed to purchase two companies that, though smaller than we would normally acquire, have excellent economic characteristics. Combined, the two earn $100 million annually on about $125 million of net tangible assets.

I've asked Todd and Ted to each take on one as Chairman, in which role they will function in the very limited way that I do with our larger subsidiaries. This arrangement will save me a minor amount of work and, more important, make the two of them even better investors than they already are (which is to say among the best).

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Late in 2009, amidst the gloom of the Great Recession, we agreed to buy BNSF, the largest purchase in Berkshire's history. At the time, I called the transaction an "all-in wager on the economic future of the United States."

That kind of commitment was nothing new for us. We've been making similar wagers ever since Buffett Partnership Ltd. acquired control of Berkshire in 1965. For good reason, too: Charlie and I have always considered a "bet" on ever-rising U.S. prosperity to be very close to a sure thing.

Indeed, who has ever benefited during the past 238 years by betting *against* America? If you compare our country's present condition to that existing in 1776, you have to rub your eyes in wonder. In my lifetime alone, *real* per-capita U.S. output has *sextupled*. My parents could not have dreamed in 1930 of the world their son would see. Though the preachers of pessimism prattle endlessly about America's problems, I've never seen one who wishes to emigrate (though I can think of a few for whom I would happily buy a one-way ticket).

The dynamism embedded in our market economy will continue to work its magic. Gains won't come in a smooth or uninterrupted manner; they never have. And we will regularly grumble about our government. But, most assuredly, America's best days lie ahead.

With this tailwind working for us, Charlie and I hope to build Berkshire's per-share intrinsic value by (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. We will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Those building blocks rest on a rock-solid foundation. A century hence, BNSF and Berkshire Hathaway Energy will still be playing vital roles in our economy. Homes and autos will remain central to the lives of most families. Insurance will continue to be essential for both businesses and individuals. Looking ahead, Charlie and I see a world made to order for Berkshire. We feel fortunate to be entrusted with its management.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (nor, in fact, for any other stock). In our 2010 annual report, however, we laid out the three elements – one of them qualitative – that we believe are the keys to a sensible estimate of Berkshire's intrinsic value. That discussion is reproduced in full on pages 123-124.

Here is an update of the two quantitative factors: In 2014 our per-share investments increased 8.4% to $140,123, and our earnings from businesses other than insurance and investments increased 19% to $10,847 per share.

Since 1970, our per-share investments have increased at a rate of 19% compounded annually, and our earnings figure has grown at a 20.6% clip. It is no coincidence that the price of Berkshire stock over the ensuing 44 years has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both sectors, but our main focus is to build operating earnings. That's why we were pleased to exchange our Phillips 66 and Graham Holdings stock for operating businesses last year and to contract with Procter and Gamble to acquire Duracell by means of a similar exchange set to close in 2015.

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Now, let's examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. So we'll present them as four separate businesses, which is how Charlie and I view them (though there are important and *enduring* advantages to having them all under one roof). Our goal is to provide you with the information we would wish to have if our positions were reversed, with you being the reporting manager and we the absentee shareholders. (But don't get any ideas!)

Insurance

Let's look first at insurance, Berkshire's core operation. That industry has been the engine that has propelled our expansion since 1967, when we acquired National Indemnity and its sister company, National Fire & Marine, for $8.6 million. Though that purchase had monumental consequences for Berkshire, its execution was simplicity itself.

Jack Ringwalt, a friend of mine who was the controlling shareholder of the two companies, came to my office saying he would like to sell. Fifteen minutes later, we had a deal. Neither of Jack's companies had ever had an audit by a public accounting firm, and I didn't ask for one. My reasoning: (1) Jack was honest and (2) He was also a bit quirky and likely to walk away if the deal became at all complicated.

On pages 128-129, we reproduce the 1½-page purchase agreement we used to finalize the transaction. That contract was homemade: Neither side used a lawyer. Per page, this has to be Berkshire's best deal: National Indemnity today has GAAP (generally accepted accounting principles) net worth of $111 billion, which exceeds that of any other insurer in the world.

One reason we were attracted to the property-casualty business was its financial characteristics: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over many decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

Year	*Float (in $ millions)*
1970	$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2014	83,921

Further gains in float will be tough to achieve. On the plus side, GEICO and our new commercial insurance operation are almost certain to grow at a good clip. National Indemnity's reinsurance division, however, is party to a number of run-off contracts whose float drifts downward. If we do in time experience a decline in float, it will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate demands for sums that are large compared to our cash resources. This strength is a key pillar in Berkshire's economic fortress.

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it frequently causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses. The prolonged period of low interest rates our country is now dealing with causes earnings on float to decrease, thereby exacerbating the profit problems of the industry.

As noted in the first section of this report, Berkshire has now operated at an underwriting profit for twelve consecutive years, our pre-tax gain for the period having totaled $24 billion. Looking ahead, I believe we will continue to underwrite profitably in most years. Doing so is the daily focus of *all* of our insurance managers, who know that while float is valuable, its benefits can be drowned by poor underwriting results. That message is given at least lip service by all insurers; at Berkshire it is a religion.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a *liability*, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as strictly a liability is incorrect; it should instead be viewed as a revolving fund. Daily, we pay old claims and related expenses – a huge $22.7 billion to more than six million claimants in 2014 – and that reduces float. Just as surely, we each day write new business and thereby generate new claims that add to float.

If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability. Owing $1 that in effect will never leave the premises – because new business is almost certain to deliver a substitute – is worlds different from owing $1 that will go out the door tomorrow and not be replaced. The two types of liabilities are treated as equals, however, under GAAP.

A partial offset to this overstated liability is a $15.5 billion "goodwill" asset that we incurred in buying our insurance companies and that increases book value. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, *any* goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay for float *of similar quality* were we to purchase an insurance operation possessing it – to be *far* in excess of its historic carrying value. Under present accounting rules (with which we agree) this excess value will *never* be entered on our books. But I can assure you that it's real. That's one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

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Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that possess hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources.

Indeed, we are *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a $250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because of its many streams of earnings. We would also remain awash in cash and be looking for large opportunities in a market that might well have gone into shock. Meanwhile, other major insurers and reinsurers would be far in the red, if not facing insolvency.

Ajit's underwriting skills are unmatched. His mind, moreover, is an idea factory that is always looking for more lines of business he can add to his current assortment. Last year I told you about his formation of Berkshire Hathaway Specialty Insurance ("BHSI"). This initiative took us into commercial insurance, where we were instantly welcomed by both major insurance brokers and corporate risk managers throughout America. Previously, we had written only a few specialized lines of commercial insurance.

BHSI is led by Peter Eastwood, an experienced underwriter who is widely respected in the insurance world. During 2014, Peter expanded his talented group, moving into both international business and new lines of insurance. We repeat last year's prediction that BHSI will be a major asset for Berkshire, one that will generate volume in the billions within a few years.

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We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been considerably better than cost-free under his leadership, and we expect that, on average, to continue. We are particularly enthusiastic about General Re's international life reinsurance business, which has grown consistently and profitably since we acquired the company in 1998.

It can be remembered that soon after we purchased General Re, it was beset by problems that caused commentators – and me as well, briefly – to believe I had made a huge mistake. That day is long gone. General Re is now a gem.

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Finally, there is GEICO, the insurer on which I cut my teeth 64 years ago. GEICO is managed by Tony Nicely, who joined the company at 18 and completed 53 years of service in 2014. Tony became CEO in 1993, and since then the company has been flying. There is *no* better manager than Tony.

When I was first introduced to GEICO in January 1951, I was blown away by the huge cost advantage the company enjoyed compared to the expenses borne by the giants of the industry. It was clear to me that GEICO would succeed because it *deserved* to succeed. No one *likes* to buy auto insurance. Almost everyone, though, likes to drive. The insurance consequently needed is a major expenditure for most families. Savings matter to them – and *only* a low-cost operation can deliver these. Indeed, at least 40% of the people reading this letter can save money by insuring with GEICO. So stop reading and go to geico.com or call 800-368-2734.

GEICO's cost advantage is the factor that has enabled the company to gobble up market share year after year. (We ended 2014 at 10.8% compared to 2.5% in 1995, when Berkshire acquired control of GEICO.) The company's low costs create a moat – an *enduring* one – that competitors are unable to cross. Our gecko never tires of telling Americans how GEICO can save them important money. The gecko, I should add, has one particularly endearing quality – he works without pay. Unlike a human spokesperson, he never gets a swelled head from his fame nor does he have an agent to constantly remind us how valuable he is. I love the little guy.

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In addition to our three major insurance operations, we own a group of smaller companies, most of them plying their trade in odd corners of the insurance world. In aggregate, these companies are a growing operation that consistently delivers an underwriting profit. Indeed, over the past decade, they have earned $2.95 billion from underwriting while growing their float from $1.7 billion to $8.6 billion. Charlie and I treasure these companies and their managers.

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2014*	*2013*	*2014*	*2013*
BH Reinsurance	$ 606	$1,294	$42,454	$37,231
General Re	277	283	19,280	20,013
GEICO	1,159	1,127	13,569	12,566
Other Primary	626	385	8,618	7,430
	$2,668	$3,089	$83,921	$77,240

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Simply put, insurance is the sale of promises. The "customer" pays money now; the insurer promises to pay money in the future should certain unwanted events occur.

Sometimes, the promise will not be tested for decades. (Think of life insurance bought by people in their 20s.) Therefore, both the ability and willingness of the insurer to pay, even if economic chaos prevails when payment time arrives, is all-important.

Berkshire's promises have no equal, a fact affirmed in recent years by certain of the world's largest and most sophisticated P/C insurers, who wished to shed themselves of huge and exceptionally long-lived liabilities. That is, these insurers wished to "cede" these liabilities – most of them potential losses from asbestos claims – to a reinsurer. They needed the right one, though: If a reinsurer fails to pay a loss, the original insurer is still on the hook for it. Choosing a reinsurer, therefore, that down the road proves to be financially strapped or a bad actor threatens the original insurer with getting huge liabilities right back in its lap.

Last year, our premier position in reinsurance was reaffirmed by our writing a policy carrying a $3 billion single premium. I believe that the policy's size has only been exceeded by our 2007 transaction with Lloyd's, in which the premium was $7.1 billion.

In fact, I know of only eight P/C policies in history that had a single premium exceeding $1 billion. And, yes, all eight were written by Berkshire. Certain of these contracts will require us to make substantial payments 50 years or more from now. When major insurers have needed an unquestionable promise that payments of this type will be made, Berkshire has been the party – the *only* party – to call.

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Berkshire's great managers, premier financial strength and a variety of business models protected by wide moats amount to something unique in the insurance world. This assemblage of strengths is a huge asset for Berkshire shareholders that will only get more valuable with time.

Regulated, Capital-Intensive Businesses

We have two major operations, BNSF and Berkshire Hathaway Energy ("BHE"), that share important characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions will far exceed its interest requirements. Last year, for example, BNSF's interest coverage was more than 8:1. (Our definition of coverage is pre-tax earnings/interest, *not* EBITDA/interest, a commonly used measure we view as seriously flawed.)

At BHE, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies offering an essential service on an exclusive basis. The second is enjoyed by few other utilities: a great diversity of earnings streams, which shield us from being seriously harmed by any single regulatory body. Recently, we have further broadened that base through our $3 billion (Canadian) acquisition of AltaLink, an electric transmission system serving 85% of Alberta's population. This multitude of profit streams, supplemented by the inherent advantage of being owned by a strong parent, has enabled BHE and its utility subsidiaries to significantly lower their cost of debt. This economic fact benefits both us *and* our customers.

Every day, our two subsidiaries power the American economy in major ways:

- BNSF carries about 15% (measured by ton-miles) of *all* inter-city freight, whether it is transported by truck, rail, water, air, or pipeline. Indeed, we move more ton-miles of goods than *anyone* else, a fact establishing BNSF as the most important artery in our economy's circulatory system.

  BNSF, like all railroads, also moves its cargo in an extraordinarily fuel-efficient and environmentally friendly way, carrying a ton of freight about 500 miles on a single gallon of diesel fuel. Trucks taking on the same job guzzle about four times as much fuel.

- BHE's utilities serve regulated retail customers in eleven states. No utility company stretches further. In addition, we are a leader in renewables: From a standing start ten years ago, BHE now accounts for 6% of the country's wind generation capacity and 7% of its solar generation capacity. Beyond these businesses, BHE owns two large pipelines that deliver 8% of our country's natural gas consumption; the recently-purchased electric transmission operation in Canada; and major electric businesses in the U.K. and Philippines. And the beat goes on: We will continue to buy and build utility operations throughout the world for decades to come.

  BHE can make these investments because it retains *all* of its earnings. In fact, last year the company retained more dollars of earnings – by far – than any other American electric utility. We and our regulators see this 100% retention policy as an important advantage – one almost certain to distinguish BHE from other utilities for many years to come.

When BHE completes certain renewables projects that are underway, the company's renewables portfolio will have cost $15 billion. In addition, we have conventional projects in the works that will also cost many billions. We relish making such commitments as long as they promise reasonable returns – and, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need massive investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is concomitantly in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Last year we fully met this objective at BHE, just as we have in every year of our ownership. Our rates remain low, our customer satisfaction is high and our record for employee safety is among the best in the industry.

The story at BNSF, however – as I noted earlier – was not good in 2014, a year in which the railroad disappointed many of its customers. This problem occurred despite the record capital expenditures that BNSF has made in recent years, with those having far exceeded the outlays made by Union Pacific, our principal competitor.

The two railroads are of roughly equal size measured by revenues, though we carry considerably more freight (measured either by carloads or ton-miles). But our service problems exceeded Union Pacific's last year, and we lost market share as a result. Moreover, U.P.'s earnings beat ours by a record amount. Clearly, we have a lot of work to do.

We are wasting no time: As I also mentioned earlier, we will spend $6 billion in 2015 on improving our railroad's operation. That will amount to about 26% of estimated revenues (a calculation that serves as the industry's yardstick). Outlays of this magnitude are largely unheard of among railroads. For us, this percentage compares to our average of 18% in 2009-2013 and to U.P.'s projection for the near future of 16-17%. Our huge investments will soon lead to a system with greater capacity and much better service. Improved profits should follow.

Here are the key figures for Berkshire Hathaway Energy and BNSF:

Berkshire Hathaway Energy (89.9% owned)	*Earnings (in millions)*		
	2014	*2013*	*2012*
U.K. utilities	$ 527	$ 362	$ 429
Iowa utility	298	230	236
Nevada utilities	549	—	—
PacifiCorp (primarily Oregon and Utah)	1,010	982	737
Gas Pipelines (Northern Natural and Kern River)	379	385	383
HomeServices	139	139	82
Other (net)	236	4	91
Operating earnings before corporate interest and taxes	3,138	2,102	1,958
Interest	427	296	314
Income taxes	616	170	172
Net earnings	$ 2,095	$ 1,636	$ 1,472
Earnings applicable to Berkshire	$ 1,882	$ 1,470	$ 1,323

BNSF	*Earnings (in millions)*		
	2014	*2013*	*2012*
Revenues	$23,239	$22,014	$20,835
Operating expenses	16,237	15,357	14,835
Operating earnings before interest and taxes	7,002	6,657	6,000
Interest (net)	833	729	623
Income taxes	2,300	2,135	2,005
Net earnings	$ 3,869	$ 3,793	$ 3,372

Manufacturing, Service and Retailing Operations

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

Balance Sheet 12/31/14 (in millions)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 5,765	Notes payable	$ 965
Accounts and notes receivable	8,264	Other current liabilities	9,734
Inventory	10,236	Total current liabilities	10,699
Other current assets	1,117		
Total current assets	25,382		
		Deferred taxes	3,801
Goodwill and other intangibles	28,107	Term debt and other liabilities	4,269
Fixed assets	13,806	Non-controlling interests	492
Other assets	3,793	Berkshire equity	51,827
	$71,088		$71,088

Earnings Statement (in millions)

	2014	*2013**	*2012**
Revenues	$97,689	$93,472	$81,432
Operating expenses	90,788	87,208	75,734
Interest expense	109	104	112
Pre-tax earnings	6,792	6,160	5,586
Income taxes and non-controlling interests	2,324	2,283	2,229
Net earnings	$ 4,468	$ 3,877	$ 3,357

*Earnings for 2012 and 2013 have been restated to exclude Marmon's leasing operations, which are now included in the Finance and Financial Products section.

Our income and expense data conforming to GAAP is on page 49. In contrast, the operating expense figures above are non-GAAP and exclude some purchase-accounting items (primarily the amortization of certain intangible assets). We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the true economic expenses and profits of the businesses aggregated in the table than do GAAP figures.

I won't explain all of the adjustments – some are tiny and arcane – but serious investors should understand the disparate nature of intangible assets. Some truly deplete over time, while others *in no way* lose value. For software, as a big example, amortization charges are very real expenses. The concept of making charges against other intangibles, such as the amortization of customer relationships, however, arises through purchase-accounting rules and clearly does not reflect reality. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when earnings are calculated – even though from an investor's viewpoint they could not be more different.

In the GAAP-compliant figures we show on page 49, amortization charges of $1.15 billion have been deducted as expenses. We would call about 20% of these "real," the rest not. The "non-real" charges, once non-existent at Berkshire, have become significant because of the many acquisitions we have made. Non-real amortization charges will almost certainly rise further as we acquire more companies.

The GAAP-compliant table on page 67 gives you the current status of our intangible assets. We now have $7.4 billion left to amortize, of which $4.1 billion will be charged over the next five years. Eventually, of course, every dollar of non-real costs becomes entirely charged off. When that happens, reported earnings increase even if true earnings are flat.

Depreciation charges, we want to emphasize, are different: Every dime of depreciation expense we report is a real cost. That's true, moreover, at most other companies. When CEOs tout EBITDA as a valuation guide, wire them up for a polygraph test.

Our public reports of earnings will, of course, continue to conform to GAAP. To embrace reality, however, you should remember to add back most of the amortization charges we report.

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To get back to our many manufacturing, service and retailing operations, they sell products ranging from lollipops to jet airplanes. Some of this sector's businesses, measured by earnings on unleveraged net *tangible* assets, enjoy terrific economics, producing profits that run from 25% after-tax to far more than 100%. Others generate good returns in the area of 12% to 20%. A few, however, have very poor returns, the result of some serious mistakes I made in my job of capital allocation. I was not misled: I simply was wrong in my evaluation of the economic dynamics of the company or the industry in which it operates.

Fortunately, my blunders normally involved relatively small acquisitions. Our large buys have generally worked out well and, in a few cases, more than well. I have not, nonetheless, made my last mistake in purchasing either businesses or stocks. Not everything works out as planned.

Viewed as a single entity, the companies in this group are an excellent business. They employed an average of $24 billion of net tangible assets during 2014 and, despite their holding large quantities of excess cash and using little leverage, earned 18.7% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if it is bought for too high a price. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for goodwill. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Furthermore, the intrinsic value of these businesses, in aggregate, exceeds their carrying value by a good margin, and that premium is likely to widen. Even so, the difference between intrinsic value and carrying value in both the insurance and regulated-industry segments is *far* greater. It is there that the truly big winners reside.

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We have far too many companies in this group to comment on them individually. Moreover, their competitors – both current and potential – read this report. In a few of our businesses we might be disadvantaged if others knew our numbers. In some of our operations that are not of a size material to an evaluation of Berkshire, therefore, we only disclose what is required. You can find a good bit of detail about many of our operations, however, on pages 97-100.

Finance and Financial Products

This year we include in this section Marmon's very sizable leasing operations, whose wares are railcars, containers and cranes. We have also restated the previous two years to reflect that change. Why have we made it? At one time there was a large minority ownership at Marmon, and I felt it was more understandable to include all of the company's operations in one place. Today we own virtually 100% of Marmon, which makes me think you will gain more insight into our various businesses if we include Marmon's leasing operations under this heading. (The figures for the many dozens of Marmon's other businesses remain in the previous section.)

Our other leasing and rental operations are conducted by CORT (furniture) and XTRA (semi-trailers). These companies are industry leaders and have substantially increased their earnings as the American economy has gained strength. Both companies have invested more money in new equipment than have many of their competitors, and that's paying off.

Kevin Clayton has again delivered an industry-leading performance at Clayton Homes, the largest home builder in America. Last year, Clayton sold 30,871 homes, about 45% of the manufactured homes bought by Americans. When we purchased Clayton in 2003 for $1.7 billion, its share was 14%.

Key to Clayton's earnings is the company's $13 billion mortgage portfolio. During the financial panic of 2008 and 2009, when funding for the industry dried up, Clayton was able to keep lending because of Berkshire's backing. In fact, we continued during that period to finance our competitors' retail sales as well as our own.

Many of Clayton's borrowers have low incomes and mediocre FICO scores. But thanks to the company's sensible lending practices, its portfolio performed well during the recession, meaning a very high percentage of our borrowers kept their homes. Our blue-collar borrowers, in many cases, proved much better credit risks than their higher-income brethren.

At Marmon's railroad-car operation, lease rates have improved substantially over the past few years. The nature of this business, however, is that only 20% or so of our leases expire annually. Consequently, improved pricing only gradually works its way into our revenue stream. The trend, though, is strong. Our 105,000-car fleet consists largely of tank cars, but only 8% of those transport crude oil.

One further fact about our rail operation is important for you to know: Unlike many other lessors, we manufacture our own tank cars, about 6,000 of them in a good year. We do not book *any* profit when we transfer cars from our manufacturing division to our leasing division. Our fleet is consequently placed on our books at a "bargain" price. The difference between that figure and a "retail" price is only slowly reflected in our earnings through smaller annual depreciation charges that we enjoy over the 30-year life of the car. Because of that fact as well as others, Marmon's rail fleet is worth considerably more than the $5 billion figure at which it is carried on our books.

Here's the earnings recap for this sector:

	2014	*2013*	*2012*
		(in millions)	
Berkadia (our 50% share)	$ 122	$ 80	$ 35
Clayton	558	416	255
CORT	36	40	42
Marmon – Containers and Cranes	238	226	246
Marmon – Railcars	442	353	299
XTRA	147	125	106
Net financial income*	296	324	410
	$ 1,839	$ 1,564	$ 1,393

* Excludes capital gains or losses

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value.

*Shares***	*Company*	*Percentage of Company Owned*	*12/31/14* *Cost**	*Market*
			(in millions)	
151,610,700	American Express Company	14.8	$ 1,287	$ 14,106
400,000,000	The Coca-Cola Company	9.2	1,299	16,888
18,513,482	DaVita HealthCare Partners Inc.	8.6	843	1,402
15,430,586	Deere & Company	4.5	1,253	1,365
24,617,939	DIRECTV	4.9	1,454	2,134
13,062,594	The Goldman Sachs Group, Inc.	3.0	750	2,532
76,971,817	International Business Machines Corp.	7.8	13,157	12,349
24,669,778	Moody's Corporation	12.1	248	2,364
20,060,390	Munich Re	11.8	2,990	4,023
52,477,678	The Procter & Gamble Company	1.9	336	4,683 ***
22,169,930	Sanofi	1.7	1,721	2,032
96,890,665	U.S. Bancorp	5.4	3,033	4,355
43,387,980	USG Corporation	30.0	836	1,214
67,707,544	Wal-Mart Stores, Inc.	2.1	3,798	5,815
483,470,853	Wells Fargo & Company	9.4	11,871	26,504
	Others		10,180	15,704
	Total Common Stocks Carried at Market		$55,056	$ 117,470

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

**Excludes shares held by pension funds of Berkshire subsidiaries.

***Held under contract of sale for this amount.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for $5 billion. At yearend these shares were worth $12.5 billion. We are likely to purchase the shares just before expiration of our option. In the meantime, it is important for you to realize that Bank of America is, in effect, our fourth largest equity investment – and one we value highly.

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Attentive readers will notice that Tesco, which last year appeared in the list of our largest common stock investments, is now absent. An attentive *investor*, I'm embarrassed to report, would have sold Tesco shares earlier. I made a big mistake with this investment by dawdling.

At the end of 2012 we owned 415 million shares of Tesco, then and now the leading food retailer in the U.K. and an important grocer in other countries as well. Our cost for this investment was $2.3 billion, and the market value was a similar amount.

In 2013, I soured somewhat on the company's then-management and sold 114 million shares, realizing a profit of $43 million. My leisurely pace in making sales would prove expensive. Charlie calls this sort of behavior "thumb-sucking." (Considering what my delay cost us, he is being kind.)

During 2014, Tesco's problems worsened by the month. The company's market share fell, its margins contracted and accounting problems surfaced. In the world of business, bad news often surfaces serially: You see a cockroach in your kitchen; as the days go by, you meet his relatives.

We sold Tesco shares throughout the year and are now out of the position. (The company, we should mention, has hired new management, and we wish them well.) Our after-tax loss from this investment was $444 million, about 1/5 of 1% of Berkshire's net worth. In the past 50 years, we have only once realized an investment loss that at the time of sale cost us 2% of our net worth. Twice, we experienced 1% losses. All three of these losses occurred in the 1974-1975 period, when we sold stocks that were very cheap in order to buy others we believed to be even cheaper.

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Our investment results have been helped by a terrific tailwind. During the 1964-2014 period, the S&P 500 rose from 84 to 2,059, which, with reinvested dividends, generated the overall return of 11,196% shown on page 2. Concurrently, the purchasing power of the dollar declined a staggering 87%. That decrease means that it now takes $1 to buy what could be bought for 13¢ in 1965 (as measured by the Consumer Price Index).

There is an important message for investors in that disparate performance between stocks and dollars. Think back to our 2011 annual report, in which we defined investing as "the transfer to others of purchasing power now with the reasoned expectation of receiving more purchasing power – *after taxes have been paid on nominal gains* – in the future."

The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been *far* safer to invest in a diversified collection of American businesses than to invest in securities – Treasuries, for example – whose values have been tied to American currency. That was also true in the preceding half-century, a period including the Great Depression and two world wars. Investors should heed this history. To one degree or another it is almost certain to be repeated during the next century.

Stock prices will always be far more *volatile* than cash-equivalent holdings. *Over the long term*, however, currency-denominated instruments are *riskier* investments – *far* riskier investments – than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is *far* from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray.

It is true, of course, that owning equities for a day or a week or a year is far riskier (in both nominal and purchasing-power terms) than leaving funds in cash-equivalents. That is relevant to certain investors – say, investment banks – whose viability can be threatened by declines in asset prices and which might be forced to sell securities during depressed markets. Additionally, any party that might have meaningful near-term needs for funds should keep appropriate sums in Treasuries or insured bank deposits.

For the great majority of investors, however, who can – and *should* – invest with a multi-decade horizon, quotational declines are unimportant. Their focus should remain fixed on attaining significant gains in purchasing power over their investing lifetime. For them, a diversified equity portfolio, *bought over time*, will prove far less risky than dollar-based securities.

If the investor, instead, fears price volatility, erroneously viewing it as a measure of risk, he may, ironically, end up doing some very risky things. Recall, if you will, the pundits who six years ago bemoaned falling stock prices and advised investing in "safe" Treasury bills or bank certificates of deposit. People who heeded this sermon are now earning a pittance on sums they had previously expected would finance a pleasant retirement. (The S&P 500 was then below 700; now it is about 2,100.) If not for their fear of meaningless price volatility, these investors could have assured themselves of a good income for life by simply buying a very low-cost index fund whose dividends would trend upward over the years and whose principal would grow as well (with many ups and downs, to be sure).

Investors, of course, can, *by their own behavior*, make stock ownership highly risky. And many do. Active trading, attempts to "time" market movements, inadequate diversification, the payment of high and unnecessary fees to managers and advisors, and the use of borrowed money can destroy the decent returns that a life-long owner of equities would otherwise enjoy. Indeed, borrowed money has *no* place in the investor's tool kit: *Anything* can happen *anytime* in markets. And no advisor, economist, or TV commentator – and definitely not Charlie nor I – can tell you when chaos will occur. Market forecasters will fill your ear but will never fill your wallet.

The commission of the investment sins listed above is not limited to "the little guy." Huge institutional investors, viewed as a group, have long underperformed the unsophisticated index-fund investor who simply sits tight for decades. A major reason has been fees: Many institutions pay substantial sums to consultants who, in turn, recommend high-fee managers. And that is a fool's game.

There are a few investment managers, of course, who are very good – though in the short run, it's difficult to determine whether a great record is due to luck or talent. Most advisors, however, are far better at generating high fees than they are at generating high returns. In truth, their core competence is salesmanship. Rather than listen to their siren songs, investors – large and small – should instead read Jack Bogle's *The Little Book of Common Sense Investing*.

Decades ago, Ben Graham pinpointed the blame for investment failure, using a quote from Shakespeare: "The fault, dear Brutus, is not in our stars, but in ourselves."

The Annual Meeting

The annual meeting will be held on Saturday, May 2nd at the CenturyLink Center. Last year's attendance of 39,000 set a record, and we expect a further increase this year as we celebrate our Golden Anniversary. Be there when the doors open at 7 a.m.

Berkshire's talented Carrie Sova will again be in charge. Carrie joined us six years ago at the age of 24 as a secretary. Then, four years ago, I asked her to take charge of the meeting – a huge undertaking, requiring a multitude of skills – and she jumped at the chance. Carrie is unflappable, ingenious and expert at bringing out the best in the hundreds who work with her. She is aided by our entire home office crew who enjoy pitching in to make the weekend fun and informative for our owners.

And, yes, we also try to sell our visiting shareholders our products while they're here. In fact, this year we will substantially increase the hours available for purchases, opening for business at the CenturyLink on Friday, May 1st, from noon to 5 p.m. as well as the usual 7 a.m. to 4 p.m. on meeting day. So bring a smile to Charlie's face and do some serious shopping.

Get up early on Saturday morning. At 6:20 a.m., Norman and Jake, two Texas longhorns each weighing about a ton, will proceed down 10th Street to the CenturyLink. Aboard them will be a couple of our Justin Boot executives, who do double duty as cowboys. Following the steers will be four horses pulling a Wells Fargo stagecoach. Berkshire already markets planes, trains and automobiles. Adding steers and stagecoaches to our portfolio should seal our reputation as America's all-purpose transportation company.

At about 7:30 a.m. on Saturday, we will have our fourth International Newspaper Tossing Challenge. Our target again will be a Clayton Home porch, located precisely 35 feet from the throwing line. When I was a teenager – in my one brief flirtation with honest labor – I tossed about 500,000 papers. So I think I'm pretty good. Challenge me! Humiliate me! Knock me down a peg! I'll buy a Dilly Bar for anyone who lands his or her throw closer to the doorstep than I do. The papers will run 36 to 42 pages, and you must fold them yourself (no rubber bands allowed). I'll present a special prize to the 12-or-under contestant who makes the best toss. Deb Bosanek will be the judge.

At 8:30 a.m., a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (with a break for lunch at CenturyLink's stands) will last until 3:30 p.m. After a short recess, Charlie and I will convene the annual meeting at 3:45 p.m. This business session typically lasts only a half hour or so.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of Berkshire subsidiaries will be for sale. If you don't get your shopping done on Friday, slip out while Charlie's talking on Saturday and binge on our bargains. Check the terrific BNSF railroad layout also. Even though I'm 84, it still excites me.

Last year you did your part as a shopper, and most of our businesses racked up record sales. In a nine-hour period on Saturday, we sold 1,385 pairs of Justin boots (that's a pair every 23 seconds), 13,440 pounds of See's candy, 7,276 pairs of Wells Lamont work gloves and 10,000 bottles of Heinz ketchup. Heinz has a new mustard product, so both mustard and ketchup will be available this year. (Buy both!) Now that we are open for business on Friday as well, we expect new records in every precinct.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them the next day at our third annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that will be sent to you with your credentials for the meeting. Entrants in the race will find themselves running alongside many of Berkshire's managers, directors and associates. (Charlie and I, however, will sleep in.)

A GEICO booth in the shopping area will be staffed by a number of the company's top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, among them a couple of new titles. Last year, many shareholders purchased Max Olson's compilation of Berkshire letters going back to 1965, and he has produced an updated edition for the meeting. We also expect to be selling an inexpensive book commemorating our fifty years. It's currently a work in process, but I expect it to contain a wide variety of historical material, including documents from the 19th Century.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money, particularly if you had planned to rent a car in Omaha. The savings for a couple could run to $1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. Last year in the week surrounding the meeting, the store did a record $40,481,817 of business. (An average week for NFM's Omaha store is about $9 million.)

To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, April 28th and Monday, May 4th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Friday, 10 a.m. to 9:30 p.m. on Saturday and 10 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is having a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 1st. The second, the main gala, will be held on Sunday, May 3rd, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. In recent years, our three-day volume has far exceeded our sales in all of December, normally a jeweler's best month.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 27th through Saturday, May 9th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in the mall outside of Borsheims, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon. Don't play them for money.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine and even then I was unable to score a point against her. Now, she's a sophomore at Princeton, having already represented the United States in the 2012 Olympics. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates and I will lead off and try to soften her up.

Gorat's and Piccolo's will again be open exclusively for Berkshire shareholders on Sunday, May 3rd. Both will be serving until 10 p.m., with Gorat's opening at 1 p.m. and Piccolo's opening at 4 p.m. These restaurants are my favorites, and I will eat at both of them on Sunday evening. Remember: To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*); for Piccolo's, call 402-346-2865. At Piccolo's, order a giant root beer float for dessert. Only sissies get the small one.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, who retired last year after sixty years at Fortune, but remains *the* expert on business and financial matters, and who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

We will also have a panel of three analysts who follow Berkshire. This year the insurance specialist will be Gary Ransom of Dowling & Partners. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. All told we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. (Last year we had 62 in total.) The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and should also have adequate time to analyze it. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday. We do not talk one-on-one to large institutional investors or analysts, treating them instead as we do all other shareholders.

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We get terrific help at meeting time from literally thousands of Omaha residents and businesses who want you to enjoy yourselves. This year, because we expect record attendance, we have worried about a shortage of hotel rooms. To deal with that possible problem, Airbnb is making a special effort to obtain listings for the period around meeting time and is likely to have a wide array of accommodations to offer. Airbnb's services may be especially helpful to shareholders who expect to spend only a single night in Omaha and are aware that last year a few hotels required guests to pay for a minimum of three nights. That gets expensive. Those people on a tight budget should check the Airbnb website.

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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 the mindset of our managers also to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 24 men and women who work with me at our corporate office. This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 24,100-page Federal income tax return and oversees the filing of 3,400 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and french fries (smothered in Heinz ketchup, of course) for lunch. No CEO has it better; I truly do feel like tap dancing to work every day.

Last year, for the annual report, we dropped our 48-year-old "no pictures" policy – who says I'm not flexible? – and ran a photo of our remarkable home-office crew that was taken at our Christmas lunch. I didn't warn the gang of the public exposure they were to receive, so they didn't have on their Sunday best. This year was a different story: On the facing page you will see what our group looks like when they think someone will be noticing. However they dress, their performance is mind-boggling.

Come meet them on May 2nd and enjoy our Woodstock for Capitalists.

February 27, 2015

Warren E. Buffett
Chairman of the Board

BERKSHIRE HATHAWAY INC.

ACQUISITION CRITERIA

We are eager to hear *from principals or their representatives* about businesses that meet all of the following criteria:

(1) Large purchases (at least $75 million of pre-tax earnings unless the business will fit into one of our existing units),
(2) Demonstrated consistent earning power (future projections are of no interest to us, nor are "turnaround" situations),
(3) Businesses earning good returns on equity while employing little or no debt,
(4) Management in place (we can't supply it),
(5) Simple businesses (if there's lots of technology, we won't understand it),
(6) An offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

The larger the company, the greater will be our interest: We would like to make an acquisition in the $5-20 billion range. *We are not interested, however, in receiving suggestions about purchases we might make in the general stock market.*

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer – customarily within five minutes – as to whether we're interested. We prefer to buy for cash, but will consider issuing stock when we receive as much in intrinsic business value as we give. *We don't participate in auctions*.

Charlie and I frequently get approached about acquisitions that don't come close to meeting our tests: We've found that if you advertise an interest in buying collies, a lot of people will call hoping to sell you their cocker spaniels. A line from a country song expresses our feeling about new ventures, turnarounds, or auction-like sales: "When the phone don't ring, you'll know it's me."

Berkshire – Past, Present and Future

In the Beginning

On May 6, 1964, Berkshire Hathaway, then run by a man named Seabury Stanton, sent a letter to its shareholders offering to buy 225,000 shares of its stock for $11.375 per share. I had expected the letter; I was surprised by the price.

Berkshire then had 1,583,680 shares outstanding. About 7% of these were owned by Buffett Partnership Ltd. ("BPL"), an investing entity that I managed and in which I had virtually all of my net worth. Shortly before the tender offer was mailed, Stanton had asked me at what price BPL would sell its holdings. I answered $11.50, and he said, "Fine, we have a deal." Then came Berkshire's letter, offering an eighth of a point less. I bristled at Stanton's behavior and didn't tender.

That was a monumentally stupid decision.

Berkshire was then a northern textile manufacturer mired in a terrible business. The industry in which it operated was heading south, both metaphorically and physically. And Berkshire, for a variety of reasons, was unable to change course.

That was true even though the industry's problems had long been widely understood. Berkshire's own Board minutes of July 29, 1954, laid out the grim facts: "The textile industry in New England started going out of business forty years ago. During the war years this trend was stopped. The trend must continue until supply and demand have been balanced."

About a year after that board meeting, Berkshire Fine Spinning Associates and Hathaway Manufacturing – both with roots in the 19th Century – joined forces, taking the name we bear today. With its fourteen plants and 10,000 employees, the merged company became the giant of New England textiles. What the two managements viewed as a merger agreement, however, soon morphed into a suicide pact. During the seven years following the consolidation, Berkshire operated at an overall loss, and its net worth shrunk by 37%.

Meanwhile, the company closed nine plants, sometimes using the liquidation proceeds to repurchase shares. And that pattern caught my attention.

I purchased BPL's first shares of Berkshire in December 1962, anticipating more closings and more repurchases. The stock was then selling for $7.50, a wide discount from per-share working capital of $10.25 and book value of $20.20. Buying the stock at that price was like picking up a discarded cigar butt that had one puff remaining in it. Though the stub might be ugly and soggy, the puff would be free. Once that momentary pleasure was enjoyed, however, no more could be expected.

Berkshire thereafter stuck to the script: It soon closed another two plants, and in that May 1964 move, set out to repurchase shares with the shutdown proceeds. The price that Stanton offered was 50% above the cost of our original purchases. There it was – my free puff, just waiting for me, after which I could look elsewhere for other discarded butts.

Instead, irritated by Stanton's chiseling, I ignored his offer and began to aggressively buy more Berkshire shares.

By April 1965, BPL owned 392,633 shares (out of 1,017,547 then outstanding) and at an early-May board meeting we formally took control of the company. Through Seabury's and my childish behavior – after all, what was an eighth of a point to either of us? – he lost his job, and I found myself with more than 25% of BPL's capital invested in a terrible business about which I knew very little. I became the dog who caught the car.

Because of Berkshire's operating losses and share repurchases, its net worth at the end of fiscal 1964 had fallen to $22 million from $55 million at the time of the 1955 merger. The full $22 million was required by the textile operation: The company had no excess cash and owed its bank $2.5 million. (Berkshire's 1964 annual report is reproduced on pages 130-142.)

For a time I got lucky: Berkshire immediately enjoyed two years of good operating conditions. Better yet, its earnings in those years were free of income tax because it possessed a large loss carry-forward that had arisen from the disastrous results in earlier years.

Then the honeymoon ended. During the 18 years following 1966, we struggled unremittingly with the textile business, all to no avail. But stubbornness – stupidity? – has its limits. In 1985, I finally threw in the towel and closed the operation.

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Undeterred by my first mistake of committing much of BPL's resources to a dying business, I quickly compounded the error. Indeed, my second blunder was far more serious than the first, eventually becoming the most costly in my career.

Early in 1967, I had Berkshire pay $8.6 million to buy National Indemnity Company ("NICO"), a small but promising Omaha-based insurer. (A tiny sister company was also included in the deal.) Insurance was in my sweet spot: I understood and liked the industry.

Jack Ringwalt, the owner of NICO, was a long-time friend who wanted to sell to me – me, personally. In no way was his offer intended for Berkshire. So why did I purchase NICO for Berkshire rather than for BPL? I've had 48 years to think about that question, and I've yet to come up with a good answer. I simply made a colossal mistake.

If BPL had been the purchaser, my partners and I would have owned 100% of a fine business, destined to form the base for building the company Berkshire has become. Moreover, our growth would not have been impeded for nearly two decades by the unproductive funds imprisoned in the textile operation. Finally, our subsequent acquisitions would have been owned in their entirety by my partners and me rather than being 39%-owned by the legacy shareholders of Berkshire, to whom we had no obligation. Despite these facts staring me in the face, I opted to marry 100% of an excellent business (NICO) to a 61%-owned terrible business (Berkshire Hathaway), a decision that eventually diverted $100 billion or so from BPL partners to a collection of strangers.

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One more confession and then I'll go on to more pleasant topics: Can you believe that in 1975 I bought Waumbec Mills, another New England textile company? Of course, the purchase price was a "bargain" based on the assets we received and the *projected* synergies with Berkshire's existing textile business. Nevertheless – surprise, surprise – Waumbec was a disaster, with the mill having to be closed down not many years later.

And now some good news: The northern textile industry is finally extinct. You need no longer panic if you hear that I've been spotted wandering around New England.

Charlie Straightens Me Out

My cigar-butt strategy worked very well while I was managing small sums. Indeed, the many dozens of free puffs I obtained in the 1950s made that decade by far the best of my life for both relative and absolute investment performance.

Even then, however, I made a few exceptions to cigar butts, the most important being GEICO. Thanks to a 1951 conversation I had with Lorimer Davidson, a wonderful man who later became CEO of the company, I learned that GEICO was a terrific business and promptly put 65% of my $9,800 net worth into its shares. Most of my gains in those early years, though, came from investments in mediocre companies that traded at bargain prices. Ben Graham had taught me that technique, and it worked.

But a major weakness in this approach gradually became apparent: Cigar-butt investing was scalable only to a point. With large sums, it would never work well.

In addition, though marginal businesses purchased at cheap prices may be attractive as short-term investments, they are the wrong foundation on which to build a large and enduring enterprise. Selecting a marriage partner clearly requires more demanding criteria than does dating. (Berkshire, it should be noted, would have been a highly satisfactory "date": If we had taken Seabury Stanton's $11.375 offer for our shares, BPL's weighted annual return on its Berkshire investment would have been about 40%.)

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It took Charlie Munger to break my cigar-butt habits and set the course for building a business that could combine huge size with satisfactory profits. Charlie had grown up a few hundred feet from where I now live and as a youth had worked, as did I, in my grandfather's grocery store. Nevertheless, it was 1959 before I met Charlie, long after he had left Omaha to make Los Angeles his home. I was then 28 and he was 35. The Omaha doctor who introduced us predicted that we would hit it off – and we did.

If you've attended our annual meetings, you know Charlie has a wide-ranging brilliance, a prodigious memory, and some firm opinions. I'm not exactly wishy-washy myself, and we sometimes don't agree. In 56 years, however, we've never had an argument. When we differ, Charlie usually ends the conversation by saying: "Warren, think it over and you'll agree with me because you're smart and I'm right."

What most of you do *not* know about Charlie is that architecture is among his passions. Though he began his career as a practicing lawyer (with his time billed at $15 per hour), Charlie made his first real money in his 30s by designing and building five apartment projects near Los Angeles. Concurrently, he designed the house that he lives in today – some 55 years later. (Like me, Charlie can't be budged if he is happy in his surroundings.) In recent years, Charlie has designed large dorm complexes at Stanford and the University of Michigan and today, at age 91, is working on another major project.

From my perspective, though, Charlie's most important architectural feat was the design of today's Berkshire. The blueprint he gave me was simple: Forget what you know about buying fair businesses at wonderful prices; instead, buy wonderful businesses at fair prices.

Altering my behavior is not an easy task (ask my family). I had enjoyed reasonable success without Charlie's input, so why should I listen to a lawyer who had never spent a day in business school (when – ahem – *I* had attended *three*). But Charlie never tired of repeating his maxims about business and investing to me, and his logic was irrefutable. Consequently, Berkshire has been built to Charlie's blueprint. My role has been that of general contractor, with the CEOs of Berkshire's subsidiaries doing the real work as sub-contractors.

The year 1972 was a turning point for Berkshire (though not without occasional backsliding on my part – remember my 1975 purchase of Waumbec). We had the opportunity then to buy See's Candy for Blue Chip Stamps, a company in which Charlie, I and Berkshire had major stakes, and which was later merged into Berkshire.

See's was a legendary West Coast manufacturer and retailer of boxed chocolates, then annually earning about $4 million pre-tax while utilizing only $8 million of net tangible assets. Moreover, the company had a huge asset that did not appear on its balance sheet: a broad and durable competitive advantage that gave it significant pricing power. That strength was virtually certain to give See's major gains in earnings over time. Better yet, these would materialize with only minor amounts of incremental investment. In other words, See's could be expected to gush cash for decades to come.

The family controlling See's wanted $30 million for the business, and Charlie rightly said it was worth that much. But I didn't want to pay more than $25 million and wasn't all that enthusiastic even at that figure. (A price that was three times net tangible assets made me gulp.) My misguided caution could have scuttled a terrific purchase. But, luckily, the sellers decided to take our $25 million bid.

To date, See's has earned $1.9 billion pre-tax, with its growth having required added investment of only $40 million. See's has thus been able to distribute huge sums that have helped Berkshire buy other businesses that, in turn, have themselves produced large distributable profits. (Envision rabbits breeding.) Additionally, through watching See's in action, I gained a business education about the value of powerful brands that opened my eyes to many other profitable investments.

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Even with Charlie's blueprint, I have made plenty of mistakes since Waumbec. The most gruesome was Dexter Shoe. When we purchased the company in 1993, it had a terrific record and in no way looked to me like a cigar butt. Its competitive strengths, however, were soon to evaporate because of foreign competition. And I simply didn't see that coming.

Consequently, Berkshire paid $433 million for Dexter and, rather promptly, its value went to zero. GAAP accounting, however, doesn't come close to recording the magnitude of my error. The fact is that I gave Berkshire stock to the sellers of Dexter rather than cash, and the shares I used for the purchase are now worth about $5.7 billion. As a financial disaster, this one deserves a spot in the Guinness Book of World Records.

Several of my subsequent errors also involved the use of Berkshire shares to purchase businesses whose earnings were destined to simply limp along. Mistakes of that kind are deadly. Trading shares of a wonderful business – which Berkshire most certainly is – for ownership of a so-so business irreparably destroys value.

We've also suffered financially when this mistake has been committed by companies whose shares Berkshire has owned (with the errors sometimes occurring while I was serving as a director). Too often CEOs seem blind to an elementary reality: The intrinsic value of the shares you give in an acquisition must not be greater than the intrinsic value of the business you receive.

I've yet to see an investment banker quantify this all-important math when he is presenting a stock-for-stock deal to the board of a potential acquirer. Instead, the banker's focus will be on describing "customary" premiums-to-market-price that are currently being paid for acquisitions – an absolutely asinine way to evaluate the attractiveness of an acquisition – or whether the deal will increase the acquirer's earnings-per-share (which in itself should be far from determinative). In striving to achieve the desired per-share number, a panting CEO and his "helpers" will often conjure up fanciful "synergies." (As a director of 19 companies over the years, I've never heard "dis-synergies" mentioned, though I've witnessed plenty of these once deals have closed.) Post mortems of acquisitions, in which reality is honestly compared to the original projections, are rare in American boardrooms. They should instead be standard practice.

I can promise you that long after I'm gone, Berkshire's CEO and Board will carefully make intrinsic value calculations before issuing shares in any acquisitions. You can't get rich trading a hundred-dollar bill for eight tens (even if your advisor has handed you an expensive "fairness" opinion endorsing that swap).

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Overall, Berkshire's acquisitions have worked out well – and *very* well in the case of a few large ones. So, too, have our investments in marketable securities. The latter are always valued on our balance sheet at their market prices so any gains – including those unrealized – are immediately reflected in our net worth. But the businesses we buy outright are never revalued upward on our balance sheet, even when we could sell them for many billions of dollars more than their carrying value. The unrecorded gains in the value of Berkshire's subsidiaries have become huge, with these growing at a particularly fast pace in the last decade.

Listening to Charlie has paid off.

Berkshire Today

Berkshire is now a sprawling conglomerate, constantly trying to sprawl further.

Conglomerates, it should be acknowledged, have a terrible reputation with investors. And they richly deserve it. Let me first explain why they are in the doghouse, and then I will go on to describe why the conglomerate form brings huge and enduring advantages to Berkshire.

Since I entered the business world, conglomerates have enjoyed several periods of extreme popularity, the silliest of which occurred in the late 1960s. The drill for conglomerate CEOs then was simple: By personality, promotion or dubious accounting – and often by all three – these managers drove a fledgling conglomerate's stock to, say, 20 times earnings and then issued shares as fast as possible to acquire another business selling at ten-or-so times earnings. They immediately applied "pooling" accounting to the acquisition, which – with not a dime's worth of change in the underlying businesses – automatically increased per-share earnings, and used the rise as proof of managerial genius. They next explained to investors that this sort of talent justified the maintenance, or even the enhancement, of the acquirer's p/e multiple. And, finally, they promised to endlessly repeat this procedure and thereby create ever-increasing per-share earnings.

Wall Street's love affair with this hocus-pocus intensified as the 1960s rolled by. The Street's denizens are always ready to suspend disbelief when dubious maneuvers are used to manufacture rising per-share earnings, particularly if these acrobatics produce mergers that generate huge fees for investment bankers. Auditors willingly sprinkled their holy water on the conglomerates' accounting and sometimes even made suggestions as to how to further juice the numbers. For many, gushers of easy money washed away ethical sensitivities.

Since the per-share earnings gains of an expanding conglomerate came from exploiting p/e differences, its CEO had to search for businesses selling at low multiples of earnings. These, of course, were characteristically mediocre businesses with poor long-term prospects. This incentive to bottom-fish usually led to a conglomerate's collection of underlying businesses becoming more and more junky. That mattered little to investors: It was deal velocity and pooling accounting they looked to for increased earnings.

The resulting firestorm of merger activity was fanned by an adoring press. Companies such as ITT, Litton Industries, Gulf & Western, and LTV were lionized, and their CEOs became celebrities. (These once-famous conglomerates are now long gone. As Yogi Berra said, "Every Napoleon meets his Watergate.")

Back then, accounting shenanigans of all sorts – many of them ridiculously transparent – were excused or overlooked. Indeed, having an accounting wizard at the helm of an expanding conglomerate was viewed as a huge plus: Shareholders in those instances could be sure that *reported* earnings would never disappoint, no matter how bad the operating realities of the business might become.

In the late 1960s, I attended a meeting at which an acquisitive CEO bragged of his "bold, imaginative accounting." Most of the analysts listening responded with approving nods, seeing themselves as having found a manager whose forecasts were certain to be met, whatever the business results might be.

Eventually, however, the clock struck twelve, and everything turned to pumpkins and mice. Once again, it became evident that business models based on the serial issuances of overpriced shares – just like chain-letter models – most assuredly redistribute wealth, but in no way create it. Both phenomena, nevertheless, periodically blossom in our country – they are every promoter's dream – though often they appear in a carefully-crafted disguise. The ending is always the same: Money flows from the gullible to the fraudster. And with stocks, unlike chain letters, the sums hijacked can be staggering.

At both BPL and Berkshire, we have *never* invested in companies that are hell-bent on issuing shares. That behavior is one of the surest indicators of a promotion-minded management, weak accounting, a stock that is overpriced and – all too often – outright dishonesty.

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So what do Charlie and I find so attractive about Berkshire's conglomerate structure? To put the case simply: If the conglomerate form is used judiciously, it is an ideal structure for maximizing long-term capital growth.

One of the heralded virtues of capitalism is that it efficiently allocates funds. The argument is that markets will direct investment to promising businesses and deny it to those destined to wither. That is true: With all its excesses, market-driven allocation of capital is usually far superior to any alternative.

Nevertheless, there are often obstacles to the rational movement of capital. As those 1954 Berkshire minutes made clear, capital withdrawals within the textile industry that should have been obvious were delayed for decades because of the vain hopes and self-interest of managements. Indeed, I myself delayed abandoning our obsolete textile mills for far too long.

A CEO with capital employed in a declining operation seldom elects to massively redeploy that capital into unrelated activities. A move of that kind would usually require that long-time associates be fired and mistakes be admitted. Moreover, it's unlikely *that* CEO would be the manager you would wish to handle the redeployment job even if he or she was inclined to undertake it.

At the shareholder level, taxes and frictional costs weigh heavily on individual investors when they attempt to reallocate capital among businesses and industries. Even tax-free institutional investors face major costs as they move capital because they usually need intermediaries to do this job. A lot of mouths with expensive tastes then clamor to be fed – among them investment bankers, accountants, consultants, lawyers and such capital-reallocators as leveraged buyout operators. Money-shufflers don't come cheap.

In contrast, a conglomerate such as Berkshire is perfectly positioned to allocate capital rationally and at minimal cost. Of course, form itself is no guarantee of success: We have made plenty of mistakes, and we will make more. Our structural advantages, however, are formidable.

At Berkshire, we can – without incurring taxes or much in the way of other costs – move huge sums from businesses that have limited opportunities for incremental investment to other sectors with greater promise. Moreover, we are free of historical biases created by lifelong association with a given industry and are not subject to pressures from colleagues having a vested interest in maintaining the status quo. That's important: If horses had controlled investment decisions, there would have been no auto industry.

Another major advantage we possess is the ability to buy *pieces* of wonderful businesses – a.k.a. common stocks. That's not a course of action open to most managements. Over our history, this strategic alternative has proved to be very helpful; a broad range of options always sharpens decision-making. The businesses we are offered by the stock market every day – in small pieces, to be sure – are often far more attractive than the businesses we are concurrently being offered in their entirety. Additionally, the gains we've realized from marketable securities have helped us make certain large acquisitions that would otherwise have been beyond our financial capabilities.

In effect, the world is Berkshire's oyster – a world offering us a range of opportunities far beyond those realistically open to most companies. We are limited, of course, to businesses whose economic prospects we can evaluate. And that's a serious limitation: Charlie and I have no idea what a great many companies will look like ten years from now. But that limitation is much smaller than that borne by an executive whose experience has been confined to a single industry. On top of that, we can profitably scale to a *far* larger size than the many businesses that are constrained by the limited potential of the single industry in which they operate.

I mentioned earlier that See's Candy had produced huge earnings compared to its modest capital requirements. We would have loved, of course, to intelligently use those funds to expand our candy operation. But our many attempts to do so were largely futile. So, without incurring tax inefficiencies or frictional costs, we have used the excess funds generated by See's to help purchase other businesses. If See's had remained a stand-alone company, its earnings would have had to be distributed to investors to redeploy, sometimes after being heavily depleted by large taxes and, almost always, by significant frictional and agency costs.

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Berkshire has one further advantage that has become increasingly important over the years: We are now the home of choice for the owners and managers of many outstanding businesses.

Families that own successful businesses have multiple options when they contemplate sale. Frequently, the best decision is to do nothing. There are worse things in life than having a prosperous business that one understands well. But sitting tight is seldom recommended by Wall Street. (Don't ask the barber whether you need a haircut.)

When one part of a family wishes to sell while others wish to continue, a public offering often makes sense. But, when owners wish to cash out entirely, they usually consider one of two paths.

The first is sale to a competitor who is salivating at the possibility of wringing "synergies" from the combining of the two companies. This buyer invariably contemplates getting rid of large numbers of the seller's associates, the very people who have helped the owner build his business. A caring owner, however – and there are plenty of them – usually does not want to leave his long-time associates sadly singing the old country song: "*She got the goldmine, I got the shaft.*"

The second choice for sellers is the Wall Street buyer. For some years, these purchasers accurately called themselves "leveraged buyout firms." When that term got a bad name in the early 1990s – remember RJR and *Barbarians at the Gate*? – these buyers hastily relabeled themselves "private-equity."

The name may have changed but that was all: Equity is dramatically *reduced* and debt is piled on in virtually all private-equity purchases. Indeed, the amount that a private-equity purchaser offers to the seller is in part determined by the buyer assessing the *maximum* amount of debt that can be placed on the acquired company.

Later, if things go well and equity begins to build, leveraged buy-out shops will often seek to re-leverage with new borrowings. They then typically use part of the proceeds to pay a huge dividend that drives equity sharply downward, sometimes even to a negative figure.

In truth, "equity" is a dirty word for many private-equity buyers; what they love is debt. And, because debt is currently so inexpensive, these buyers can frequently pay top dollar. Later, the business will be resold, often to another leveraged buyer. In effect, the business becomes a piece of merchandise.

Berkshire offers a third choice to the business owner who wishes to sell: a permanent home, in which the company's people and culture will be retained (though, occasionally, management changes will be needed). Beyond that, any business we acquire dramatically increases its financial strength and ability to grow. Its days of dealing with banks and Wall Street analysts are also forever ended.

Some sellers don't care about these matters. But, when sellers do, Berkshire does not have a lot of competition.

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Sometimes pundits propose that Berkshire spin-off certain of its businesses. These suggestions make no sense. Our companies are worth more as part of Berkshire than as separate entities. One reason is our ability to move funds between businesses or into new ventures instantly and without tax. In addition, certain costs duplicate themselves, in full or part, if operations are separated. Here's the most obvious example: Berkshire incurs nominal costs for its single board of directors; were our dozens of subsidiaries to be split off, the overall cost for directors would soar. So, too, would regulatory and administration expenditures.

Finally, there are sometimes important tax efficiencies for Subsidiary A because we own Subsidiary B. For example, certain tax credits that are available to our utilities are currently realizable only because we generate huge amounts of taxable income at other Berkshire operations. That gives Berkshire Hathaway Energy a major advantage over most public-utility companies in developing wind and solar projects.

Investment bankers, being paid as they are for action, constantly urge acquirers to pay 20% to 50% premiums over market price for publicly-held businesses. The bankers tell the buyer that the premium is justified for "control value" and for the wonderful things that are going to happen once the acquirer's CEO takes charge. (What acquisition-hungry manager will challenge *that* assertion?)

A few years later, bankers – bearing straight faces – again appear and just as earnestly urge spinning off the earlier acquisition in order to "unlock shareholder value." Spin-offs, of course, strip the owning company of its purported "control value" without any compensating payment. The bankers explain that the spun-off company will flourish because its management will be more entrepreneurial, having been freed from the smothering bureaucracy of the parent company. (So much for that talented CEO we met earlier.)

If the divesting company later wishes to reacquire the spun-off operation, it presumably would again be urged by its bankers to pay a hefty "control" premium for the privilege. (Mental "flexibility" of this sort by the banking fraternity has prompted the saying that fees too often lead to transactions rather than transactions leading to fees.)

It's possible, of course, that someday a spin-off or sale at Berkshire would be required by regulators. Berkshire carried out such a spin-off in 1979, when new regulations for bank holding companies forced us to divest a bank we owned in Rockford, Illinois.

Voluntary spin-offs, though, make no sense for us: We would lose control value, capital-allocation flexibility and, in some cases, important tax advantages. The CEOs who brilliantly run our subsidiaries now would have difficulty in being as effective if running a spun-off operation, given the operating and financial advantages derived from Berkshire's ownership. Moreover, the parent and the spun-off operations, once separated, would likely incur moderately greater costs than existed when they were combined.

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Before I depart the subject of spin-offs, let's look at a lesson to be learned from a conglomerate mentioned earlier: LTV. I'll summarize here, but those who enjoy a good financial story should read the piece about Jimmy Ling that ran in the October 1982 issue of *D Magazine*. Look it up on the Internet.

Through a lot of corporate razzle-dazzle, Ling had taken LTV from sales of only $36 million in 1965 to number 14 on the Fortune 500 list just two years later. Ling, it should be noted, had never displayed any managerial skills. But Charlie told me long ago to never underestimate the man who overestimates himself. And Ling had no peer in that respect.

Ling's strategy, which he labeled "project redeployment," was to buy a large company and then partially spin off its various divisions. In LTV's 1966 annual report, he explained the magic that would follow: "Most importantly, acquisitions must meet the test of the 2 plus 2 equals 5 (or 6) formula." The press, the public and Wall Street loved this sort of talk.

In 1967 Ling bought Wilson & Co., a huge meatpacker that also had interests in golf equipment and pharmaceuticals. Soon after, he split the parent into three businesses, Wilson & Co. (meatpacking), Wilson Sporting Goods and Wilson Pharmaceuticals, each of which was to be partially spun off. These companies quickly became known on Wall Street as Meatball, Golf Ball and Goof Ball.

Soon thereafter, it became clear that, like Icarus, Ling had flown too close to the sun. By the early 1970s, Ling's empire was melting, and he himself had been spun off from LTV . . . that is, *fired*.

Periodically, financial markets will become divorced from reality – you can count on that. More Jimmy Lings will appear. They will look and sound authoritative. The press will hang on their every word. Bankers will fight for their business. What they are saying will recently have "worked." Their early followers will be feeling very clever. Our suggestion: Whatever their line, never forget that 2+2 will always equal 4. And when someone tells you how old-fashioned that math is --- zip up your wallet, take a vacation and come back in a few years to buy stocks at cheap prices.

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Today Berkshire possesses (1) an unmatched collection of businesses, most of them now enjoying favorable economic prospects; (2) a cadre of outstanding managers who, with few exceptions, are unusually devoted to both the subsidiary they operate *and* to Berkshire; (3) an extraordinary diversity of earnings, premier financial strength and oceans of liquidity that we will maintain under *all* circumstances; (4) a first-choice ranking among many owners and managers who are contemplating sale of their businesses and (5) in a point related to the preceding item, a culture, distinctive in many ways from that of most large companies, that we have worked 50 years to develop and that is now rock-solid.

These strengths provide us a wonderful foundation on which to build.

The Next 50 Years at Berkshire

Now let's take a look at the road ahead. Bear in mind that if I had attempted 50 years ago to gauge what was coming, certain of my predictions would have been far off the mark. With that warning, I will tell you what I would say to my family today if they asked me about Berkshire's future.

- First and definitely foremost, I believe that the chance of permanent capital loss for patient Berkshire shareholders is as low as can be found among single-company investments. That's because our per-share *intrinsic business value* is almost certain to advance over time.

  This cheery prediction comes, however, with an important caution: If an investor's entry point into Berkshire stock is unusually high – at a price, say, approaching double book value, which Berkshire shares have occasionally reached – it may well be many years before the investor can realize a profit. In other words, a sound investment can morph into a rash speculation if it is bought at an elevated price. Berkshire is not exempt from this truth.

  Purchases of Berkshire that investors make at a price modestly above the level at which the company would repurchase its shares, however, should produce gains within a reasonable period of time. Berkshire's directors will only authorize repurchases at a price they believe to be *well below* intrinsic value. (In our view, that is an essential criterion for repurchases that is often ignored by other managements.)

  For those investors who plan to sell within a year or two after their purchase, I can offer *no* assurances, whatever the entry price. Movements of the general stock market during such abbreviated periods will likely be far more important in determining your results than the concomitant change in the intrinsic value of your Berkshire shares. As Ben Graham said many decades ago: "In the short-term the market is a voting machine; in the long-run it acts as a weighing machine." Occasionally, the voting decisions of investors – amateurs and professionals alike – border on lunacy.

  Since I know of no way to reliably predict market movements, I recommend that you purchase Berkshire shares *only* if you expect to hold them for at least five years. Those who seek short-term profits should look elsewhere.

  Another warning: Berkshire shares should not be purchased with borrowed money. There have been three times since 1965 when our stock has fallen about 50% from its high point. Someday, something close to this kind of drop will happen again, and no one knows when. Berkshire will almost certainly be a satisfactory holding for *investors*. But it could well be a disastrous choice for speculators employing leverage.

- I believe the chance of any event causing Berkshire to experience financial problems is essentially zero. We will always be prepared for the thousand-year flood; in fact, if it occurs we will be selling life jackets to the unprepared. Berkshire played an important role as a "first responder" during the 2008-2009 meltdown, and we have since more than doubled the strength of our balance sheet and our earnings potential. Your company is the Gibraltar of American business and will remain so.

  Financial staying power requires a company to maintain three strengths under *all* circumstances: (1) a large and reliable stream of earnings; (2) massive liquid assets and (3) *no* significant near-term cash requirements. Ignoring that last necessity is what usually leads companies to experience unexpected problems: Too often, CEOs of profitable companies feel they will always be able to refund maturing obligations, however large these are. In 2008-2009, many managements learned how perilous that mindset can be.

  Here's how we will *always* stand on the three essentials. First, our earnings stream is huge and comes from a vast array of businesses. Our shareholders now own many large companies that have durable competitive advantages, and we will acquire more of those in the future. Our diversification assures Berkshire's continued profitability, even if a catastrophe causes insurance losses that far exceed any previously experienced.

Next up is cash. At a healthy business, cash is sometimes thought of as something to be minimized – as an unproductive asset that acts as a drag on such markers as return on equity. Cash, though, is to a business as oxygen is to an individual: never thought about when it is present, the only thing in mind when it is absent.

American business provided a case study of that in 2008. In September of that year, many long-prosperous companies suddenly wondered whether their checks would bounce in the days ahead. Overnight, their financial oxygen disappeared.

At Berkshire, our "breathing" went uninterrupted. Indeed, in a three-week period spanning late September and early October, we supplied $15.6 *billion* of fresh money to American businesses.

We could do that because we always maintain at least $20 billion – and usually far more – in cash equivalents. And by that we mean U.S. Treasury bills, not other substitutes for cash that are claimed to deliver liquidity and actually do so, *except* when it is truly needed. When bills come due, only cash is legal tender. Don't leave home without it.

Finally – getting to our third point – we will never engage in operating or investment practices that can result in sudden demands for large sums. That means we will not expose Berkshire to short-term debt maturities of size nor enter into derivative contracts or other business arrangements that could require large collateral calls.

Some years ago, we became a party to certain derivative contracts that we believed were significantly mispriced and that had only minor collateral requirements. These have proved to be quite profitable. Recently, however, newly-written derivative contracts have required full collateralization. And that ended our interest in derivatives, regardless of what profit potential they might offer. We have not, for some years, written these contracts, except for a few needed for operational purposes at our utility businesses.

Moreover, we will not write insurance contracts that give policyholders the right to cash out at their option. Many *life* insurance products contain redemption features that make them susceptible to a "run" in times of extreme panic. Contracts of that sort, however, do not exist in the property-casualty world that we inhabit. If our premium volume should shrink, our float would decline – but only at a very slow pace.

The reason for our conservatism, which may impress some people as extreme, is that it is entirely predictable that people will occasionally panic, but not at all predictable when this will happen. Though practically all days are relatively uneventful, tomorrow is *always* uncertain. (I felt no special apprehension on December 6, 1941 or September 10, 2001.) And if you can't predict what tomorrow will bring, you must be prepared for whatever it does.

A CEO who is 64 and plans to retire at 65 may have his own special calculus in evaluating risks that have only a tiny chance of happening in a given year. He may, in fact, be "right" 99% of the time. Those odds, however, hold no appeal for us. We will never play financial Russian roulette with the funds you've entrusted to us, even if the metaphorical gun has 100 chambers and only one bullet. In our view, it is madness to risk losing what you *need* in pursuing what you simply *desire*.

- Despite our conservatism, I think we will be able *every* year to build the underlying per-share earning power of Berkshire. That does *not* mean operating earnings will increase each year – far from it. The U.S. economy will ebb and flow – though mostly flow – and, when it weakens, so will our current earnings. But we will continue to achieve organic gains, make bolt-on acquisitions and enter new fields. I believe, therefore, that Berkshire will annually add to its *underlying* earning power.

  In some years the gains will be substantial, and at other times they will be minor. Markets, competition, and chance will determine when opportunities come our way. Through it all, Berkshire will keep moving forward, powered by the array of solid businesses we now possess and the new companies we will purchase. In most years, moreover, our country's economy will provide a strong tailwind for business. We are blessed to have the United States as our home field.

- The bad news is that Berkshire's long-term gains – measured by percentages, not by dollars – cannot be dramatic and *will not come close* to those achieved in the past 50 years. The numbers have become too big. I think Berkshire will outperform the average American company, but our advantage, if any, won't be great.

  Eventually – probably between ten and twenty years from now – Berkshire's earnings and capital resources will reach a level that will not allow management to intelligently reinvest all of the company's earnings. At that time our directors will need to determine whether the best method to distribute the excess earnings is through dividends, share repurchases or both. If Berkshire shares are selling below intrinsic business value, massive repurchases will almost certainly be the best choice. You can be comfortable that your directors will make the right decision.

- No company will be more shareholder-minded than Berkshire. For more than 30 years, we have annually reaffirmed our Shareholder Principles (see page 117), always leading off with: "Although our form is corporate, our attitude is partnership." This covenant with you is etched in stone.

  We have an extraordinarily knowledgeable and business-oriented board of directors ready to carry out that promise of partnership. None took the job for the money: In an arrangement almost non-existent elsewhere, our directors are paid only token fees. They receive their rewards instead through ownership of Berkshire shares and the satisfaction that comes from being good stewards of an important enterprise.

  The shares that they and their families own – which, in many cases, are worth very substantial sums – were *purchased* in the market (rather than their materializing through options or grants). In addition, unlike almost all other sizable public companies, we carry no directors and officers liability insurance. At Berkshire, directors walk in your shoes.

  To further ensure continuation of our culture, I have suggested that my son, Howard, succeed me as a *non-executive* Chairman. My only reason for this wish is to make change easier if the wrong CEO should ever be employed and there occurs a need for the Chairman to move forcefully. I can assure you that this problem has a *very* low probability of arising at Berkshire – likely as low as at any public company. In my service on the boards of nineteen public companies, however, I've seen how hard it is to replace a mediocre CEO if that person is also Chairman. (The deed usually gets done, but almost always very late.)

  If elected, Howard will receive no pay and will spend no time at the job other than that required of all directors. He will simply be a safety valve to whom any director can go if he or she has concerns about the CEO and wishes to learn if other directors are expressing doubts as well. Should multiple directors be apprehensive, Howard's chairmanship will allow the matter to be promptly and properly addressed.

- Choosing the right CEO is all-important and is a subject that commands much time at Berkshire board meetings. Managing Berkshire is primarily a job of capital allocation, coupled with the selection and retention of outstanding managers to captain our operating subsidiaries. Obviously, the job also requires the replacement of a subsidiary's CEO when that is called for. These duties require Berkshire's CEO to be a rational, calm and decisive individual who has a broad understanding of business and good insights into human behavior. It's important as well that he knows his limits. (As Tom Watson, Sr. of IBM said, "I'm no genius, but I'm smart in spots and I stay around those spots.")

  Character is crucial: A Berkshire CEO must be "all in" for the company, not for himself. (I'm using male pronouns to avoid awkward wording, but gender should never decide who becomes CEO.) He can't help but earn money far in excess of any possible need for it. But it's important that neither ego nor avarice motivate him to reach for pay matching his most lavishly-compensated peers, even if his achievements far exceed theirs. A CEO's behavior has a huge impact on managers down the line: If it's clear to them that shareholders' interests are paramount to him, they will, with few exceptions, also embrace that way of thinking.

My successor will need one other particular strength: the ability to fight off the ABCs of business decay, which are arrogance, bureaucracy and complacency. When these corporate cancers metastasize, even the strongest of companies can falter. The examples available to prove the point are legion, but to maintain friendships I will exhume only cases from the distant past.

In their glory days, General Motors, IBM, Sears Roebuck and U.S. Steel sat atop huge industries. Their strengths seemed unassailable. But the destructive behavior I deplored above eventually led each of them to fall to depths that their CEOs and directors had not long before thought impossible. Their one-time financial strength and their historical earning power proved no defense.

Only a vigilant and determined CEO can ward off such debilitating forces as Berkshire grows ever larger. He must never forget Charlie's plea: "Tell me where I'm going to die, so I'll never go there." If our non-economic values were to be lost, much of Berkshire's economic value would collapse as well. "Tone at the top" will be key to maintaining Berkshire's special culture.

Fortunately, the structure our future CEOs will need to be successful is firmly in place. The extraordinary delegation of authority now existing at Berkshire is the ideal antidote to bureaucracy. In an operating sense, Berkshire is not a giant company but rather a collection of large companies. At headquarters, we have never had a committee nor have we ever required our subsidiaries to submit budgets (though many use them as an important internal tool). We don't have a legal office nor departments that other companies take for granted: human relations, public relations, investor relations, strategy, acquisitions, you name it.

We do, of course, have an active audit function; no sense being a damned fool. To an unusual degree, however, we trust our managers to run their operations with a keen sense of stewardship. After all, they were doing exactly that before we acquired their businesses. With only occasional exceptions, furthermore, our trust produces better results than would be achieved by streams of directives, endless reviews and layers of bureaucracy. Charlie and I try to interact with our managers in a manner consistent with what we would wish for, if the positions were reversed.

- Our directors believe that our future CEOs should come from internal candidates whom the Berkshire board has grown to know well. Our directors also believe that an incoming CEO should be relatively young, so that he or she can have a long run in the job. Berkshire will operate best if its CEOs average well over ten years at the helm. (It's hard to teach a new dog old tricks.) And they are not likely to retire at 65 either (or have you noticed?).

  In both Berkshire's business acquisitions and large, tailored investment moves, it is important that our counterparties be both familiar with and feel comfortable with Berkshire's CEO. Developing confidence of that sort and cementing relationships takes time. The payoff, though, can be huge.

  Both the board and I believe we now have the right person to succeed me as CEO – a successor ready to assume the job the day after I die or step down. In certain important respects, this person will do a better job than I am doing.

- Investments will always be of great importance to Berkshire and will be handled by several specialists. They will report to the CEO because their investment decisions, in a broad way, will need to be coordinated with Berkshire's operating and acquisition programs. Overall, though, our investment managers will enjoy great autonomy. In this area, too, we are in fine shape for decades to come. Todd Combs and Ted Weschler, each of whom has spent several years on Berkshire's investment team, are first-rate in all respects and can be of particular help to the CEO in evaluating acquisitions.

  All told, Berkshire is ideally positioned for life after Charlie and I leave the scene. We have the right people in place – the right directors, managers and prospective successors to those managers. Our culture, furthermore, is embedded throughout their ranks. Our system is also regenerative. To a large degree, both good and bad cultures self-select to perpetuate themselves. For very good reasons, business owners and operating managers with values similar to ours will continue to be attracted to Berkshire as a one-of-a-kind and *permanent* home.

- I would be remiss if I didn't salute another key constituency that makes Berkshire special: our shareholders. Berkshire truly has an owner base unlike that of any other giant corporation. That fact was demonstrated in spades at last year's annual meeting, where the shareholders were offered a proxy resolution:

  > RESOLVED: Whereas the corporation has more money than it needs and since the owners unlike Warren are not multi billionaires, the board shall consider paying a meaningful annual dividend on the shares.

  The sponsoring shareholder of that resolution never showed up at the meeting, so his motion was not officially proposed. Nevertheless, the proxy votes had been tallied, and they were enlightening.

  Not surprisingly, the A shares – owned by relatively few shareholders, each with a large economic interest – voted "no" on the dividend question by a margin of 89 to 1.

  The remarkable vote was that of our B shareholders. They number in the hundreds of thousands – perhaps even totaling one million – and they voted 660,759,855 "no" and 13,927,026 "yes," a ratio of about 47 to 1.

  Our directors recommended a "no" vote but the company did not otherwise attempt to influence shareholders. Nevertheless, 98% of the shares voting said, in effect, "Don't send us a dividend but instead reinvest all of the earnings." To have our fellow owners – large and small – be so in sync with our managerial philosophy is both remarkable and rewarding.

  I am a lucky fellow to have you as partners.

Warren E. Buffett

Vice Chairman's Thoughts – Past and Future

To the shareholders of Berkshire Hathaway Inc.:

I closely watched the 50-year history of Berkshire's uncommon success under Warren Buffett. And it now seems appropriate that I independently supplement whatever celebratory comment comes from him. I will try to do five things.

(1) Describe the management system and policies that caused a small and unfixably-doomed commodity textile business to morph into the mighty Berkshire that now exists,

(2) Explain how the management system and policies came into being,

(3) Explain, to some extent, why Berkshire did so well,

(4) Predict whether abnormally good results would continue if Buffett were soon to depart, and

(5) Consider whether Berkshire's great results over the last 50 years have implications that may prove useful elsewhere.

The management system and policies of Berkshire under Buffett (herein together called "the Berkshire system") were fixed early and are described below:

(1) Berkshire would be a diffuse conglomerate, averse only to activities about which it could not make useful predictions.
(2) Its top company would do almost all business through separately incorporated subsidiaries whose CEOs would operate with very extreme autonomy.
(3) There would be almost nothing at conglomerate headquarters except a tiny office suite containing a Chairman, a CFO, and a few assistants who mostly helped the CFO with auditing, internal control, etc.
(4) Berkshire subsidiaries would always prominently include casualty insurers. Those insurers as a group would be expected to produce, in due course, dependable underwriting gains while also producing substantial "float" (from unpaid insurance liabilities) for investment.
(5) There would be no significant system-wide personnel system, stock option system, other incentive system, retirement system, or the like, because the subsidiaries would have their own systems, often different.
(6) Berkshire's Chairman would reserve only a few activities for himself.

(i) He would manage almost all security investments, with these normally residing in Berkshire's casualty insurers.

(ii) He would choose all CEOs of important subsidiaries, and he would fix their compensation and obtain from each a private recommendation for a successor in case one was suddenly needed.

(iii) He would deploy most cash not needed in subsidiaries after they had increased their competitive advantage, with the ideal deployment being the use of that cash to acquire new subsidiaries.

(iv) He would make himself promptly available for almost any contact wanted by any subsidiary's CEO, and he would require almost no additional contact.

(v) He would write a long, logical, and useful letter for inclusion in his annual report, designed as he would wish it to be if he were only a passive shareholder, and he would be available for hours of answering questions at annual shareholders' meetings.

(vi) He would try to be an exemplar in a culture that would work well for customers, shareholders, and other incumbents for a long time, both before and after his departure.

(vii) His first priority would be reservation of much time for quiet reading and thinking, particularly that which might advance his determined learning, no matter how old he became; and

(viii) He would also spend much time in enthusiastically admiring what others were accomplishing.

(7) New subsidiaries would usually be bought with cash, not newly issued stock.

(8) Berkshire would not pay dividends so long as more than one dollar of market value for shareholders was being created by each dollar of retained earnings.

(9) In buying a new subsidiary, Berkshire would seek to pay a fair price for a good business that the Chairman could pretty well understand. Berkshire would also want a good CEO in place, one expected to remain for a long time and to manage well without need for help from headquarters.

(10) In choosing CEOs of subsidiaries, Berkshire would try to secure trustworthiness, skill, energy, and love for the business and circumstances the CEO was in.

(11) As an important matter of preferred conduct, Berkshire would almost never sell a subsidiary.

(12) Berkshire would almost never transfer a subsidiary's CEO to another unrelated subsidiary.

(13) Berkshire would never force the CEO of a subsidiary to retire on account of mere age.

(14) Berkshire would have little debt outstanding as it tried to maintain (i) virtually perfect creditworthiness under all conditions and (ii) easy availability of cash and credit for deployment in times presenting unusual opportunities.

(15) Berkshire would always be user-friendly to a prospective seller of a large business. An offer of such a business would get prompt attention. No one but the Chairman and one or two others at Berkshire would ever know about the offer if it did not lead to a transaction. And they would never tell outsiders about it.

Both the elements of the Berkshire system and their collected size are quite unusual. No other large corporation I know of has half of such elements in place.

How did Berkshire happen to get a corporate personality so different from the norm?

Well, Buffett, even when only 34 years old, controlled about 45% of Berkshire's shares and was completely trusted by all the other big shareholders. He could install whatever system he wanted. And he did so, creating the Berkshire system.

Almost every element was chosen because Buffett believed that, under him, it would help maximize Berkshire's achievement. He was not trying to create a one-type-fits-all system for other corporations. Indeed, Berkshire's subsidiaries were not required to use the Berkshire system in their own operations. And some flourished while using different systems.

What was Buffett aiming at as he designed the Berkshire system?

Well, over the years I diagnosed several important themes:

(1) He particularly wanted continuous maximization of the rationality, skills, and devotion of the most important people in the system, starting with himself.
(2) He wanted win/win results everywhere--in gaining loyalty by giving it, for instance.
(3) He wanted decisions that maximized long-term results, seeking these from decision makers who usually stayed long enough in place to bear the consequences of decisions.
(4) He wanted to minimize the bad effects that would almost inevitably come from a large bureaucracy at headquarters.
(5) He wanted to personally contribute, like Professor Ben Graham, to the spread of wisdom attained.

When Buffett developed the Berkshire system, did he foresee all the benefits that followed? No. Buffett stumbled into some benefits through practice evolution. But, when he saw useful consequences, he strengthened their causes.

Why did Berkshire under Buffett do so well?

Only four large factors occur to me:

(1) The constructive peculiarities of Buffett,
(2) The constructive peculiarities of the Berkshire system,
(3) Good luck, and
(4) The weirdly intense, contagious devotion of some shareholders and other admirers, including some in the press.

I believe all four factors were present and helpful. But the heavy freight was carried by the constructive peculiarities, the weird devotion, and their interactions.

In particular, Buffett's decision to limit his activities to a few kinds and to maximize his attention to them, and to keep doing so for 50 years, was a lollapalooza. Buffett succeeded for the same reason Roger Federer became good at tennis.

Buffett was, in effect, using the winning method of the famous basketball coach, John Wooden, who won most regularly after he had learned to assign virtually all playing time to his seven best players. That way, opponents always faced his best players, instead of his second best. And, with the extra playing time, the best players improved more than was normal.

And Buffett much out-Woodened Wooden, because in his case the exercise of skill was concentrated in one person, not seven, and his skill improved and improved as he got older and older during 50 years, instead of deteriorating like the skill of a basketball player does.

Moreover, by concentrating so much power and authority in the often-long-serving CEOs of important subsidiaries, Buffett was also creating strong Wooden-type effects there. And such effects enhanced the skills of the CEOs and the achievements of the subsidiaries.

Then, as the Berkshire system bestowed much-desired autonomy on many subsidiaries and their CEOs, and Berkshire became successful and well known, these outcomes attracted both more and better subsidiaries into Berkshire, and better CEOs as well.

And the better subsidiaries and CEOs then required less attention from headquarters, creating what is often called a "virtuous circle."

How well did it work out for Berkshire to always include casualty insurers as important subsidiaries?

Marvelously well. Berkshire's ambitions were unreasonably extreme and, even so, it got what it wanted.

Casualty insurers often invest in common stocks with a value amounting roughly to their shareholders' equity, as did Berkshire's insurance subsidiaries. And the S&P 500 Index produced about 10% per annum, pre-tax, during the last 50 years, creating a significant tailwind.

And, in the early decades of the Buffett era, common stocks within Berkshire's insurance subsidiaries greatly outperformed the index, exactly as Buffett expected. And, later, when both the large size of Berkshire's stockholdings and income tax considerations caused the index-beating part of returns to fade to insignificance (perhaps not forever), other and better advantage came. Ajit Jain created out of nothing an immense reinsurance business that produced both a huge "float" and a large underwriting gain. And all of GEICO came into Berkshire, followed by a quadrupling of GEICO's market share. And the rest of Berkshire's insurance operations hugely improved, largely by dint of reputational advantage, underwriting discipline, finding and staying within good niches, and recruiting and holding outstanding people.

Then, later, as Berkshire's nearly unique and quite dependable corporate personality and large size became well known, its insurance subsidiaries got and seized many attractive opportunities, not available to others, to buy privately issued securities. Most of these securities had fixed maturities and produced outstanding results.

Berkshire's marvelous outcome in insurance was not a natural result. Ordinarily, a casualty insurance business is a producer of mediocre results, even when very well managed. And such results are of little use. Berkshire's better outcome was so astoundingly large that I believe that Buffett would now fail to recreate it if he returned to a small base while retaining his smarts and regaining his youth.

Did Berkshire suffer from being a diffuse conglomerate? No, its opportunities were usefully enlarged by a widened area for operation. And bad effects, common elsewhere, were prevented by Buffett's skills.

Why did Berkshire prefer to buy companies with cash, instead of its own stock? Well, it was hard to get anything in exchange for Berkshire stock that was as valuable as what was given up.

Why did Berkshire's acquisition of companies outside the insurance business work out so well for Berkshire shareholders when the normal result in such acquisitions is bad for shareholders of the acquirer?

Well, Berkshire, by design, had methodological advantages to supplement its better opportunities. It never had the equivalent of a "department of acquisitions" under pressure to buy. And it never relied on advice from "helpers" sure to be prejudiced in favor of transactions. And Buffett held self-delusion at bay as he underclaimed expertise while he knew better than most corporate executives what worked and what didn't in business, aided by his long experience as a passive investor. And, finally, even when Berkshire was getting much better opportunities than most others, Buffett often displayed almost inhuman patience and seldom bought. For instance, during his first ten years in control of Berkshire, Buffett saw one business (textiles) move close to death and two new businesses come in, for a net gain of one.

What were the big mistakes made by Berkshire under Buffett? Well, while mistakes of commission were common, almost all huge errors were in not making a purchase, including not purchasing Walmart stock when that was sure to work out enormously well. The errors of omission were of much importance. Berkshire's net worth would now be at least $50 billion higher if it had seized several opportunities it was not quite smart enough to recognize as virtually sure things.

The next to last task on my list was: Predict whether abnormally good results would continue at Berkshire if Buffett were soon to depart.

The answer is yes. Berkshire has in place in its subsidiaries much business momentum grounded in much durable competitive advantage.

Moreover, its railroad and utility subsidiaries now provide much desirable opportunity to invest large sums in new fixed assets. And many subsidiaries are now engaged in making wise "bolt-on" acquisitions.

Provided that most of the Berkshire system remains in place, the combined momentum and opportunity now present is so great that Berkshire would almost surely remain a better-than-normal company for a very long time even if (1) Buffett left tomorrow, (2) his successors were persons of only moderate ability, and (3) Berkshire never again purchased a large business.

But, under this Buffett-soon-leaves assumption, his successors would not be "of only moderate ability." For instance, Ajit Jain and Greg Abel are proven performers who would probably be under-described as "world-class." "World-leading" would be the description I would choose. In some important ways, each is a better business executive than Buffett.

And I believe neither Jain nor Abel would (1) leave Berkshire, no matter what someone else offered or (2) desire much change in the Berkshire system.

Nor do I think that desirable purchases of new businesses would end with Buffett's departure. With Berkshire now so large and the age of activism upon us, I think some desirable acquisition opportunities will come and that Berkshire's $60 billion in cash will constructively decrease.

My final task was to consider whether Berkshire's great results over the last 50 years have implications that may prove useful elsewhere.

The answer is plainly yes. In its early Buffett years, Berkshire had a big task ahead: turning a tiny stash into a large and useful company. And it solved that problem by avoiding bureaucracy and relying much on one thoughtful leader for a long, long time as he kept improving and brought in more people like himself.

Compare this to a typical big-corporation system with much bureaucracy at headquarters and a long succession of CEOs who come in at about age 59, pause little thereafter for quiet thought, and are soon forced out by a fixed retirement age.

I believe that versions of the Berkshire system should be tried more often elsewhere and that the worst attributes of bureaucracy should much more often be treated like the cancers they so much resemble. A good example of bureaucracy fixing was created by George Marshall when he helped win World War II by getting from Congress the right to ignore seniority in choosing generals.

Sincerely,

Charles T. Munger

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change in Per-Share Book Value of Berkshire	Annual Percentage Change in Per-Share Market Value of Berkshire	Annual Percentage Change in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
Compounded Annual Gain – 1965-2015	19.2%	20.8%	9.7%
Overall Gain – 1964-2015	798,981%	1,598,284%	11,355%

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2015 was $15.4 billion, which increased the per-share book value of both our Class A and Class B stock by 6.4%. Over the last 51 years (that is, since present management took over), per-share book value has grown from $19 to $155,501, a rate of 19.2% compounded annually.*

During the first half of those years, Berkshire's net worth was roughly equal to the number that really counts: the intrinsic value of the business. The similarity of the two figures existed then because most of our resources were deployed in marketable securities that were regularly revalued to their quoted prices (less the tax that would be incurred if they were to be sold). In Wall Street parlance, our balance sheet was then in very large part "marked to market."

By the early 1990s, however, our focus had changed to the outright ownership of businesses, a shift that diminished the relevance of balance-sheet figures. That disconnect occurred because the accounting rules that apply to controlled companies are materially different from those used in valuing marketable securities. The carrying value of the "losers" we own is written down, but "winners" are *never* revalued upwards.

We've had experience with both outcomes: I've made some dumb purchases, and the amount I paid for the economic goodwill of those companies was later written off, a move that reduced Berkshire's book value. We've also had some winners – a few of them very big – but have not written those up by a penny.

Over time, this asymmetrical accounting treatment (with which we agree) necessarily widens the gap between intrinsic value and book value. Today, the large – and growing – unrecorded gains at our "winners" make it clear that Berkshire's intrinsic value *far* exceeds its book value. That's why we would be delighted to repurchase our shares should they sell as low as 120% of book value. At that level, purchases would instantly and meaningfully increase per-share intrinsic value for Berkshire's continuing shareholders.

The unrecorded increase in the value of our owned businesses explains why Berkshire's aggregate market-value gain – tabulated on the facing page – materially exceeds our book-value gain. The two indicators vary erratically over short periods. Last year, for example, book-value performance was superior. Over time, however, market-value gains should continue their historical tendency to exceed gains in book value.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

The Year at Berkshire

Charlie Munger, Berkshire Vice Chairman and my partner, and I expect Berkshire's *normalized* earning power to increase every year. (*Actual* year-to-year earnings, of course, will sometimes decline because of weakness in the U.S. economy or, possibly, because of insurance mega-catastrophes.) In some years the normalized gains will be small; at other times they will be material. Last year was a good one. Here are the highlights:

- The most important development at Berkshire during 2015 was not financial, though it led to better earnings. After a poor performance in 2014, our BNSF railroad dramatically improved its service to customers last year. To attain that result, we invested about $5.8 billion during the year in capital expenditures, a sum far and away the record for any American railroad and nearly three times our annual depreciation charge. It was money well spent.

  BNSF moves about 17% of America's intercity freight (measured by revenue ton-miles), whether transported by rail, truck, air, water or pipeline. In that respect, we are a strong number one among the seven large American railroads (two of which are Canadian-based), carrying 45% more ton-miles of freight than our closest competitor. Consequently, our maintaining first-class service is not only vital to our shippers' welfare but also important to the smooth functioning of the U.S. economy.

  For most American railroads, 2015 was a disappointing year. Aggregate ton-miles fell, and earnings weakened as well. BNSF, however, maintained volume, and pre-tax income rose to a record $6.8 billion* (a gain of $606 million from 2014). Matt Rose and Carl Ice, the managers of BNSF, have my thanks and deserve yours.

- BNSF is the largest of our "Powerhouse Five," a group that also includes Berkshire Hathaway Energy, Marmon, Lubrizol and IMC. Combined, these companies – our five most profitable non-insurance businesses – earned $13.1 billion in 2015, an increase of $650 million over 2014.

  Of the five, only Berkshire Hathaway Energy, then earning $393 million, was owned by us in 2003. Subsequently, we purchased three of the other four on an all-cash basis. In acquiring BNSF, however, we paid about 70% of the cost in cash and, for the remainder, issued Berkshire shares that increased the number outstanding by 6.1%. In other words, the $12.7 billion gain in annual earnings delivered Berkshire by the five companies over the twelve-year span has been accompanied by only minor dilution. That satisfies our goal of not simply increasing earnings, but making sure we also increase *per-share* results.

- Next year, I will be discussing the "Powerhouse Six." The newcomer will be Precision Castparts Corp. ("PCC"), a business that we purchased a month ago for more than $32 billion of cash. PCC fits perfectly into the Berkshire model and will substantially increase our *normalized* per-share earning power.

  Under CEO Mark Donegan, PCC has become the world's premier supplier of aerospace components (most of them destined to be original equipment, though spares are important to the company as well). Mark's accomplishments remind me of the magic regularly performed by Jacob Harpaz at IMC, our remarkable Israeli manufacturer of cutting tools. The two men transform very ordinary raw materials into extraordinary products that are used by major manufacturers worldwide. Each is the da Vinci of his craft.

  PCC's products, often delivered under multi-year contracts, are key components in most large aircraft. Other industries are served as well by the company's 30,466 employees, who work out of 162 plants in 13 countries. In building his business, Mark has made many acquisitions and will make more. We look forward to having him deploy Berkshire's capital.

* Throughout this letter, all earnings are stated on a pre-tax basis unless otherwise designated.

A personal thank-you: The PCC acquisition would not have happened without the input and assistance of our own Todd Combs, who brought the company to my attention a few years ago and went on to educate me about both the business and Mark. Though Todd and Ted Weschler are primarily investment managers – they each handle about $9 billion for us – both of them cheerfully and ably add major value to Berkshire in other ways as well. Hiring these two was one of my best moves.

- With the PCC acquisition, Berkshire will own 10 ¼ companies that would populate the Fortune 500 if they were stand-alone businesses. (Our 27% holding of Kraft Heinz is the ¼.) That leaves just under 98% of America's business giants that have yet to call us. Operators are standing by.

- Our many dozens of smaller non-insurance businesses earned $5.7 billion last year, up from $5.1 billion in 2014. Within this group, we have one company that last year earned more than $700 million, two that earned between $400 million and $700 million, seven that earned between $250 million and $400 million, six that earned between $100 million and $250 million, and eleven that earned between $50 million and $100 million. We love them all: This collection of businesses will expand both in number and earnings as the years go by.

- When you hear talk about America's crumbling infrastructure, rest assured that they're not talking about Berkshire. We invested $16 billion in property, plant and equipment last year, a full 86% of it deployed in the United States.

  I told you earlier about BNSF's record capital expenditures in 2015. At the end of *every* year, our railroad's physical facilities will be improved from those existing twelve months earlier.

  Berkshire Hathaway Energy ("BHE") is a similar story. That company has invested $16 billion in renewables and now owns 7% of the country's wind generation and 6% of its solar generation. Indeed, the 4,423 megawatts of wind generation owned and operated by our regulated utilities is *six* times the generation of the runner-up utility.

  We're not done. Last year, BHE made major commitments to the future development of renewables in support of the Paris Climate Change Conference. Our fulfilling those promises will make great sense, both for the environment and for Berkshire's economics.

- Berkshire's huge and growing insurance operation again operated at an underwriting profit in 2015 – that makes 13 years in a row – and increased its float. During those years, our float – money that doesn't belong to us but that we can invest for Berkshire's benefit – grew from $41 billion to $88 billion. Though neither that gain nor the size of our float is reflected in Berkshire's earnings, float generates significant investment income because of the assets it allows us to hold.

  Meanwhile, our underwriting profit totaled $26 billion during the 13-year period, including $1.8 billion earned in 2015. Without a doubt, Berkshire's largest unrecorded wealth lies in its insurance business. We've spent 48 years building this multi-faceted operation, and it can't be replicated.

- While Charlie and I search for new businesses to buy, our many subsidiaries are regularly making bolt-on acquisitions. Last year we contracted for 29 bolt-ons, scheduled to cost $634 million in aggregate. The cost of these purchases ranged from $300,000 to $143 million.

  Charlie and I encourage bolt-ons, *if* they are sensibly-priced. (Most deals offered us most definitely aren't.) These purchases deploy capital in operations that fit with our existing businesses and that will be managed by our corps of expert managers. That means no additional work for us, yet more earnings for Berkshire, a combination we find highly appealing. We will make many dozens of bolt-on deals in future years.

- Our Heinz partnership with Jorge Paulo Lemann, Alex Behring and Bernardo Hees more than doubled its size last year by merging with Kraft. Before this transaction, we owned about 53% of Heinz at a cost of $4.25 billion. Now we own 325.4 million shares of Kraft Heinz (about 27%) that cost us $9.8 billion. The new company has annual sales of $27 billion and can supply you Heinz ketchup or mustard to go with your Oscar Mayer hot dogs that come from the Kraft side. Add a Coke, and you will be enjoying my favorite meal. (We will have the Oscar Mayer Wienermobile at the annual meeting – bring your kids.)

  Though we sold no Kraft Heinz shares, "GAAP" (Generally Accepted Accounting Principles) required us to record a $6.8 billion write-up of our investment upon completion of the merger. That leaves us with our Kraft Heinz holding carried on our balance sheet at a value many billions above our cost and many billions below its market value, an outcome only an accountant could love.

  Berkshire also owns Kraft Heinz preferred shares that pay us $720 million annually and are carried at $7.7 billion on our balance sheet. That holding will almost certainly be redeemed for $8.32 billion in June (the earliest date allowed under the preferred's terms). That will be good news for Kraft Heinz and bad news for Berkshire.

  Jorge Paulo and his associates could not be better partners. We share with them a passion to buy, build and *hold* large businesses that satisfy basic needs and desires. We follow different paths, however, in pursuing this goal.

  Their method, at which they have been extraordinarily successful, is to buy companies that offer an opportunity for eliminating many unnecessary costs and then – *very promptly* – to make the moves that will get the job done. Their actions significantly boost productivity, the all-important factor in America's economic growth over the past 240 years. Without more output of desired goods and services per working hour – that's the measure of productivity gains – an economy inevitably stagnates. At much of corporate America, truly major gains in productivity are possible, a fact offering opportunities to Jorge Paulo and his associates.

  At Berkshire, we, too, crave efficiency and detest bureaucracy. To achieve our goals, however, we follow an approach emphasizing *avoidance* of bloat, buying businesses such as PCC that have long been run by cost-conscious and efficient managers. After the purchase, *our* role is simply to create an environment in which these CEOs – and their eventual successors, who typically are like-minded – can maximize both their managerial effectiveness and the pleasure they derive from their jobs. (With this hands-off style, I am heeding a well-known Mungerism: "If you want to guarantee yourself a lifetime of misery, be sure to marry someone with the intent of changing their behavior.")

  We will continue to operate with extreme – indeed, almost unheard of – decentralization at Berkshire. But we will also look for opportunities to partner with Jorge Paulo, either as a financing partner, as was the case when his group purchased Tim Horton's, or as a combined equity-and-financing partner, as at Heinz. We also may occasionally partner with others, as we have successfully done at Berkadia.

  Berkshire, however, will join only with partners making friendly acquisitions. To be sure, certain hostile offers are justified: Some CEOs forget that it is shareholders for whom they should be working, while other managers are woefully inept. In either case, directors may be blind to the problem or simply reluctant to make the change required. That's when new faces are needed. We, though, will leave these "opportunities" for others. At Berkshire, we go only where we are welcome.

- Berkshire increased its ownership interest last year in each of its "Big Four" investments – American Express, Coca-Cola, IBM and Wells Fargo. We purchased additional shares of IBM (increasing our ownership to 8.4% versus 7.8% at yearend 2014) and Wells Fargo (going to 9.8% from 9.4%). At the other two companies, Coca-Cola and American Express, stock repurchases raised our percentage ownership. Our equity in Coca-Cola grew from 9.2% to 9.3%, and our interest in American Express increased from 14.8% to 15.6%. In case you think these seemingly small changes aren't important, consider this math: For the four companies in aggregate, each increase of one percentage point in our ownership raises Berkshire's portion of their annual earnings by about $500 million.

  These four investees possess excellent businesses and are run by managers who are both talented and shareholder-oriented. Their returns on tangible equity range from excellent to staggering. At Berkshire, we much prefer owning a non-controlling but substantial portion of a wonderful company to owning 100% of a so-so business. It's better to have a partial interest in the Hope Diamond than to own all of a rhinestone.

  If Berkshire's yearend holdings are used as the marker, our portion of the "Big Four's" 2015 earnings amounted to $4.7 billion. In the earnings we report to you, however, we include only the dividends they pay us – about $1.8 billion last year. But make no mistake: The nearly $3 billion of these companies' earnings we don't report are every bit as valuable to us as the portion Berkshire records.

  The earnings our investees retain are often used for repurchases of their own stock – a move that increases Berkshire's share of future earnings without requiring us to lay out a dime. The retained earnings of these companies also fund business opportunities that usually turn out to be advantageous. All that leads us to expect that the per-share earnings of these four investees, in aggregate, will grow substantially over time. If gains do indeed materialize, dividends to Berkshire will increase and so, too, will our unrealized capital gains.

  Our flexibility in capital allocation – our willingness to invest large sums passively in non-controlled businesses – gives us a significant edge over companies that limit themselves to acquisitions they will operate. Woody Allen once explained that the advantage of being bi-sexual is that it doubles your chance of finding a date on Saturday night. In like manner – well, not exactly like manner – our appetite for either operating businesses or passive investments doubles *our* chances of finding sensible uses for Berkshire's endless gusher of cash. Beyond that, having a huge portfolio of marketable securities gives us a stockpile of funds that can be tapped when an elephant-sized acquisition is offered to us.

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It's an election year, and candidates can't stop speaking about our country's problems (which, of course, only *they* can solve). As a result of this negative drumbeat, many Americans now believe that their children will not live as well as they themselves do.

That view is dead wrong: The babies being born in America today are the luckiest crop in history.

American GDP per capita is now about $56,000. As I mentioned last year that – *in real terms* – is a staggering six times the amount in 1930, the year I was born, a leap far beyond the wildest dreams of my parents or their contemporaries. U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more. This all-powerful trend is certain to continue: America's economic magic remains alive and well.

Some commentators bemoan our current 2% per year growth in real GDP – and, yes, we would all like to see a higher rate. But let's do some simple math using the much-lamented 2% figure. That rate, we will see, delivers astounding gains.

America's population is growing about .8% per year (.5% from births minus deaths and .3% from net migration). Thus 2% of *overall* growth produces about 1.2% of *per capita* growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in *real* GDP per capita. (Compounding's effects produce the excess over the percentage that would result by simply multiplying 25 x 1.2%.) In turn, that 34.4% gain will produce a staggering $19,000 increase in *real GDP per capita* for the next generation. Were that to be distributed equally, the gain would be $76,000 annually for a family of four. Today's politicians need not shed tears for tomorrow's children.

Indeed, most of *today's* children are doing well. *All* families in my upper middle-class neighborhood regularly enjoy a living standard better than that achieved by John D. Rockefeller Sr. at the time of my birth. His unparalleled fortune couldn't buy what we now take for granted, whether the field is – to name just a few – transportation, entertainment, communication or medical services. Rockefeller certainly had power and fame; he could not, however, live as well as my neighbors now do.

Though the pie to be shared by the next generation will be *far* larger than today's, how it will be divided will remain fiercely contentious. Just as is now the case, there will be struggles for the increased output of goods and services between those people in their productive years and retirees, between the healthy and the infirm, between the inheritors and the Horatio Algers, between investors and workers and, in particular, between those with talents that are valued highly by the marketplace and the equally decent hard-working Americans who lack the skills the market prizes. Clashes of that sort have forever been with us – and will forever continue. Congress will be the battlefield; money and votes will be the weapons. Lobbying will remain a growth industry.

The good news, however, is that even members of the "losing" sides will almost certainly enjoy – *as they should* – far more goods and services in the future than they have in the past. The quality of their increased bounty will also dramatically improve. Nothing rivals the market system in producing what people want – nor, even more so, in delivering what people don't yet know they want. My parents, when young, could not envision a television set, nor did I, in my 50s, think I needed a personal computer. Both products, once people saw what they could do, quickly revolutionized their lives. I now spend ten hours a week playing bridge online. And, as I write this letter, "search" is invaluable to me. (I'm not ready for Tinder, however.)

For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did.

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Considering this favorable tailwind, Berkshire (and, to be sure, a great many other businesses) will almost certainly prosper. The managers who succeed Charlie and me will build Berkshire's per-share intrinsic value by following our simple blueprint of: (1) constantly improving the basic earning power of our many subsidiaries; (2) further increasing their earnings through bolt-on acquisitions; (3) benefiting from the growth of our investees; (4) repurchasing Berkshire shares when they are available at a meaningful discount from intrinsic value; and (5) making an occasional large acquisition. Management will also try to maximize results for *you* by rarely, if ever, issuing Berkshire shares.

Intrinsic Business Value

As much as Charlie and I talk about intrinsic business value, we cannot tell you precisely what that number is for Berkshire shares (nor, in fact, for any other stock). It is possible, however, to make a sensible estimate. In our 2010 annual report we laid out the three elements – one of them qualitative – that we believe are the keys to an estimation of Berkshire's intrinsic value. That discussion is reproduced in full on pages 113-114.

Here is an update of the two quantitative factors: In 2015 our per-share cash and investments increased 8.3% to $159,794 (with our Kraft Heinz shares stated at market value), and earnings from our many businesses – *including insurance underwriting income* – increased 2.1% to $12,304 per share. We exclude in the second factor the dividends and interest from the investments we hold because including them would produce a double-counting of value. In arriving at our earnings figure, we deduct all corporate overhead, interest, depreciation, amortization and minority interests. Income taxes, though, are not deducted. That is, the earnings are pre-tax.

I used the italics in the paragraph above because we are for the first time including insurance underwriting income in business earnings. We did not do that when we initially introduced Berkshire's two quantitative pillars of valuation because our insurance results were then heavily influenced by catastrophe coverages. If the wind didn't blow and the earth didn't shake, we made large profits. But a mega-catastrophe would produce red ink. In order to be conservative then in stating our business earnings, we consistently assumed that underwriting would break even over time and ignored any of its gains or losses in our annual calculation of the second factor of value.

Today, our insurance results are likely to be more stable than was the case a decade or two ago because we have deemphasized catastrophe coverages and greatly expanded our bread-and-butter lines of business. Last year, our underwriting income contributed $1,118 per share to the $12,304 per share of earnings referenced in the second paragraph of this section. Over the past decade, annual underwriting income has averaged $1,434 per share, and we anticipate being profitable in most years. You should recognize, however, that underwriting in any given year could well be unprofitable, perhaps substantially so.

Since 1970, our per-share investments have increased at a rate of 18.9% compounded annually, and our earnings (*including* the underwriting results in both the initial and terminal year) have grown at a 23.7% clip. It is no coincidence that the price of Berkshire stock over the ensuing 45 years has increased at a rate very similar to that of our two measures of value. Charlie and I like to see gains in both sectors, but our main goal is to build operating earnings.

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Now, let's examine the four major sectors of our operations. Each has vastly different balance sheet and income characteristics from the others. So we'll present them as four separate businesses, which is how Charlie and I view them (though there are important and *enduring* economic advantages to having them all under one roof). Our intent is to provide you with the information we would wish to have if our positions were reversed, with you being the reporting manager and we the absentee shareholders. (Don't get excited; this is not a switch we are considering.)

Insurance

Let's look first at insurance. The property-casualty ("P/C") branch of that industry has been the engine that has propelled our expansion since 1967, when we acquired National Indemnity and its sister company, National Fire & Marine, for $8.6 million. Today, National Indemnity is the largest property-casualty company in the world, as measured by net worth. Moreover, its intrinsic value is *far* in excess of the value at which it is carried on our books.

One reason we were attracted to the P/C business was its financial characteristics: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over many decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* we have grown, as the following table shows:

Year	*Float (in millions)*
1970	$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2015	87,722

Further gains in float will be tough to achieve. On the plus side, GEICO and several of our specialized operations are almost certain to grow at a good clip. National Indemnity's reinsurance division, however, is party to a number of run-off contracts whose float drifts downward. If we do in time experience a decline in float, it will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. This structure is by design and is a key component in the strength of Berkshire's economic fortress. It will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it sometimes causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses. The prolonged period of low interest rates the world is now dealing with also virtually guarantees that earnings on float will steadily decrease for many years to come, thereby exacerbating the profit problems of insurers. It's a good bet that industry results over the next ten years will fall short of those recorded in the past decade, particularly for those companies that specialize in reinsurance.

As noted early in this report, Berkshire has now operated at an underwriting profit for 13 consecutive years, our pre-tax gain for the period having totaled $26.2 billion. That's no accident: Disciplined risk evaluation is the daily focus of *all* of our insurance managers, who know that while float is valuable, its benefits can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a *liability*, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as strictly a liability is incorrect. It should instead be viewed as a revolving fund. Daily, we pay old claims and related expenses – a huge $24.5 billion to more than six million claimants in 2015 – and that reduces float. Just as surely, we each day write new business that will soon generate its own claims, adding to float.

If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability. Owing $1 that in effect will never leave the premises – because new business is almost certain to deliver a substitute – is worlds different from owing $1 that will go out the door tomorrow and not be replaced. The two types of liabilities, however, are treated as equals under GAAP.

A partial offset to this overstated liability is a $15.5 billion "goodwill" asset that we incurred in buying our insurance companies and that increases book value. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, *any* goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay for float *of similar quality* were we to purchase an insurance operation possessing it – to be *far* in excess of its historic carrying value. Indeed, almost the entire $15.5 billion we carry for goodwill in our insurance business was already on our books in 2000. Yet we subsequently *tripled* our float. Its value today is one reason – a huge reason – why we believe Berkshire's intrinsic business value substantially exceeds its book value.

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Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that possess hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources.

Indeed, Berkshire is *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a $250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a significant profit for the year because of its many streams of earnings. We would also remain awash in cash and be looking for large opportunities to write business in an insurance market that might well be in disarray. Meanwhile, other major insurers and reinsurers would be swimming in red ink, if not facing insolvency.

When Ajit entered Berkshire's office on a Saturday in 1986, he did not have a day's experience in the insurance business. Nevertheless, Mike Goldberg, then our manager of insurance, handed him the keys to our reinsurance business. With that move, Mike achieved sainthood: Since then, Ajit has created tens of billions of value for Berkshire shareholders.

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We have another reinsurance powerhouse in General Re, managed by Tad Montross.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance.

Tad has observed all four of the insurance commandments, and it shows in his results. General Re's huge float has been considerably better than cost-free under his leadership, and we expect that, on average, to continue. We are particularly enthusiastic about General Re's international life reinsurance business, which has grown consistently and profitably since we acquired the company in 1998.

It can be remembered that soon after we purchased General Re, it was beset by problems that caused commentators – and me as well, briefly – to believe I had made a huge mistake. That day is long gone. General Re is now a gem.

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Finally, there is GEICO, the insurer on which I cut my teeth 65 years ago. GEICO is managed by Tony Nicely, who joined the company at 18 and completed 54 years of service in 2015. Tony became CEO in 1993, and since then the company has been flying. There is *no* better manager than Tony. In the 40 years that I've known him, his every action has made great sense.

When I was first introduced to GEICO in January 1951, I was blown away by the huge cost advantage the company enjoyed compared to the expenses borne by the giants of the industry. It was clear to me that GEICO would succeed because it *deserved* to succeed.

No one *likes* to buy auto insurance. Almost everyone, though, likes to drive. The insurance consequently needed is a major expenditure for most families. Savings matter to them – and *only* a low-cost operation can deliver these. Indeed, at least 40% of the people reading this letter can save money by insuring with GEICO. So stop reading – right now! – and go to geico.com or call 800-368-2734.

GEICO's cost advantage is the factor that has enabled the company to gobble up market share year after year. (We ended 2015 with 11.4% of the market compared to 2.5% in 1995, when Berkshire acquired control of GEICO.) The company's low costs create a moat – an *enduring* one – that competitors are unable to cross.

All the while, our gecko never tires of telling Americans how GEICO can save them important money. I love hearing the little guy deliver his message: "15 minutes could save you 15% or more on car insurance." (Of course, there's always a grouch in the crowd. One of my friends says he is glad that only a few animals can talk, since the ones that do speak seem unable to discuss any subject but insurance.)

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In addition to our three major insurance operations, we own a group of smaller companies that primarily write commercial coverages. In aggregate, these companies are a large, growing and valuable operation that consistently delivers an underwriting profit, usually much better than that reported by their competitors. Indeed, over the past 13 years, this group has earned $4 billion from underwriting – about 13% of its premium volume – while increasing its float from $943 million to $9.9 billion.

Less than three years ago, we formed Berkshire Hathaway Specialty Insurance ("BHSI"), which we include in this group. Our first decision was to put Peter Eastwood in charge. That move was a home run: BHSI has already developed $1 billion of annual premium volume and, under Peter's direction, is destined to become one of the world's leading P/C insurers.

Here's a recap of underwriting earnings and float by division:

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2015*	*2014*	*2015*	*2014*
BH Reinsurance	$ 421	$ 606	$ 44,108	$ 42,454
General Re	132	277	18,560	19,280
GEICO	460	1,159	15,148	13,569
Other Primary	824	626	9,906	8,618
	$ 1,837	$ 2,668	$ 87,722	$ 83,921

Berkshire's great managers, premier financial strength and a variety of business models protected by wide moats amount to something unique in the insurance world. This assemblage of strengths is a huge asset for Berkshire shareholders that will only get more valuable with time.

Regulated, Capital-Intensive Businesses

We have two major operations, BNSF and BHE, that share important characteristics distinguishing them from our other businesses. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement. Together, they last year accounted for 37% of Berkshire's after-tax operating earnings.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions would far exceed its interest requirements. Last year, for example, in a disappointing year for railroads, BNSF's interest coverage was more than 8:1. (Our definition of coverage is the ratio of earnings before interest and taxes to interest, *not* EBITDA/interest, a commonly used measure we view as seriously flawed.)

At BHE, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies offering an essential service on an exclusive basis. The second is enjoyed by few other utilities: a great and ever-widening diversity of earnings streams, which shield BHE from being seriously harmed by any single regulatory body. These many sources of profit, supplemented by the inherent advantage of being owned by a strong parent, have allowed BHE and its utility subsidiaries to significantly lower their cost of debt. This economic fact benefits both us *and* our customers.

All told, BHE and BNSF invested $11.6 billion in plant and equipment last year, a massive commitment to key components of America's infrastructure. We relish making such investments as long as they promise reasonable returns – and, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need huge investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is concomitantly in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Low prices are a powerful way to keep these constituencies happy. In Iowa, BHE's average retail rate is 6.8¢ per KWH. Alliant, the other major electric utility in the state, averages 9.5¢. Here are the comparable industry figures for adjacent states: Nebraska 9.0¢, Missouri 9.3¢, Illinois 9.3¢, Minnesota 9.7¢. The national average is 10.4¢. Our rock-bottom prices add up to real money for paycheck-strapped customers.

At BNSF, price comparisons between major railroads are far more difficult to make because of significant differences in both their mix of cargo and the average distance it is carried. To supply a *very* crude measure, however, our revenue per ton-mile was just under 3¢ last year, while shipping costs for customers of the other four major U.S.-based railroads were at least 40% higher, ranging from 4.2¢ to 5.3¢.

Both BHE and BNSF have been leaders in pursuing planet-friendly technology. In wind generation, no state comes close to Iowa, where last year megawatt-hours we generated from wind equaled 47% of all megawatt-hours sold to our retail customers. (Additional wind projects to which we are committed will take that figure to 58% in 2017.)

BNSF, like other Class I railroads, uses only a single gallon of diesel fuel to move a ton of freight almost 500 miles. That makes the railroads four times as fuel-efficient as trucks! Furthermore, railroads alleviate highway congestion – and the taxpayer-funded maintenance expenditures that come with heavier traffic – in a major way.

Here are the key figures for BHE and BNSF:

Berkshire Hathaway Energy (89.9% owned)	*Earnings (in millions)*		
	2015	*2014*	*2013*
U.K. utilities	$ 460	$ 527	$ 362
Iowa utility	314	298	230
Nevada utilities	586	549	(58)
PacifiCorp (primarily Oregon and Utah)	1,026	1,010	982
Gas pipelines (Northern Natural and Kern River)	401	379	385
Canadian transmission utility	170	16	—
Renewable projects	175	194	50
HomeServices	191	139	139
Other (net)	27	26	12
Operating earnings before corporate interest and taxes	3,350	3,138	2,102
Interest	499	427	296
Income taxes	481	616	170
Net earnings	$ 2,370	$ 2,095	$ 1,636
Earnings applicable to Berkshire	$ 2,132	$ 1,882	$ 1,470

BNSF	*Earnings (in millions)*		
	2015	*2014*	*2013*
Revenues	$ 21,967	$ 23,239	$ 22,014
Operating expenses	14,264	16,237	15,357
Operating earnings before interest and taxes	7,703	7,002	6,657
Interest (net)	928	833	729
Income taxes	2,527	2,300	2,135
Net earnings	$ 4,248	$ 3,869	$ 3,793

I currently expect increased after-tax earnings at BHE in 2016, but lower earnings at BNSF.

Manufacturing, Service and Retailing Operations

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

Balance Sheet 12/31/15 (in millions)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 6,807	Notes payable	$ 2,135
Accounts and notes receivable	8,886	Other current liabilities	10,565
Inventory	11,916	Total current liabilities	12,700
Other current assets	970		
Total current assets	28,579		
		Deferred taxes	3,649
Goodwill and other intangibles	30,289	Term debt and other liabilities	4,767
Fixed assets	15,161	Non-controlling interests	521
Other assets	4,445	Berkshire equity	56,837
	$ 78,474		$ 78,474

Earnings Statement (in millions)

	2015	*2014*	*2013**
Revenues	$107,825	$ 97,689	$ 93,472
Operating expenses	100,607	90,788	87,208
Interest expense	103	109	104
Pre-tax earnings	7,115	6,792	6,160
Income taxes and non-controlling interests	2,432	2,324	2,283
Net earnings	$ 4,683	$ 4,468	$ 3,877

* Earnings for 2013 have been restated to exclude Marmon's leasing operations, which are now included in the Finance and Financial Products results.

Our income and expense data conforming to GAAP is on page 38. In contrast, the operating expense figures above are non-GAAP because they exclude some purchase-accounting items (primarily the amortization of certain intangible assets). We present the data in this manner because Charlie and I believe the adjusted numbers more accurately reflect the true economic expenses and profits of the businesses aggregated in the table than do GAAP figures.

I won't explain all of the adjustments – some are tiny and arcane – but serious investors should understand the disparate nature of intangible assets. Some truly deplete in value over time, while others *in no way* lose value. For software, as a big example, amortization charges are very real expenses. Conversely, the concept of recording charges against other intangibles, such as customer relationships, arises from purchase-accounting rules and clearly does not reflect economic reality. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when earnings are calculated – even though, from an investor's viewpoint, they could not differ more.

In the GAAP-compliant figures we show on page 38, amortization charges of $1.1 billion have been deducted as expenses. We would call about 20% of these "real," the rest not. The "non-real" charges, once non-existent at Berkshire, have become significant because of the many acquisitions we have made. Non-real amortization charges are likely to climb further as we acquire more companies.

The table on page 55 gives you the current status of our intangible assets as calculated by GAAP. We now have $6.8 billion left of amortizable intangibles, of which $4.1 billion will be expensed over the next five years. Eventually, of course, every dollar of these "assets" will be charged off. When that happens, reported earnings increase even if true earnings are flat. (My gift to my successor.)

I suggest that you ignore a portion of GAAP amortization costs. But it is with some trepidation that I do that, knowing that it has become common for managers to tell their owners to ignore certain expense items that are all too real. "Stock-based compensation" is the most egregious example. The very name says it all: "compensation." If compensation isn't an expense, what is it? And, if real and recurring expenses don't belong in the calculation of earnings, where in the world do they belong?

Wall Street analysts often play their part in this charade, too, parroting the phony, compensation-ignoring "earnings" figures fed them by managements. Maybe the offending analysts don't know any better. Or maybe they fear losing "access" to management. Or maybe they are cynical, telling themselves that since everyone else is playing the game, why shouldn't they go along with it. Whatever their reasoning, these analysts are guilty of propagating misleading numbers that can deceive investors.

Depreciation charges are a more complicated subject but are almost always true costs. Certainly they are at Berkshire. I wish we could keep our businesses competitive while spending less than our depreciation charge, but in 51 years I've yet to figure out how to do so. Indeed, the depreciation charge we record in our railroad business falls far short of the capital outlays needed to merely keep the railroad running properly, a mismatch that leads to GAAP earnings that are higher than true economic earnings. (This overstatement of earnings exists at all railroads.) When CEOs or investment bankers tout pre-depreciation figures such as EBITDA as a valuation guide, watch their noses lengthen while they speak.

Our public reports of earnings will, of course, continue to conform to GAAP. To embrace reality, however, you should remember to add back most of the amortization charges we report. You should also subtract something to reflect BNSF's inadequate depreciation charge.

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Let's get back to our many manufacturing, service and retailing operations, which sell products ranging from lollipops to jet airplanes. Some of this sector's businesses, measured by earnings on unleveraged net *tangible* assets, enjoy terrific economics, producing profits that run from 25% after-tax to far more than 100%. Others generate good returns in the area of 12% to 20%.

A few, however – these are serious mistakes I made in my job of capital allocation – have very poor returns. In most of these cases, I was wrong in my evaluation of the economic dynamics of the company or the industry in which it operates, and we are now paying the price for my misjudgments. At other times, I stumbled in evaluating either the fidelity or the ability of incumbent managers or ones I later appointed. I will commit more errors; you can count on that. If we luck out, they will occur at our smaller operations.

Viewed as a single entity, the companies in this group are an excellent business. They employed an average of $25.6 billion of net tangible assets during 2015 and, despite their holding large quantities of excess cash and using only token amounts of leverage, earned 18.4% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if it is bought at too high a price. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show for goodwill and other intangibles. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Earnings from the group should grow substantially in 2016 as Duracell and Precision Castparts enter the fold.

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We have far too many companies in this group to comment on them individually. Moreover, their competitors – both current and potential – read this report. In a few of our businesses we might be disadvantaged if others knew our numbers. In some of our operations that are not of a size material to an evaluation of Berkshire, therefore, we only disclose what is required. You can nevertheless find a good bit of detail about many of our operations on pages 88-91.

Finance and Financial Products

Our three leasing and rental operations are conducted by CORT (furniture), XTRA (semi-trailers), and Marmon (primarily tank cars but also freight cars, intermodal tank containers and cranes). These companies are industry leaders and have substantially increased their earnings as the American economy has gained strength. At each of the three, we have invested more money in new equipment than have many of our competitors, and that's paid off. Dealing from strength is one of Berkshire's enduring advantages.

Kevin Clayton has again delivered an industry-leading performance at Clayton Homes, the second-largest home builder in America. Last year, the company sold 34,397 homes, about 45% of the manufactured homes bought by Americans. In contrast, the company was number three in the field, with a 14% share, when Berkshire purchased it in 2003.

Manufactured homes allow the American dream of home ownership to be achieved by lower-income citizens: Around 70% of new homes costing $150,000 or less come from our industry. About 46% of Clayton's homes are sold through the 331 stores we ourselves own and operate. Most of Clayton's remaining sales are made to 1,395 independent retailers.

Key to Clayton's operation is its $12.8 billion mortgage portfolio. We originate about 35% of *all* mortgages on manufactured homes. About 37% of our mortgage portfolio emanates from our retail operation, with the balance primarily originated by independent retailers, some of which sell our homes while others market only the homes of our competitors.

Lenders other than Clayton have come and gone. With Berkshire's backing, however, Clayton steadfastly financed home buyers throughout the panic days of 2008-2009. Indeed, during that period, Clayton used precious capital to finance dealers who did *not* sell our homes. The funds we supplied to Goldman Sachs and General Electric at that time produced headlines; the funds Berkshire quietly delivered to Clayton both made home ownership possible for thousands of families and kept many non-Clayton dealers alive.

Our retail outlets, employing simple language and large type, consistently inform home buyers of alternative sources for financing – most of it coming from local banks – and always secure acknowledgments from customers that this information has been received and read. (The form we use is reproduced in its actual size on page 119.)

Mortgage-origination practices are of great importance to both the borrower and to society. There is no question that reckless practices in home lending played a major role in bringing on the financial panic of 2008, which in turn led to the Great Recession. In the years preceding the meltdown, a destructive and often corrupt pattern of mortgage creation flourished whereby (1) an originator in, say, California would make loans and (2) promptly sell them to an investment or commercial bank in, say, New York, which would package many mortgages to serve as collateral for a dizzyingly complicated array of mortgage-backed securities to be (3) sold to unwitting institutions around the world.

As if these sins weren't sufficient to create an unholy mess, imaginative investment bankers sometimes concocted a second layer of sliced-up financing whose value depended on the junkier portions of primary offerings. (When Wall Street gets "innovative," watch out!) While that was going on, I described this "doubling-up" practice as requiring an investor to read tens of thousands of pages of mind-numbing prose to evaluate a single security being offered.

Both the originator and the packager of these financings had no skin in the game and were driven by volume and mark-ups. Many housing borrowers joined the party as well, blatantly lying on their loan applications while mortgage originators looked the other way. Naturally, the gamiest credits generated the most profits. Smooth Wall Street salesmen garnered millions annually by manufacturing products that their customers were unable to understand. (It's also questionable as to whether the major rating agencies were capable of evaluating the more complex structures. But rate them they did.)

Barney Frank, perhaps the most financially-savvy member of Congress during the panic, recently assessed the 2010 Dodd-Frank Act, saying, "The one major weakness that I've seen in the implementation was this decision by the regulators not to impose risk retention on all residential mortgages." Today, some legislators and commentators continue to advocate a 1%-to-5% retention by the originator as a way to align its interests with that of the ultimate lender or mortgage guarantor.

At Clayton, our risk retention was, and is, 100%. When we originate a mortgage we keep it (leaving aside the few that qualify for a government guarantee). When we make mistakes in granting credit, we therefore pay a price – a hefty price that dwarfs any profit we realized upon the original sale of the home. Last year we had to foreclose on 8,444 manufactured-housing mortgages at a cost to us of $157 million.

The average loan we made in 2015 was only $59,942, small potatoes for traditional mortgage lenders, but a daunting commitment for our many lower-income borrowers. Our buyer acquires a decent home – take a look at the home we will have on display at our annual meeting – requiring monthly principal-and-interest payments that average $522.

Some borrowers, of course, will lose their jobs, and there will be divorces and deaths. Others will get over-extended on credit cards and mishandle their finances. We will lose money then, and our borrower will lose his down payment (though his mortgage payments during his time of occupancy may have been well under rental rates for comparable quarters). Nevertheless, despite the low FICO scores and income of our borrowers, their payment behavior during the Great Recession was *far* better than that prevailing in many mortgage pools populated by people earning multiples of our typical borrower's income.

The strong desire of our borrowers to have a home of their own is one reason we've done well with our mortgage portfolio. Equally important, we have financed much of the portfolio with floating-rate debt or with short-term fixed-rate debt. Consequently, the incredibly low short-term rates of recent years have provided us a constantly-widening spread between our interest costs and the income we derive from our mortgage portfolio, which bears fixed rates. (Incidentally, we would have enjoyed similar margins had we simply bought long-term bonds and financed the position in some short-term manner.)

Normally, it is risky business to lend long at fixed rates and borrow short as we have been doing at Clayton. Over the years, some important financial institutions have gone broke doing that. At Berkshire, however, we possess a natural offset in that our businesses always maintain at least $20 billion in cash-equivalents that *earn* short-term rates. More often, our short-term investments are in the $40 billion to $60 billion range. If we have, say, $60 billion invested at ¼% or less, a sharp move to higher short-term rates would bring benefits to us far exceeding the higher financing costs we would incur in funding Clayton's $13 billion mortgage portfolio. In banking terms, Berkshire is – and always will be – heavily asset-sensitive and will consequently benefit from rising interest rates.

Let me talk about one subject of which I am particularly proud, that having to do with regulation. The Great Recession caused mortgage originators, servicers and packagers to come under intense scrutiny and to be assessed many billions of dollars in fines and penalties.

The scrutiny has certainly extended to Clayton, whose mortgage practices have been continuously reviewed and examined in respect to such items as originations, servicing, collections, advertising, compliance, and internal controls. At the federal level, we answer to the Federal Trade Commission, the Department of Housing and Urban Development and the Consumer Financial Protection Bureau. Dozens of states regulate us as well. During the past two years, indeed, various federal and state authorities (from 25 states) examined and reviewed Clayton and its mortgages on 65 occasions. The result? Our total fines during this period were $38,200 and our refunds to customers $704,678. Furthermore, though we had to foreclose on 2.64% of our manufactured-home mortgages last year, 95.4% of our borrowers were current on their payments at yearend, as they moved toward owning a debt-free home.

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Marmon's rail fleet expanded to 133,220 units by yearend, a number significantly increased by the company's purchase of 25,085 cars from General Electric on September 30. If our fleet was connected to form a single train, the engine would be in Omaha and the caboose in Portland, Maine.

At yearend, 97% of our railcars were leased, with about 15-17% of the fleet coming up for renewal each year. Though "tank cars" sound like vessels carrying crude oil, only about 7% of our fleet carries that product; chemicals and refined petroleum products are the lead items we transport. When trains roll by, look for the UTLX or Procor markings that identify our tank cars. When you spot the brand, puff out your chest; you own a portion of that car.

Here's the earnings recap for this sector:

	2015	*2014*	*2013*
		(in millions)	
Berkadia (our 50% share)	$ 74	$ 122	$ 80
Clayton	706	558	416
CORT	55	49	42
Marmon – Containers and Cranes	192	238	226
Marmon – Railcars	546	442	353
XTRA	172	147	125
Net financial income*	341	283	322
	$ 2,086	$ 1,839	$ 1,564

* Excludes capital gains or losses

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding because we are part of a control group and account for it on the "equity" method.

			12/31/15	
*Shares***	*Company*	*Percentage of Company Owned*	*Cost**	*Market*
			(in millions)	
151,610,700	American Express Company	15.6	$ 1,287	$ 10,545
46,577,138	AT&T	0.8	1,283	1,603
7,463,157	Charter Communications, Inc.	6.6	1,202	1,367
400,000,000	The Coca-Cola Company	9.3	1,299	17,184
18,513,482	DaVita HealthCare Partners Inc.	8.8	843	1,291
22,164,450	Deere & Company	7.0	1,773	1,690
11,390,582	The Goldman Sachs Group, Inc.	2.7	654	2,053
81,033,450	International Business Machines Corp.	8.4	13,791	11,152
24,669,778	Moody's Corporation	12.6	248	2,475
55,384,926	Phillips 66	10.5	4,357	4,530
52,477,678	The Procter & Gamble Company	1.9	336	4,683 ***
22,169,930	Sanofi	1.7	1,701	1,896
101,859,335	U.S. Bancorp	5.8	3,239	4,346
63,507,544	Wal-Mart Stores, Inc.	2.0	3,593	3,893
500,000,000	Wells Fargo & Company	9.8	12,730	27,180
	Others		10,276	16,450
	Total Common Stocks Carried at Market		$ 58,612	$ 112,338

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

** Excludes shares held by pension funds of Berkshire subsidiaries.

*** Held under contract of sale for this amount.

Berkshire has one major equity position that is not included in the table: We can buy 700 million shares of Bank of America at any time prior to September 2021 for $5 billion. At yearend these shares were worth $11.8 billion. We are likely to purchase them just before expiration of our option and, if we wish, we can use our $5 billion of Bank of America 6% preferred to fund the purchase. In the meantime, it is important for you to realize that Bank of America is, in effect, our fourth largest equity investment – and one we value highly.

Productivity and Prosperity

Earlier, I told you how our partners at Kraft Heinz root out inefficiencies, thereby increasing output per hour of employment. That kind of improvement has been the secret sauce of America's remarkable gains in living standards since the nation's founding in 1776. Unfortunately, the label of "secret" is appropriate: Too few Americans fully grasp the linkage between productivity and prosperity. To see that connection, let's look first at the country's most dramatic example – farming – and later examine three Berkshire-specific areas.

In 1900, America's civilian work force numbered 28 million. Of these, 11 million, a staggering 40% of the total, worked in farming. The leading crop then, as now, was corn. About 90 million acres were devoted to its production and the yield per acre was 30 bushels, for a total output of 2.7 billion bushels annually.

Then came the tractor and one innovation after another that revolutionized such keys to farm productivity as planting, harvesting, irrigation, fertilization and seed quality. Today, we devote about 85 million acres to corn. Productivity, however, has improved yields to more than 150 bushels per acre, for an annual output of 13-14 billion bushels. Farmers have made similar gains with other products.

Increased yields, though, are only half the story: The huge increases in physical output have been accompanied by a dramatic reduction in the number of farm laborers ("human input"). Today about three million people work on farms, a tiny 2% of our 158-million-person work force. Thus, improved farming methods have allowed tens of millions of present-day workers to utilize their time and talents in other endeavors, a reallocation of human resources that enables Americans of today to enjoy huge quantities of *non-farm* goods and services they would otherwise lack.

It's easy to look back over the 115-year span and realize how extraordinarily beneficial agricultural innovations have been – not just for farmers but, more broadly, for our entire society. We would not have anything close to the America we now know had we stifled those improvements in productivity. (It was fortunate that horses couldn't vote.) On a day-to-day basis, however, talk of the "greater good" must have rung hollow to farm hands who lost their jobs to machines that performed routine tasks far more efficiently than humans ever could. We will examine this flip-side to productivity gains later in this section.

For the moment, however, let's move on to three stories of efficiencies that have had major consequences for Berkshire subsidiaries. Similar transformations have been commonplace throughout American business.

- In 1947, shortly after the end of World War II, the American workforce totaled 44 million. About 1.35 million workers were employed in the railroad industry. The revenue ton-miles of freight moved by Class I railroads that year totaled 655 billion.

  By 2014, Class I railroads carried 1.85 trillion ton-miles, an increase of 182%, while employing only 187,000 workers, a reduction of 86% since 1947. (Some of this change involved passenger-related employees, but most of the workforce reduction came on the freight side.) As a result of this staggering improvement in productivity, the inflation-adjusted price for moving a ton-mile of freight has fallen by 55% since 1947, a drop saving shippers about $90 billion *annually* in current dollars.

  Another startling statistic: If it took as many people now to move freight as it did in 1947, we would need well over three million railroad workers to handle present volumes. (Of course, that level of employment would raise freight charges by a lot; consequently, nothing close to today's volume would actually move.)

Our own BNSF was formed in 1995 by a merger between Burlington Northern and Santa Fe. In 1996, the merged company's first full year of operation, 411 million ton-miles of freight were transported by 45,000 employees. Last year the comparable figures were 702 million ton-miles (plus 71%) and 47,000 employees (plus only 4%). That dramatic gain in productivity benefits both owners and shippers. Safety at BNSF has improved as well: Reportable injuries were 2.04 per 200,000 man-hours in 1996 and have since fallen more than 50% to 0.95.

- A bit more than a century ago, the auto was invented, and around it formed an industry that insures cars and their drivers. Initially, this business was written through traditional insurance agencies – the kind dealing in fire insurance. This agency-centric approach included high commissions and other underwriting expenses that consumed about 40¢ of the premium dollar. Strong local agencies were then in the driver's seat because they represented multiple insurers and could play one company off against another when commissions were being negotiated. Cartel-like pricing prevailed, and all involved were doing fine – except for the consumer.

  And then some American ingenuity came into play: G. J. Mecherle, a farmer from Merna, Illinois, came up with the idea of a captive sales force that would sell the insurance products of only a single company. His baby was christened State Farm Mutual. The company cut commissions and expenses – moves that permitted lower prices – and soon became a powerhouse. For many decades, State Farm has been the runaway volume leader in both auto and homeowner's insurance. Allstate, which also operated with a direct distribution model, was long the runner-up. Both State Farm and Allstate have had underwriting expenses of about 25%.

  In the early 1930s, another contender, United Services Auto Association ("USAA"), a mutual-like company, was writing auto insurance for military officers on a direct-to-the-customer basis. This marketing innovation rose from a need that military personnel had to buy insurance that would stay with them as they moved from base to base. That was business of little interest to local insurance agencies, which wanted the steady renewals that came from permanent residents.

  The direct distribution method of USAA, as it happened, incurred lower costs than those enjoyed by State Farm and Allstate and therefore delivered an even greater bargain to customers. That made Leo and Lillian Goodwin, employees of USAA, dream of broadening the target market for its direct distribution model beyond military officers. In 1936, starting with $100,000 of capital, they incorporated Government Employees Insurance Co. (later compressing this mouthful to GEICO).

  Their fledgling did $238,000 of auto insurance business in 1937, its first full year. Last year GEICO did $22.6 *billion*, more than double the volume of USAA. (Though the early bird gets the worm, the second mouse gets the cheese.) GEICO's underwriting expenses in 2015 were 14.7% of premiums, with USAA being the only large company to achieve a lower percentage. (GEICO is fully as efficient as USAA but spends considerably more on advertising aimed at promoting growth.)

  With the price advantage GEICO's low costs allow, it's not surprising that several years ago the company seized the number two spot in auto insurance from Allstate. GEICO is also gaining ground on State Farm, though it is still far ahead of us in volume. On August 30, 2030 – my 100th birthday – I plan to announce that GEICO has taken over the top spot. Mark your calendar.

  GEICO employs about 34,000 people to serve its 14 million policyholders. I can only guess at the workforce it would require to serve a similar number of policyholders under the agency system. I believe, however, that the number would be at least 60,000, a combination of what the insurer would need in direct employment and the personnel required at supporting agencies.

- In its electric utility business, our Berkshire Hathaway Energy ("BHE") operates within a changing economic model. Historically, the survival of a local electric company did not depend on its efficiency. In fact, a "sloppy" operation could do just fine financially.

  That's because utilities were usually the sole supplier of a needed product and were allowed to price at a level that gave them a prescribed return upon the capital they employed. The joke in the industry was that a utility was the only business that would automatically earn more money by redecorating the boss's office. And some CEOs ran things accordingly.

  That's all changing. Today, society has decided that federally-subsidized wind and solar generation is in our country's long-term interest. Federal tax credits are used to implement this policy, support that makes renewables price-competitive in certain geographies. Those tax credits, or other government-mandated help for renewables, may eventually erode the economics of the incumbent utility, particularly if it is a high-cost operator. BHE's long-established emphasis on efficiency – even when the company didn't need it to attain authorized earnings – leaves us particularly competitive in today's market (and, more important, in tomorrow's as well).

  BHE acquired its Iowa utility in 1999. In the year before, that utility employed 3,700 people and produced 19 million megawatt-hours of electricity. Now we employ 3,500 people and produce 29 million megawatt-hours. That major increase in efficiency allowed us to operate without a rate increase for 16 years, a period during which industry rates increased 44%.

  The safety record of our Iowa utility is also outstanding. It had .79 injuries per 100 employees in 2015 compared to the rate of 7.0 experienced by the previous owner in the year before we bought the operation.

  In 2006 BHE purchased PacifiCorp, which operated primarily in Oregon and Utah. The year before our purchase PacifiCorp employed 6,750 people and produced 52.6 million megawatt-hours. Last year the numbers were 5,700 employees and 56.3 million megawatt-hours. Here, too, safety improved dramatically, with the accident-rate-per-100-employees falling from 3.4 in 2005 to .85 in 2015. In safety, BHE now ranks in the industry's top decile.

  Those outstanding performances explain why BHE is welcomed by regulators when it proposes to buy a utility in their jurisdiction. The regulators know the company will run an efficient, safe and reliable operation and also arrive with unlimited capital to fund whatever projects make sense. (BHE has never paid a dividend to Berkshire since we assumed ownership. No investor-owned utility in America comes close to matching BHE's enthusiasm for reinvestment.)

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The productivity gains that I've just spelled out – and countless others that have been achieved in America – have delivered awesome benefits to society. That's the reason our citizens, as a whole, have enjoyed – and will continue to enjoy – major gains in the goods and services they receive.

To this thought there are offsets. First, the productivity gains achieved in recent years have largely benefitted the wealthy. Second, productivity gains frequently cause upheaval: Both capital and labor can pay a terrible price when innovation or new efficiencies upend their worlds.

We need shed no tears for the capitalists (whether they be private owners or an army of public shareholders). It's their job to take care of themselves. When large rewards can flow to investors from good decisions, these parties should not be spared the losses produced by *wrong* choices. Moreover, investors who diversify widely and simply sit tight with their holdings are certain to prosper: In America, gains from winning investments have always *far* more than offset the losses from clunkers. (During the 20^{th} Century, the Dow Jones Industrial Average – an index fund of sorts – soared from 66 to 11,497, with its component companies all the while paying ever-increasing dividends.)

A long-employed worker faces a different equation. When innovation and the market system interact to produce efficiencies, many workers may be rendered unnecessary, their talents obsolete. Some can find decent employment elsewhere; for others, that is not an option.

When low-cost competition drove shoe production to Asia, our once-prosperous Dexter operation folded, putting 1,600 employees in a small Maine town out of work. Many were past the point in life at which they could learn another trade. We lost our entire investment, which we could afford, but many workers lost a livelihood they could not replace. The same scenario unfolded in slow-motion at our original New England textile operation, which struggled for 20 years before expiring. Many older workers at our New Bedford plant, as a poignant example, spoke Portuguese and knew little, if any, English. They had no Plan B.

The answer in such disruptions is not the restraining or outlawing of actions that increase productivity. Americans would not be living nearly as well as we do if we had mandated that 11 million people should forever be employed in farming.

The solution, rather, is a variety of safety nets aimed at providing a decent life for those who are willing to work but find their specific talents judged of small value because of market forces. (I personally favor a reformed and expanded Earned Income Tax Credit that would try to make sure America works for those willing to work.) The price of achieving ever-increasing prosperity for the great majority of Americans should not be penury for the unfortunate.

Important Risks

We, like all public companies, are required by the SEC to annually catalog "risk factors" in our 10-K. I can't remember, however, an instance when reading a 10-K's "risk" section has helped me in evaluating a business. That's not because the identified risks aren't real. The truly important risks, however, are usually well known. Beyond that, a 10-K's catalog of risks is seldom of aid in assessing: (1) the probability of the threatening event actually occurring; (2) the range of costs if it does occur; and (3) the timing of the possible loss. A threat that will only surface 50 years from now may be a problem for society, but it is not a *financial* problem for today's investor.

Berkshire operates in more industries than any company I know of. Each of our pursuits has its own array of possible problems and opportunities. Those are easy to list but hard to evaluate: Charlie, I and our various CEOs often differ in a very major way in our calculation of the likelihood, the timing and the cost (or benefit) that may result from these possibilities.

Let me mention just a few examples. To begin with an obvious threat, BNSF, along with other railroads, is *certain* to lose significant coal volume over the next decade. At some point in the future – though not, in my view, for a long time – GEICO's premium volume *may* shrink because of driverless cars. This development could hurt our auto dealerships as well. Circulation of our print newspapers will continue to fall, a certainty we allowed for when purchasing them. To date, renewables have helped our utility operation but that could change, particularly if storage capabilities for electricity materially improve. Online retailing threatens the business model of our retailers and certain of our consumer brands. These potentialities are just a few of the negative possibilities facing us – but even the most casual follower of business news has long been aware of them.

None of these problems, however, is crucial to Berkshire's long-term well-being. When we took over the company in 1965, its risks could have been encapsulated in a single sentence: "The northern textile business in which all of our capital resides is destined for recurring losses and will eventually disappear." That development, however, was no death knell. We simply adapted. And we will continue to do so.

Every day Berkshire managers are thinking about how they can better compete in an always-changing world. Just as vigorously, Charlie and I focus on where a steady stream of funds should be deployed. In that respect, we possess a major advantage over one-industry companies, whose options are far more limited. I firmly believe that Berkshire has the money, talent and culture to plow through the sort of adversities I've itemized above – and many more – and to emerge with ever-greater earning power.

There is, however, one clear, present and enduring danger to Berkshire against which Charlie and I are powerless. That threat to Berkshire is also the major threat our citizenry faces: a "successful" (as defined by the aggressor) cyber, biological, nuclear or chemical attack on the United States. That is a risk Berkshire shares with *all* of American business.

The probability of such mass destruction in any given year is likely very small. It's been more than 70 years since I delivered a Washington Post newspaper headlining the fact that the United States had dropped the first atomic bomb. Subsequently, we've had a few close calls but avoided catastrophic destruction. We can thank our government – and luck! – for this result.

Nevertheless, what's a small probability in a short period approaches certainty in the longer run. (If there is only one chance in thirty of an event occurring in a given year, the likelihood of it occurring at least once in a century is 96.6%.) The added bad news is that there will forever be people and organizations and perhaps even nations that would like to inflict maximum damage on our country. Their means of doing so have increased exponentially during my lifetime. "Innovation" has its dark side.

There is no way for American corporations or their investors to shed this risk. If an event occurs in the U.S. that leads to mass devastation, the value of all equity investments will almost certainly be decimated.

No one knows what "the day after" will look like. I think, however, that Einstein's 1949 appraisal remains apt: "I know not with what weapons World War III will be fought, but World War IV will be fought with sticks and stones."

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I am writing this section because we have a proxy proposal regarding climate change to consider at this year's annual meeting. The sponsor would like us to provide a report on the dangers that this change might present to our insurance operation and explain how we are responding to these threats.

It seems highly likely to me that climate change poses a major problem for the planet. I say "highly likely" rather than "certain" because I have no scientific aptitude and remember well the dire predictions of most "experts" about Y2K. It would be foolish, however, for me or anyone to demand 100% proof of huge forthcoming damage to the world if that outcome seemed at all possible and if prompt action had even a small chance of thwarting the danger.

This issue bears a similarity to Pascal's Wager on the Existence of God. Pascal, it may be recalled, argued that if there were only a tiny probability that God truly existed, it made sense to behave as if He did because the rewards could be infinite whereas the lack of belief risked eternal misery. Likewise, if there is only a 1% chance the planet is heading toward a truly major disaster and delay means passing a point of no return, inaction now is foolhardy. Call this Noah's Law: If an ark may be essential for *survival*, begin building it today, no matter how cloudless the skies appear.

It's understandable that the sponsor of the proxy proposal believes Berkshire is especially threatened by climate change because we are a huge insurer, covering all sorts of risks. The sponsor may worry that property losses will skyrocket because of weather changes. And such worries might, in fact, be warranted if we wrote ten- or twenty-year policies at fixed prices. But insurance policies are customarily written for one year and repriced annually to reflect changing exposures. Increased possibilities of loss translate promptly into increased premiums.

Think back to 1951 when I first became enthused about GEICO. The company's average loss-per-policy was then about $30 annually. Imagine your reaction if I had predicted then that in 2015 the loss costs would increase to about $1,000 per policy. Wouldn't such skyrocketing losses prove disastrous, you might ask? Well, no.

Over the years, inflation has caused a huge increase in the cost of repairing both the cars and the humans involved in accidents. But these increased costs have been promptly matched by increased premiums. So, paradoxically, the upward march in loss costs has made insurance companies far more *valuable*. If costs had remained unchanged, Berkshire would now own an auto insurer doing $600 million of business annually rather than one doing $23 billion.

Up to now, climate change has *not* produced more frequent nor more costly hurricanes nor other weather-related events covered by insurance. As a consequence, U.S. super-cat rates have *fallen* steadily in recent years, which is why we have backed away from that business. If super-cats become costlier and more frequent, the likely – though far from certain – effect on Berkshire's insurance business would be to make it larger and more profitable.

As a citizen, you may understandably find climate change keeping you up nights. As a homeowner in a low-lying area, you may wish to consider moving. But when you are thinking only as a shareholder of a major insurer, climate change should not be on your list of worries.

The Annual Meeting

Charlie and I have finally decided to enter the 21st Century. Our annual meeting this year will be webcast worldwide in its entirety. To view the meeting, simply go to https://finance.yahoo.com/brklivestream at 9 a.m. Central Daylight Time on Saturday, April 30th. The Yahoo! webcast will begin with a half hour of interviews with managers, directors and shareholders. Then, at 9:30, Charlie and I will commence answering questions.

This new arrangement will serve two purposes. First, it may level off or modestly decrease attendance at the meeting. Last year's record of more than 40,000 attendees strained our capacity. In addition to quickly filling the CenturyLink Center's main arena, we packed its overflow rooms and then spilled into two large meeting rooms at the adjoining Omaha Hilton. All major hotels were sold out notwithstanding Airbnb's stepped-up presence. Airbnb was especially helpful for those visitors on limited budgets.

Our second reason for initiating a webcast is more important. Charlie is 92, and I am 85. If we were partners with you in a small business, and were charged with running the place, you would want to look in occasionally to make sure we hadn't drifted off into la-la land. Shareholders, in contrast, should not need to come to Omaha to monitor how we look and sound. (In making your evaluation, be kind: Allow for the fact that we didn't look that impressive when we were at our best.)

Viewers can also observe our life-prolonging diet. During the meeting, Charlie and I will each consume enough Coke, See's fudge and See's peanut brittle to satisfy the weekly caloric needs of an NFL lineman. Long ago we discovered a fundamental truth: There's nothing like eating carrots and broccoli when you're *really* hungry – and want to stay that way.

Shareholders planning to attend the meeting should come at 7 a.m. when the doors open at CenturyLink Center and *start shopping*. Carrie Sova will again be in charge of the festivities. She had her second child late last month, but that did not slow her down. Carrie is unflappable, ingenious and expert at bringing out the best in those who work with her. She is aided by hundreds of Berkshire employees from around the country and by our entire home office crew as well, all of them pitching in to make the weekend fun and informative for our owners.

Last year we increased the number of hours available for shopping at the CenturyLink. Sales skyrocketed – so, naturally, we will stay with the new schedule. On Friday, April 29th you can shop between noon and 5 p.m., and on Saturday exhibits and stores will be open from 7 a.m. until 4:30 p.m.

On Saturday morning, we will have our fifth International Newspaper Tossing Challenge. Our target will again be a Clayton Home porch, located precisely 35 feet from the throwing line. When I was a teenager – in my one brief flirtation with honest labor – I delivered about 500,000 papers. So I think I'm pretty good at this game. Challenge me! Humiliate me! Knock me down a peg! The papers will run 36 to 42 pages, and you must fold them yourself (no rubber bands allowed).

The competition begins at 7:15, when contestants will make preliminary tosses. The eight throws judged most accurate – four made by contestants 12 or under, and four made by the older set – will compete against me at 7:45. The young challengers will each receive a prize. But the older ones will have to beat me to take anything home.

And be sure to check out the Clayton home itself. It can be purchased for $78,900, fully installed on land you provide. In past years, we've made many sales on the meeting day. Kevin Clayton will be on hand with his order book.

At 8:30 a.m., a new Berkshire movie will be shown. An hour later, we will start the question-and-answer period, which (including a break for lunch at CenturyLink's stands) will last until 3:30 p.m. After a short recess, Charlie and I will convene the annual meeting at 3:45 p.m. This business session typically lasts only a half hour or so and can safely be skipped by those craving a little last-minute shopping.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of Berkshire subsidiaries will be for sale. Say hello to the many Berkshire managers who will be captaining their exhibits. And be sure to view the terrific BNSF railroad layout that salutes all of our subsidiaries. Your children (and you!) will be enchanted with it.

We will have a new and very special exhibit in the hall this year: a full-size model of the world's largest aircraft engine, for which Precision Castparts makes many key components. The real engines weigh about 20,000 pounds and are ten feet in diameter and 22 feet in length. The bisected model at the meeting will give you a good look at many PCC components that help power your flights.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them on Sunday at our fourth annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that will be sent to you with your meeting credentials. Entrants in the race will find themselves running alongside many of Berkshire's managers, directors and associates. (Charlie and I, however, will sleep in; the fudge and peanut brittle take their toll.) Participation in the 5K grows every year. Help us set another record.

A GEICO booth in the shopping area will be staffed by a number of the company's top counselors from around the country. Stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money. Spend the savings on our other products.

Be sure to visit the Bookworm. It will carry about 35 books and DVDs, among them a couple of new titles. Andy Kilpatrick will introduce (and be glad to sign) the latest edition of his all-encompassing coverage of Berkshire. It's 1,304 pages and weighs 9.8 pounds. (My blurb for the book: "Ridiculously skimpy.") Check out Peter Bevelin's new book as well. Peter has long been a keen observer of Berkshire.

We will also have a new, 20-page-longer edition of Berkshire's 50-year commemorative book that at last year's meeting sold 12,000 copies. Since then, Carrie and I have uncovered additional material that we find fascinating, such as some very personal letters sent by Grover Cleveland to Edward Butler, his friend and the then-publisher of *The Buffalo News*. Nothing from the original edition has been changed or eliminated, and the price remains $20. Charlie and I will jointly sign 100 copies that will be randomly placed among the 5,000 available for sale at the meeting.

My friend, Phil Beuth, has written *Limping on Water*, an autobiography that chronicles his life at Capital Cities Communications and tells you a lot about its leaders, Tom Murphy and Dan Burke. These two were the best managerial duo – both in *what* they accomplished and *how* they did it – that Charlie and I ever witnessed. Much of what you become in life depends on whom you choose to admire and copy. Start with Tom Murphy, and you'll never need a second exemplar.

Finally, Jeremy Miller has written *Warren Buffett's Ground Rules*, a book that will debut at the annual meeting. Mr. Miller has done a superb job of researching and dissecting the operation of Buffett Partnership Ltd. and of explaining how Berkshire's culture has evolved from its BPL origin. If you are fascinated by investment theory and practice, you will enjoy this book.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Airlines have sometimes jacked up prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2½ hours, and it may be that Kansas City can save you significant money, particularly if you had planned to rent a car in Omaha. The savings for a couple could run to $1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. Last year in the week encompassing the meeting, the store did a record $44,239,493 of business. If you repeat that figure to a retailer, he is not going to believe you. (An average week for NFM's Omaha store – the highest-volume home furnishings store in the United States except for our new Dallas store – is about $9 million.)

To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, April 26th and Monday, May 2nd inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. During "Berkshire Weekend" NFM will be open from 10 a.m. to 9 p.m. Monday through Friday, 10 a.m. to 9:30 p.m. on Saturday and 10 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is hosting a picnic to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, April 29th. The second, the main gala, will be held on Sunday, May 1st, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. During last year's Friday-Sunday stretch, the store wrote a sales ticket every 15 seconds that it was open.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 25th through Saturday, May 7th. During that period, please identify yourself as a shareholder either by presenting your meeting credential or a brokerage statement showing you own our stock.

On Sunday, in the mall outside of Borsheims, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. On the upper level, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon. I will join them and hope to have Ajit and Charlie there also.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine and even then I was unable to score a point against her. Now, she's a junior at Princeton, having already represented the United States in the 2012 Olympics. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates and I will lead off and try to soften her up.

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 1st, serving from 1 p.m. until 10 p.m. To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*). As for my other favorite restaurant, Piccolo's, I'm sad to report it closed.

We will again have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, the preeminent business journalist of her time, who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

An accompanying set of questions will be asked by three analysts who follow Berkshire. This year the insurance specialist will be Cliff Gallant of Nomura Securities. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. Multi-part questions aren't allowed; we want to give as many questioners as possible a shot at us.

All told we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. (Last year we had 64 in total.) The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and, if possible, should also have adequate time to digest and analyze it before any trading takes place. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday. We do not follow the common practice of talking one-on-one with large institutional investors or analysts, treating them instead as we do all other shareholders. There is no one more important to us than the shareholder of limited means who trusts us with a substantial portion of his savings.

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For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I also believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the 24 men and women who work with me at our corporate office. This group efficiently deals with a multitude of SEC and other regulatory requirements, files a 30,400-page Federal income tax return – that's up 6,000 pages from the prior year! – oversees the filing of 3,530 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities, fact-checks this letter – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year, for example, they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and french fries (smothered in Heinz ketchup, of course) for lunch. No CEO has it better; I truly do feel like tap dancing to work every day. In fact, my job becomes more fun every year.

In 2015, Berkshire's revenues increased by $16 billion. Look carefully, however, at the two pictures on the facing page. The top one is from last year's report and shows the entire Berkshire home-office crew at our Christmas lunch. Below that photo is this year's Christmas photo portraying the *same* 25 people identically positioned. In 2015, no one joined us, no one left. And the odds are good that you will see a photo of the same 25 next year.

Can you imagine another very large company – we employ 361,270 people worldwide – enjoying that kind of employment stability at headquarters? At Berkshire we have hired some wonderful people – and they have stayed with us. Moreover, no one is hired unless he or she is truly needed. That's why you've never read about "restructuring" charges at Berkshire.

On April 30th, come to Omaha – the cradle of capitalism – and meet my gang. They are the best.

February 27, 2016

Warren E. Buffett
Chairman of the Board

Front Row – Becki Amick, Sharon Heck, Melissa Hawk, Jalayna Busse, Warren Buffett, Angie Wells, Alisa Krueger, Deb Ray, Carrie Sova, Ellen Schmidt **Back Row –** Tracy Britt Cool, Jennifer Tselentis, Ted Weschler, Joanne Manhart, Bob Reeson, Todd Combs, Dan Jaksich, Debbie Bosanek, Mark Sisley, Marc Hamburg, Kerby Ham, Mark Millard, Allyson Ballard, Stacy Gottschalk, Tiffany Vokt

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change: in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
2016	10.7	23.4	12.0
Compounded Annual Gain – 1965-2016	19.0%	20.8%	9.7%
Overall Gain – 1964-2016	884,319%	1,972,595%	12,717%

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2016 was $27.5 billion, which increased the per-share book value of both our Class A and Class B stock by 10.7%. Over the last 52 years (that is, since present management took over), per-share book value has grown from $19 to $172,108, a rate of 19% compounded annually.*

During the first half of those years, Berkshire's net worth was roughly equal to the number that really counts: the intrinsic value of the business. The similarity of the two figures existed then because most of our resources were deployed in marketable securities that were regularly revalued to their quoted prices (less the tax that would be incurred if they were to be sold). In Wall Street parlance, our balance sheet was then in very large part "marked to market."

By the early 1990s, however, our focus was changing to the outright ownership of businesses, a shift that materially diminished the relevance of balance sheet figures. That disconnect occurred because the accounting rules (commonly referred to as "GAAP") that apply to companies we control differ in important ways from those used to value marketable securities. Specifically, the accounting for *businesses* we own requires that the carrying value of "losers" be written down when their failures become apparent. "Winners," conversely, are *never* revalued upwards.

We've experienced both outcomes: As is the case in marriage, business acquisitions often deliver surprises *after* the "I do's." I've made some dumb purchases, paying far too much for the economic goodwill of companies we acquired. That later led to goodwill write-offs and to consequent reductions in Berkshire's book value. We've also had some winners among the businesses we've purchased – a few of the winners very big – but have not written those up by a penny.

We have no quarrel with the asymmetrical accounting that applies here. But, over time, it necessarily widens the gap between Berkshire's intrinsic value and its book value. Today, the large – and growing – unrecorded gains at our winners produce an intrinsic value for Berkshire's shares that *far* exceeds their book value. The overage is truly huge in our property/casualty insurance business and significant also in many other operations.

Over time, stock prices gravitate toward intrinsic value. That's what has happened at Berkshire, a fact explaining why the company's 52-year market-price gain – shown on the facing page – materially exceeds its book-value gain.

* All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

What We Hope to Accomplish

Charlie Munger, Berkshire's Vice Chairman and my partner, and I expect Berkshire's *normalized* earning power per share to increase every year. *Actual* earnings, of course, will sometimes decline because of periodic weakness in the U.S. economy. In addition, insurance mega-catastrophes or other industry-specific events may occasionally reduce earnings at Berkshire, even when most American businesses are doing well.

It's our job, though, to over time deliver significant growth, bumpy or not. After all, as stewards of *your* capital, Berkshire directors have opted to retain all earnings. Indeed, in both 2015 and 2016 Berkshire ranked first among American businesses in the dollar volume of earnings retained, in each year reinvesting many billions of dollars more than did the runner-up. Those reinvested dollars must earn their keep.

Some years, the gains in underlying earning power we achieve will be minor; very occasionally, the cash register will ring loud. Charlie and I have no magic plan to add earnings except to dream big and to be prepared mentally and financially to act fast when opportunities present themselves. Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons. And that we will do.

I earlier described our gradual shift from a company obtaining most of its gains from investment activities to one that grows in value by owning businesses. Launching that transition, we took baby steps – making small acquisitions whose impact on Berkshire's profits was dwarfed by our gains from marketable securities. Despite that cautious approach, I made one particularly egregious error, acquiring Dexter Shoe for $434 million in 1993. Dexter's value promptly went to zero. The story gets worse: I used stock for the purchase, giving the sellers 25,203 shares of Berkshire that at yearend 2016 were worth more than $6 billion.

That wreck was followed by three key happenings – two positive, one negative – that set us firmly on our present course. At the beginning of 1996, we acquired the half of GEICO we didn't already own, a cash transaction that changed our holding from a portfolio investment into a wholly-owned operating business. GEICO, with its almost unlimited potential, quickly became the centerpiece around which we built what I believe is now the world's premier property/casualty business.

Unfortunately, I followed the GEICO purchase by foolishly using Berkshire stock – a *boatload* of stock – to buy General Reinsurance in late 1998. After some early problems, General Re has become a fine insurance operation that we prize. It was, nevertheless, a terrible mistake on my part to issue 272,200 shares of Berkshire in buying General Re, an act that increased our outstanding shares by a whopping 21.8%. My error caused Berkshire shareholders to give far more than they received (a practice that – despite the Biblical endorsement – is far from blessed when you are buying businesses).

Early in 2000, I atoned for that folly by buying 76% (since grown to 90%) of MidAmerican Energy, a brilliantly-managed utility business that has delivered us many large opportunities to make profitable and socially-useful investments. The MidAmerican *cash* purchase – I was learning – firmly launched us on our present course of (1) continuing to build our insurance operation; (2) energetically acquiring large and diversified non-insurance businesses and (3) largely making our deals from internally-generated cash. (Today, I would rather prep for a colonoscopy than issue Berkshire shares.)

Our portfolio of bonds and stocks, de-emphasized though it is, has continued in the post-1998 period to grow and to deliver us hefty capital gains, interest, and dividends. Those portfolio earnings have provided us major help in financing the purchase of businesses. Though unconventional, Berkshire's two-pronged approach to capital allocation gives us a real edge.

Here's our financial record since 1999, when the redirection of our business began in earnest. During the 18-year period covered, Berkshire's outstanding shares grew by only 8.3%, with most of the increase occurring when we purchased BNSF. That, I'm happy to say, was one issuance of stock that made good sense.

After-Tax Earnings
(in billions of dollars)

Year	Operations (1)	Capital Gains (2)	Year	Operations (1)	Capital Gains (2)
1999	0.67	0.89	2008	9.64	(4.65)
2000	0.94	2.39	2009	7.57	0.49
2001	(0.13)	0.92	2010	11.09	1.87
2002	3.72	0.57	2011	10.78	(0.52)
2003	5.42	2.73	2012	12.60	2.23
2004	5.05	2.26	2013	15.14	4.34
2005	5.00	3.53	2014	16.55	3.32
2006	9.31	1.71	2015	17.36	6.73
2007	9.63	3.58	2016	17.57	6.50

(1) Including interest and dividends from investments, but *excluding* capital gains or losses.

(2) In very large part, this tabulation includes only *realized* capital gains or losses. Unrealized gains and losses are also included, however, when GAAP requires that treatment.

Our expectation is that investment gains will continue to be substantial – though totally random as to timing – and that these will supply significant funds for business purchases. Concurrently, Berkshire's superb corps of operating CEOs will focus on increasing earnings at the individual businesses they manage, sometimes helping them to grow by making bolt-on acquisitions. By our avoiding the issuance of Berkshire stock, any improvement in earnings will translate into equivalent per-share gains.

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Our efforts to materially increase the normalized earnings of Berkshire will be aided – as they have been throughout our managerial tenure – by America's economic dynamism. One word sums up our country's achievements: miraculous. From a standing start 240 years ago – a span of time less than triple my days on earth – Americans have combined human ingenuity, a market system, a tide of talented and ambitious immigrants, and the rule of law to deliver abundance beyond any dreams of our forefathers.

You need not be an economist to understand how well our system has worked. Just look around you. See the 75 million owner-occupied homes, the bountiful farmland, the 260 million vehicles, the hyper-productive factories, the great medical centers, the talent-filled universities, you name it – they all represent a net gain for Americans from the barren lands, primitive structures and meager output of 1776. Starting from scratch, America has amassed wealth totaling $90 trillion.

It's true, of course, that American owners of homes, autos and other assets have often borrowed heavily to finance their purchases. If an owner defaults, however, his or her asset does not disappear or lose its usefulness. Rather, ownership customarily passes to an American lending institution that then disposes of it to an American buyer. Our *nation's* wealth remains intact. As Gertrude Stein put it, "Money is always there, but the pockets change."

Above all, it's our market system – an economic traffic cop ably directing capital, brains and labor – that has created America's abundance. This system has also been the primary factor in allocating rewards. Governmental redirection, through federal, state and local taxation, has in addition determined the distribution of a significant portion of the bounty.

America has, for example, decided that those citizens in their productive years should help both the old and the young. Such forms of aid – sometimes enshrined as "entitlements" – are generally thought of as applying to the aged. But don't forget that four million American babies are born each year with an entitlement to a public education. That societal commitment, largely financed at the local level, costs about $150,000 per baby. The annual cost totals more than $600 billion, which is about 3 ½% of GDP.

However our wealth may be divided, the mind-boggling amounts you see around you belong almost exclusively to Americans. Foreigners, of course, own or have claims on a modest portion of our wealth. Those holdings, however, are of little importance to our national balance sheet: *Our* citizens own assets abroad that are roughly comparable in value.

Early Americans, we should emphasize, were neither smarter nor more hard working than those people who toiled century after century before them. But those venturesome pioneers crafted a system that unleashed human potential, and their successors built upon it.

This economic creation will deliver increasing wealth to our progeny far into the future. Yes, the build-up of wealth will be interrupted for short periods from time to time. It will not, however, be stopped. I'll repeat what I've both said in the past and expect to say in future years: Babies born in America today are the luckiest crop in history.

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America's economic achievements have led to staggering profits for stockholders. During the 20th century the Dow-Jones Industrials advanced from 66 to 11,497, a 17,320% capital gain that was materially boosted by steadily increasing dividends. The trend continues: By yearend 2016, the index had advanced a further 72%, to 19,763.

American business – and consequently a basket of stocks – is virtually certain to be worth far more in the years ahead. Innovation, productivity gains, entrepreneurial spirit and an abundance of capital will see to that. Ever-present naysayers may prosper by marketing their gloomy forecasts. But heaven help them if they act on the nonsense they peddle.

Many companies, of course, will fall behind, and some will fail. Winnowing of that sort is a product of market dynamism. Moreover, the years ahead will occasionally deliver major market declines – even panics – that will affect virtually all stocks. No one can tell you when these traumas will occur – not me, not Charlie, not economists, not the media. Meg McConnell of the New York Fed aptly described the reality of panics: "We spend a lot of time looking for systemic risk; in truth, however, it tends to find us."

During such scary periods, you should never forget two things: First, widespread fear is your *friend* as an investor, because it serves up bargain purchases. Second, *personal* fear is your enemy. It will also be unwarranted. Investors who avoid high and unnecessary costs and simply sit for an extended period with a collection of large, conservatively-financed American businesses will almost certainly do well.

As for Berkshire, our size precludes a *brilliant* result: Prospective returns fall as assets increase. Nonetheless, Berkshire's collection of good businesses, along with the company's impregnable financial strength and owner-oriented culture, should deliver decent results. We won't be satisfied with less.

Share Repurchases

In the investment world, discussions about share repurchases often become heated. But I'd suggest that participants in this debate take a deep breath: Assessing the desirability of repurchases isn't that complicated.

From the standpoint of exiting shareholders, repurchases are always a plus. Though the day-to-day impact of these purchases is usually minuscule, it's always better for a seller to have an additional buyer in the market.

For continuing shareholders, however, repurchases only make sense if the shares are bought at a price below intrinsic value. When that rule is followed, the remaining shares experience an immediate gain in intrinsic value. Consider a simple analogy: If there are three equal partners in a business worth $3,000 and one is bought out by the partnership for $900, each of the remaining partners realizes an immediate gain of $50. If the exiting partner is paid $1,100, however, the continuing partners each suffer a loss of $50. The same math applies with corporations and their shareholders. Ergo, the question of whether a repurchase action is value-enhancing or value-destroying for continuing shareholders is entirely purchase-price dependent.

It is puzzling, therefore, that corporate repurchase announcements almost never refer to a price above which repurchases will be eschewed. That certainly wouldn't be the case if a management was buying an outside business. There, price would always factor into a buy-or-pass decision.

When CEOs or boards are buying a small part of their own company, though, they all too often seem oblivious to price. Would they behave similarly if they were managing a private company with just a few owners and were evaluating the wisdom of buying out one of them? Of course not.

It is important to remember that there are two occasions in which repurchases should not take place, even if the company's shares are underpriced. One is when a business both needs all its available money to protect or expand its own operations and is also uncomfortable adding further debt. Here, the internal need for funds should take priority. This exception assumes, of course, that the business has a decent future awaiting it after the needed expenditures are made.

The second exception, less common, materializes when a business acquisition (or some other investment opportunity) offers far greater value than do the undervalued shares of the potential repurchaser. Long ago, Berkshire itself often had to choose between these alternatives. At our present size, the issue is far less likely to arise.

My suggestion: Before even discussing repurchases, a CEO and his or her Board should stand, join hands and in unison declare, "What is smart at one price is stupid at another."

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To recap Berkshire's own repurchase policy: I am authorized to buy large amounts of Berkshire shares at 120% or less of book value because our Board has concluded that purchases at that level clearly bring an instant and material benefit to continuing shareholders. By our estimate, a 120%-of-book price is a significant discount to Berkshire's intrinsic value, a spread that is appropriate because calculations of intrinsic value can't be precise.

The authorization given me does not mean that we will "prop" our stock's price at the 120% ratio. If that level is reached, we will instead attempt to blend a desire to make meaningful purchases at a value-creating price with a related goal of not over-influencing the market.

To date, repurchasing our shares has proved hard to do. That may well be because we have been clear in describing our repurchase policy and thereby have signaled our view that Berkshire's intrinsic value is significantly higher than 120% of book value. If so, that's fine. Charlie and I prefer to see Berkshire shares sell in a fairly narrow range around intrinsic value, neither wishing them to sell at an unwarranted high price – it's no fun having owners who are disappointed with their purchases – nor one too low. Furthermore, our buying out "partners" at a discount is not a particularly gratifying way of making money. Still, market circumstances could create a situation in which repurchases would benefit both continuing and exiting shareholders. If so, we will be ready to act.

One final observation for this section: As the subject of repurchases has come to a boil, some people have come close to calling them un-American – characterizing them as corporate misdeeds that divert funds needed for productive endeavors. That simply isn't the case: Both American corporations and private investors are today awash in funds looking to be sensibly deployed. I'm not aware of *any* enticing project that in recent years has died for lack of capital. (Call us if you have a candidate.)

Insurance

Let's now look at Berkshire's various businesses, starting with our most important sector, insurance. The property/casualty ("P/C") branch of that industry has been the engine that has propelled our growth since 1967, the year we acquired National Indemnity and its sister company, National Fire & Marine, for $8.6 million. Today, National Indemnity is the largest property/casualty company in the world as measured by net worth.

One reason we were attracted to the P/C business was its financial characteristics: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as claims arising from exposure to asbestos, payments can stretch over many decades. This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* it has grown, as the following table shows:

Year	*Float (in millions)*
1970	$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2016	91,577

We recently wrote a huge policy that increased float to more than $100 billion. Beyond that one-time boost, float at GEICO and several of our specialized operations is almost certain to grow at a good clip. National Indemnity's reinsurance division, however, is party to a number of large run-off contracts whose float is certain to drift downward.

We may in time experience a decline in float. If so, the decline will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. This structure is by design and is a key component in the unequaled financial strength of our insurance companies. It will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, our insurance operation registers an underwriting profit that adds to the investment income the float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it sometimes causes the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses.

This outcome is made more certain by the dramatically lower interest rates that now exist throughout the world. The investment portfolios of almost all P/C companies – though *not* those of Berkshire – are heavily concentrated in bonds. As these high-yielding legacy investments mature and are replaced by bonds yielding a pittance, earnings from float will steadily fall. For that reason, and others as well, it's a good bet that industry results over the next ten years will fall short of those recorded in the past decade, particularly in the case of companies that specialize in reinsurance.

Nevertheless, I very much like our own prospects. Berkshire's unrivaled financial strength allows us far more flexibility in investing than that generally available to P/C companies. The many alternatives available to us are always an advantage; occasionally, they offer us major opportunities. When others are constrained, our choices expand.

Moreover, our P/C companies have an excellent underwriting record. Berkshire has now operated at an underwriting profit for 14 consecutive years, our pre-tax gain for the period having totaled $28 billion. That record is no accident: Disciplined risk evaluation is the daily focus of *all* of our insurance managers, who know that while float is valuable, its benefits can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

So how does our float affect intrinsic value? When Berkshire's *book* value is calculated, the *full* amount of our float is deducted as a *liability*, just as if we had to pay it out tomorrow and could not replenish it. But to think of float as a typical liability is a major mistake. It should instead be viewed as a revolving fund. Daily, we pay old claims and related expenses – a huge $27 billion to more than six million claimants in 2016 – and that reduces float. Just as surely, we each day write new business that will soon generate its own claims, adding to float.

If our revolving float is both costless and long-enduring, which I believe it will be, the true value of this liability is *dramatically* less than the accounting liability. Owing $1 that in effect will never leave the premises – because new business is almost certain to deliver a substitute – is worlds different from owing $1 that will go out the door tomorrow and not be replaced. The two types of liabilities, however, are treated as equals under GAAP.

A partial offset to this overstated liability is a $15.5 billion "goodwill" asset that we incurred in buying our insurance companies and that is included in our book-value figure. In very large part, this goodwill represents the price we paid for the float-generating capabilities of our insurance operations. The cost of the goodwill, however, has *no* bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, *any* goodwill asset carried on the books should be deemed valueless, whatever its original cost.

Fortunately, that does not describe Berkshire. Charlie and I believe the true economic value of our insurance goodwill – what we would happily pay for float *of similar quality* were we to purchase an insurance operation possessing it – to be *far* in excess of its historic carrying value. Indeed, almost the entire $15.5 billion we carry for goodwill in our insurance business was already on our books in 2000 when float was $28 billion. Yet we have subsequently increased our float by $64 billion, a gain that in no way is reflected in our book value. This unrecorded asset is one reason – a huge reason – why we believe Berkshire's intrinsic business value far exceeds its book value.

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Berkshire's attractive insurance economics exist only because we have some terrific managers running disciplined operations that in most cases possess hard-to-replicate business models. Let me tell you about the major units.

First by float size is the Berkshire Hathaway Reinsurance Group, managed by Ajit Jain. Ajit insures risks that no one else has the desire or the capital to take on. His operation combines capacity, speed, decisiveness and, most important, brains in a manner unique in the insurance business. Yet he never exposes Berkshire to risks that are inappropriate in relation to our resources.

Indeed, Berkshire is *far* more conservative in avoiding risk than most large insurers. For example, if the insurance industry should experience a $250 billion loss from some mega-catastrophe – a loss about triple anything it has ever experienced – Berkshire as a whole would likely record a large profit for the year. Our many streams of non-insurance earnings would see to that. Additionally, we would remain awash in cash and be eager to write business in an insurance market that might well be in disarray. Meanwhile, other major insurers and reinsurers would be swimming in red ink, if not facing insolvency.

When Ajit entered Berkshire's office on a Saturday in 1986, he did not have a day's experience in the insurance business. Nevertheless, Mike Goldberg, then our manager of insurance, handed him the keys to our small and struggling reinsurance business. With that move, Mike achieved sainthood: Since then, Ajit has created tens of billions of value for Berkshire shareholders. If there were ever to be another Ajit and you could swap me for him, *don't hesitate*. Make the trade!

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We have another reinsurance powerhouse in General Re, managed until recently by Tad Montross. After 39 years at General Re, Tad retired in 2016. Tad was a class act in every way and we owe him a ton of thanks. Kara Raiguel, who has worked with Ajit for 16 years, is now CEO of General Re.

At bottom, a sound insurance operation needs to adhere to four disciplines. It must (1) understand *all* exposures that might cause a policy to incur losses; (2) conservatively assess the likelihood of any exposure actually causing a loss and the probable cost if it does; (3) set a premium that, on average, will deliver a profit after both prospective loss costs and operating expenses are covered; and (4) be willing to walk away if the appropriate premium can't be obtained.

Many insurers pass the first three tests and flunk the fourth. They simply can't turn their back on business that is being eagerly written by their competitors. That old line, "The other guy is doing it, so we must as well," spells trouble in any business, but in none more so than insurance. Tad never listened to that nonsensical excuse for sloppy underwriting, and neither will Kara.

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Finally, there is GEICO, the company that set my heart afire 66 years ago (and for which the flame still burns). GEICO is managed by Tony Nicely, who joined the company at 18 and completed 55 years of service in 2016.

Tony became CEO of GEICO in 1993, and since then the company has been flying. There is *no* better manager than Tony, who brings his combination of brilliance, dedication *and* soundness to the job. (The latter quality is essential to sustained success. As Charlie says, it's great to have a manager with a 160 IQ – unless he thinks it's 180.) Like Ajit, Tony has created tens of billions of value for Berkshire.

On my initial visit to GEICO in 1951, I was blown away by the huge cost advantage the company enjoyed over the giants of the industry. It was clear to me that GEICO would succeed because it *deserved* to succeed. The company's annual sales were then $8 million; In 2016, GEICO did that much business every three hours of the year.

Auto insurance is a major expenditure for most families. Savings matter to them – and only a low-cost operation can deliver those. In fact, at least 40% of the people reading this letter can save money by insuring with GEICO. So stop reading – right now! – and go to geico.com or call 800-847-7536.

GEICO's low costs create a moat – an *enduring* one – that competitors are unable to cross. As a result, the company gobbles up market share year after year, ending 2016 with about 12% of industry volume. That's up from 2.5% in 1995, the year Berkshire acquired control of GEICO. Employment, meanwhile, grew from 8,575 to 36,085.

GEICO's growth accelerated dramatically during the second half of 2016. Loss costs throughout the auto-insurance industry had been increasing at an unexpected pace and some competitors lost their enthusiasm for taking on new customers. GEICO's reaction to the profit squeeze, however, was to *accelerate* its new-business efforts. We like to make hay while the sun *sets*, knowing that it will surely rise again.

GEICO continues on a roll as I send you this letter. When insurance prices increase, people shop more. And when they shop, GEICO wins.

Have you called yet? (800-847-7536 or go to geico.com)

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In addition to our three major insurance operations, we own a collection of smaller companies that primarily write commercial coverages. In aggregate, these companies are a large, growing and valuable operation that consistently delivers an underwriting profit, usually one much superior to that reported by their competitors. Over the past 14 years, this group has earned $4.7 billion from underwriting – about 13% of its premium volume – while increasing its float from $943 million to $11.6 billion.

Less than three years ago, we formed Berkshire Hathaway Specialty Insurance ("BHSI"), which is included in this grouping. Our first decision was to put Peter Eastwood in charge, a move that proved to be a home run: We expected significant losses in the early years while Peter built the personnel and infrastructure needed for a world-wide operation. Instead, he and his crew delivered significant underwriting profits throughout the start-up period. BHSI's volume increased 40% in 2016, reaching $1.3 billion. It's clear to me that the company is destined to become one of the world's leading P/C insurers.

Here's a recap of pre-tax underwriting earnings and float by division:

	Underwriting Profit		*Yearend Float*	
		(in millions)		
Insurance Operations	*2016*	*2015*	*2016*	*2015*
BH Reinsurance	$ 822	$ 421	$ 45,081	$ 44,108
General Re	190	132	17,699	18,560
GEICO	462	460	17,148	15,148
Other Primary	657	824	11,649	9,906
	$2,131	$1,837	$ 91,577	$ 87,722

Berkshire's great managers, premier financial strength and a range of business models protected by wide moats amount to something unique in the insurance world. This assemblage of strengths is a huge asset for Berkshire shareholders that time will only make more valuable.

Regulated, Capital-Intensive Businesses

Our BNSF railroad and Berkshire Hathaway Energy ("BHE"), our 90%-owned utility business, share important characteristics that distinguish them from Berkshire's other activities. Consequently, we assign them their own section in this letter and split out their combined financial statistics in our GAAP balance sheet and income statement. These two very major companies accounted for 33% of Berkshire's after-tax operating earnings last year.

A key characteristic of both companies is their huge investment in very long-lived, regulated assets, with these partially funded by large amounts of long-term debt that is *not* guaranteed by Berkshire. Our credit is in fact not needed because each company has earning power that even under terrible economic conditions would far exceed its interest requirements. Last year, for example, in a disappointing year for railroads, BNSF's interest coverage was more than 6:1. (Our definition of coverage is the ratio of earnings before interest and taxes to interest, *not* EBITDA/interest, a commonly-used measure we view as seriously flawed.)

At BHE, meanwhile, two factors ensure the company's ability to service its debt under all circumstances. The first is common to all utilities: recession-resistant earnings, which result from these companies offering an essential service for which demand is remarkably steady. The second is enjoyed by few other utilities: an ever-widening diversity of earnings streams, which shield BHE from being seriously harmed by any single regulatory body. These many sources of profit, supplemented by the inherent advantage of the company being owned by a strong parent, have allowed BHE and its utility subsidiaries to significantly lower their cost of debt. That economic fact benefits both us *and* our customers.

All told, BHE and BNSF invested $8.9 billion in plant and equipment last year, a massive commitment to their segments of America's infrastructure. We relish making such investments as long as they promise reasonable returns – and, on that front, we put a large amount of trust in future regulation.

Our confidence is justified both by our past experience and by the knowledge that society will forever need huge investments in both transportation and energy. It is in the self-interest of governments to treat capital providers in a manner that will ensure the continued flow of funds to essential projects. It is concomitantly in our self-interest to conduct our operations in a way that earns the approval of our regulators and the people they represent.

Low prices are a powerful way to keep these constituencies happy. In Iowa, BHE's average retail rate is 7.1¢ per KWH. Alliant, the other major electric utility in the state, averages 9.9¢. Here are the comparable industry figures for adjacent states: Nebraska 9.0¢, Missouri 9.5¢, Illinois 9.2¢, Minnesota 10.0¢. The national average is 10.3¢. We have promised Iowans that our base rates will not increase until 2029 *at the earliest*. Our rock-bottom prices add up to real money for paycheck-strapped customers.

At BNSF, price comparisons between major railroads are far more difficult to make because of significant differences in both their mix of cargo and the average distance the load is carried. To supply a *very* crude measure, however, our revenue per ton-mile was 3¢ last year, while shipping costs for customers of the other four major U.S.-based railroads ranged from 4¢ to 5¢.

Both BHE and BNSF have been leaders in pursuing planet-friendly technology. In wind generation, no state comes close to rivaling Iowa, where last year the megawatt-hours we generated from wind equaled 55% of all megawatt-hours sold to our Iowa retail customers. New wind projects that are underway will take that figure to 89% by 2020.

Bargain-basement electric rates carry second-order benefits with them. Iowa has attracted large high-tech installations, both because of its low prices for electricity (which data centers use in huge quantities) and because most tech CEOs are enthusiastic about using renewable energy. When it comes to wind energy, Iowa is the Saudi Arabia of America.

BNSF, like other Class I railroads, uses only a single gallon of diesel fuel to move a ton of freight almost 500 miles. Those economics make railroads four times as fuel-efficient as trucks! Furthermore, railroads alleviate highway congestion – and the taxpayer-funded maintenance expenditures that come with heavier traffic – in a major way.

All told, BHE and BNSF own assets that are of major importance to our country as well as to shareholders of Berkshire. Here are the key financial figures for both:

BNSF	*Earnings (in millions)*		
	2016	*2015*	*2014*
Revenues	$ 19,829	$ 21,967	$ 23,239
Operating expenses	13,144	14,264	16,237
Operating earnings before interest and taxes	6,685	7,703	7,002
Interest (net)	992	928	833
Income taxes	2,124	2,527	2,300
Net earnings	$ 3,569	$ 4,248	$ 3,869

Berkshire Hathaway Energy (90% owned)	*Earnings (in millions)*		
	2016	*2015*	*2014*
U.K. utilities	$ 367	$ 460	$ 527
Iowa utility	392	292	270
Nevada utilities	559	586	549
PacifiCorp (primarily Oregon and Utah)	1,105	1,026	1,010
Gas pipelines (Northern Natural and Kern River)	413	401	379
Canadian transmission utility	147	170	16
Renewable projects	157	175	194
HomeServices	225	191	139
Other (net)	73	49	54
Operating earnings before corporate interest and taxes	3,438	3,350	3,138
Interest	465	499	427
Income taxes	431	481	616
Net earnings	$ 2,542	$ 2,370	$ 2,095
Earnings applicable to Berkshire	$ 2,287	$ 2,132	$ 1,882

HomeServices may appear out of place in the above table. But it came with our purchase of MidAmerican (now BHE) in 1999 – and we are lucky that it did.

HomeServices owns 38 realty companies with more than 29,000 agents who operate in 28 states. Last year it purchased four realtors, including Houlihan Lawrence, the leader in New York's Westchester County (in a transaction that closed shortly after yearend).

In real estate parlance, representing either a buyer or a seller is called a "side," with the representation of both counting as two sides. Last year, our *owned* realtors participated in 244,000 sides, totaling $86 billion in volume.

HomeServices also *franchises* many operations throughout the country that use our name. We like both aspects of the real estate business and expect to acquire many realtors and franchisees during the next decade.

Manufacturing, Service and Retailing Operations

Our manufacturing, service and retailing operations sell products ranging from lollipops to jet airplanes. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/16 (in millions)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 8,073	Notes payable	$ 2,054
Accounts and notes receivable	11,183	Other current liabilities	12,464
Inventory	15,727	Total current liabilities	14,518
Other current assets	1,039		
Total current assets	36,022		
		Deferred taxes	12,044
Goodwill and other intangibles	71,473	Term debt and other liabilities	10,943
Fixed assets	18,915	Non-controlling interests	579
Other assets	3,183	Berkshire equity	91,509
	$129,593		$129,593

Earnings Statement (in millions)

	2016	*2015*	*2014*
Revenues	$120,059	$107,825	$97,689
Operating expenses	111,383	100,607	90,788
Interest expense	214	103	109
Pre-tax earnings	8,462	7,115	6,792
Income taxes and non-controlling interests	2,831	2,432	2,324
Net earnings	$ 5,631	$ 4,683	$ 4,468

Included in this financial summary are 44 businesses that report directly to headquarters. But some of these companies, in turn, have many individual operations under their umbrella. For example, Marmon has 175 separate business units, serving widely disparate markets, and Berkshire Hathaway Automotive owns 83 dealerships, operating in nine states.

This collection of businesses is truly a motley crew. Some operations, measured by earnings on unleveraged net *tangible* assets, enjoy terrific returns that, in a couple of instances, exceed 100%. Most are solid businesses generating good returns in the area of 12% to 20%.

A few, however – these are serious blunders I made in my job of capital allocation – produce very poor returns. In most cases, I was wrong when I originally sized up the economic characteristics of these companies or the industries in which they operate, and we are now paying the price for my misjudgments. In a couple of instances, I stumbled in assessing either the fidelity or ability of incumbent managers or ones I later put in place. I will commit more errors; you can count on that. Fortunately, Charlie – never bashful – is around to say "no" to my worst ideas.

Viewed as a single entity, the companies in the manufacturing, service and retailing group are an excellent business. They employed an average of $24 billion of net tangible assets during 2016 and, despite their holding large quantities of excess cash and carrying very little debt, earned 24% after-tax on that capital.

Of course, a business with terrific economics can be a bad investment if it is bought at too high a price. We have paid substantial premiums to net tangible assets for most of our businesses, a cost that is reflected in the large figure we show on our balance sheet for goodwill and other intangibles. Overall, however, we are getting a decent return on the capital we have deployed in this sector. Absent a recession, earnings from the group will likely grow in 2017, in part because Duracell and Precision Castparts (both bought in 2016) will for the first time contribute a full year's earnings to this group. Additionally, Duracell incurred significant transitional costs in 2016 that will not recur.

We have far too many companies in this group to comment on them individually. Moreover, their competitors – both current and potential – read this report. In a few of our businesses, we might be disadvantaged if outsiders knew our numbers. Therefore, in certain of our operations that are not of a size material to an evaluation of Berkshire, we only disclose what is required. You can nevertheless find a good bit of detail about many of our operations on pages 90 - 94. Be aware, though, that it's the growth of the Berkshire forest that counts. It would be foolish to focus over-intently on any single tree.

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For several years I have told you that the income and expense data shown in this section does not conform to GAAP. I have explained that this divergence occurs primarily because of GAAP-ordered rules regarding purchase-accounting adjustments that require the full amortization of certain intangibles over periods averaging about 19 years. In our opinion, most of those amortization "expenses" are not truly an economic cost. Our goal in diverging from GAAP in this section is to present the figures to you in a manner reflecting the way in which Charlie and I view and analyze them.

On page 54 we itemize $15.4 billion of intangibles that are yet to be amortized by annual charges to earnings. (More intangibles to be amortized will be created as we make new acquisitions.) On that page, we show that the 2016 amortization charge to GAAP earnings was $1.5 billion, up $384 million from 2015. My judgment is that about 20% of the 2016 charge is a "real" cost.

Eventually amortization charges fully write off the related asset. When that happens – most often at the 15-year mark – the GAAP earnings we report will increase without any true improvement in the underlying economics of Berkshire's business. (My gift to my successor.)

Now that I've described a GAAP expense that I believe to be overstated, let me move on to a less pleasant distortion produced by accounting rules. The subject this time is GAAP-prescribed depreciation charges, which are necessarily based on historical cost. Yet in certain cases, those charges materially *understate* true economic costs. Countless words were written about this phenomenon in the 1970s and early 1980s, when inflation was rampant. As inflation subsided – thanks to heroic actions by Paul Volcker – the inadequacy of depreciation charges became less of an issue. But the problem still prevails, *big time*, in the railroad industry, where current costs for many depreciable items far outstrip historical costs. The inevitable result is that reported earnings throughout the railroad industry are considerably higher than true economic earnings.

At BNSF, to get down to particulars, our GAAP depreciation charge last year was $2.1 billion. But were we to spend that sum and no more annually, our railroad would soon deteriorate and become less competitive. The reality is that – *simply to hold our own* – we need to spend far more than the cost we show for depreciation. Moreover, a wide disparity will prevail for decades.

All that said, Charlie and I love our railroad, which was one of our better purchases.

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Too many managements – and the number seems to grow every year – are looking for any means to report, *and indeed feature*, "adjusted earnings" that are higher than their company's GAAP earnings. There are many ways for practitioners to perform this legerdemain. Two of their favorites are the omission of "restructuring costs" and "stock-based compensation" as expenses.

Charlie and I *want* managements, *in their commentary*, to describe unusual items – good or bad – that affect the GAAP numbers. After all, the reason we look at these numbers of the past is to make estimates of the future. But a management that regularly attempts to wave away very real costs by highlighting "adjusted per-share earnings" makes us nervous. That's because bad behavior is contagious: CEOs who overtly look for ways to report high numbers tend to foster a culture in which subordinates strive to be "helpful" as well. Goals like that can lead, for example, to insurers underestimating their loss reserves, a practice that has destroyed many industry participants.

Charlie and I cringe when we hear analysts talk admiringly about managements who always "make the numbers." In truth, business is too unpredictable for the numbers always to be met. Inevitably, surprises occur. When they do, a CEO whose focus is centered on Wall Street will be tempted to *make up* the numbers.

Let's get back to the two favorites of "don't-count-this" managers, starting with "restructuring." Berkshire, I would say, has been restructuring from the first day we took over in 1965. Owning only a northern textile business then gave us no other choice. And today a fair amount of restructuring occurs every year at Berkshire. That's because there are always things that need to change in our hundreds of businesses. Last year, as I mentioned earlier, we spent significant sums getting Duracell in shape for the decades ahead.

We have never, however, singled out restructuring charges and told you to ignore them in estimating our normal earning power. If there were to be some truly major expenses in a single year, I would, of course, mention it in my commentary. Indeed, when there is a total rebasing of a business, such as occurred when Kraft and Heinz merged, it is imperative that for several years the huge one-time costs of rationalizing the combined operations be explained clearly to owners. That's precisely what the CEO of Kraft Heinz has done, in a manner approved by the company's directors (who include me). But, to tell owners year after year, "Don't count this," when management is simply making business adjustments that are necessary, is misleading. And too many analysts and journalists fall for this baloney.

To say "stock-based compensation" is not an expense is even more cavalier. CEOs who go down that road are, in effect, saying to shareholders, "If you pay me a bundle in options or restricted stock, don't worry about its effect on earnings. I'll 'adjust' it away."

To explore this maneuver further, join me for a moment in a visit to a make-believe accounting laboratory whose sole mission is to juice Berkshire's *reported* earnings. Imaginative technicians await us, eager to show their stuff.

Listen carefully while I tell these enablers that stock-based compensation usually comprises at least 20% of total compensation for the top three or four executives at most large companies. Pay attention, too, as I explain that Berkshire has several hundred such executives at its subsidiaries and pays them similar amounts, but uses only cash to do so. I further confess that, lacking imagination, I have counted *all* of these payments to Berkshire's executives as an expense.

My accounting minions suppress a giggle and immediately point out that 20% of what is paid these Berkshire managers is tantamount to "cash paid in lieu of stock-based compensation" and is therefore not a "true" expense. So – presto! – Berkshire, too, can have "adjusted" earnings.

Back to reality: If CEOs want to leave out stock-based compensation in reporting earnings, they should be required to affirm *to their owners* one of two propositions: why items of value used to pay employees are not a cost or why a payroll cost should be excluded when calculating earnings.

During the accounting nonsense that flourished during the 1960s, the story was told of a CEO who, as his company revved up to go public, asked prospective auditors, "What is two plus two?" The answer that won the assignment, of course, was, "What number do you have in mind?"

Finance and Financial Products

Our three leasing and rental operations are conducted by CORT (furniture), XTRA (semi-trailers), and Marmon (primarily tank cars but also freight cars, intermodal tank containers and cranes). Each is the leader in its field.

We also include Clayton Homes in this section. This company receives most of its revenue from the sale of manufactured homes, but derives the bulk of its *earnings* from its large mortgage portfolio. Last year, Clayton became America's largest home builder, delivering 42,075 units that accounted for 5% of all new American homes. (In fairness, other large builders do far more *dollar* volume than Clayton because they sell site-built homes that command much higher prices.)

In 2015, Clayton branched out, purchasing its first site-builder. Two similar acquisitions followed in 2016, and more will come. Site-built houses are expected to amount to 3% or so of Clayton's unit sales in 2017 and will likely deliver about 14% of its dollar volume.

Even so, Clayton's focus will always be manufactured homes, which account for about 70% of new American homes costing less than $150,000. Clayton manufactures close to one-half of the total. That is a far cry from Clayton's position in 2003 when Berkshire purchased the company. It then ranked third in the industry in units sold and employed 6,731 people. Now, when its new acquisitions are included, the employee count is 14,677. And that number will increase in the future.

Clayton's earnings in recent years have materially benefited from extraordinarily low interest rates. The company's mortgage loans to home-buyers are at fixed-rates and for long terms (averaging 25 years at inception). But Clayton's own borrowings are short-term credits that re-price frequently. When rates plunge, Clayton's earnings from its portfolio greatly increase. We normally would shun that kind of lend-long, borrow-short approach, which can cause major problems for financial institutions. As a whole, however, Berkshire is always asset-sensitive, meaning that higher short-term rates will benefit our *consolidated* earnings, even as they hurt at Clayton.

Last year Clayton had to foreclose on 8,304 manufactured-housing mortgages, about 2.5% of its total portfolio. Customer demographics help explain that percentage. Clayton's customers are usually lower-income families with mediocre credit scores; many are supported by jobs that will be at risk in any recession; many, similarly, have financial profiles that will be damaged by divorce or death to an extent that would not be typical for a high-income family. Those risks that our customers face are partly mitigated because almost all have a strong desire to own a home and because they enjoy reasonable monthly payments that average only $587, *including* the cost of insurance and property taxes.

Clayton also has long had programs that help borrowers through difficulties. The two most popular are loan extensions and payment forgiveness. Last year about 11,000 borrowers received extensions, and 3,800 had $3.4 million of scheduled payments permanently canceled by Clayton. The company does not earn interest or fees when these loss-mitigation moves are made. Our experience is that 93% of borrowers helped through these programs in the last two years now remain in their homes. Since we lose significant sums on foreclosures – losses last year totaled $150 million – our assistance programs end up helping Clayton as well as its borrowers.

Clayton and Berkshire have been a wonderful partnership. Kevin Clayton came to us with a best-in-class management group and culture. Berkshire, in turn, provided unmatched staying power when the manufactured-home industry fell apart during the Great Recession. (As other lenders to the industry vanished, Clayton supplied credit not only to its own dealers but also to dealers who sold the products of its competitors.) At Berkshire, we never count on synergies when we acquire companies. Truly important ones, however, surfaced after our purchase of Clayton.

Marmon's railcar business experienced a major slowdown in demand last year, which will cause earnings to decline in 2017. Fleet utilization was 91% in December, down from 97% a year earlier, with the drop particularly severe at the large fleet we purchased from General Electric in 2015. Marmon's crane and container rentals have weakened as well.

Big swings in railcar demand have occurred in the past and they will continue. Nevertheless, we very much like this business and expect decent returns on equity capital over the years. Tank cars are Marmon's specialty. People often associate tank cars with the transportation of crude oil; in fact, they are essential to a great variety of shippers.

Over time, we expect to expand our railcar operation. Meanwhile, Marmon is making a number of bolt-on acquisitions whose results are included in the Manufacturing, Service and Retailing section.

Here's the pre-tax earnings recap for our finance-related companies:

	2016	*2015*	*2014*
		(in millions)	
Berkadia (our 50% share)	$ 91	$ 74	$ 122
Clayton	744	706	558
CORT	60	55	49
Marmon – Containers and Cranes	126	192	238
Marmon – Railcars	654	546	442
XTRA	179	172	147
Net financial income*	276	341	283
	$ 2,130	$ 2,086	$ 1,839

* Excludes capital gains or losses

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding because Berkshire is part of a control group and therefore must account for this investment on the "equity" method. The 325,442,152 shares Berkshire owns of Kraft Heinz are carried on our balance sheet at a GAAP figure of $15.3 billion and had a yearend market value of $28.4 billion. Our cost basis for the shares is $9.8 billion.

			12/31/16	
*Shares**	*Company*	*Percentage of Company Owned*	*Cost***	*Market*
			(in millions)	
151,610,700	American Express Company	16.8	$ 1,287	$ 11,231
61,242,652	Apple Inc.	1.1	6,747	7,093
6,789,054	Charter Communications, Inc.	2.5	1,210	1,955
400,000,000	The Coca-Cola Company	9.3	1,299	16,584
54,934,718	Delta Airlines Inc.	7.5	2,299	2,702
11,390,582	The Goldman Sachs Group, Inc.	2.9	654	2,727
81,232,303	International Business Machines Corp.	8.5	13,815	13,484
24,669,778	Moody's Corporation	12.9	248	2,326
74,587,892	Phillips 66	14.4	5,841	6,445
22,169,930	Sanofi	1.7	1,692	1,791
43,203,775	Southwest Airlines Co.	7.0	1,757	2,153
101,859,335	U.S. Bancorp	6.0	3,239	5,233
26,620,184	United Continental Holdings Inc.	8.4	1,477	1,940
43,387,980	USG Corp.	29.7	836	1,253
500,000,000	Wells Fargo & Company	10.0	12,730	27,555
	Others		10,697	17,560
	Total Common Stocks Carried at Market		$ 65,828	$ 122,032

* Excludes shares held by pension funds of Berkshire subsidiaries.

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

Some of the stocks in the table are the responsibility of either Todd Combs or Ted Weschler, who work with me in managing Berkshire's investments. Each, *independently*, manages more than $10 billion; I usually learn about decisions they have made by looking at monthly trade sheets. Included in the $21 billion that the two manage is about $7.6 billion of pension trust assets of certain Berkshire subsidiaries. As noted, pension investments are not included in the preceding tabulation of Berkshire holdings.

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Excluded from the table – *but important* – is our ownership of $5 billion of preferred stock issued by Bank of America. This stock, which pays us $300 million per year, also carries with it a valuable warrant allowing Berkshire to purchase 700 million common shares of Bank of America for $5 billion at any time before September 2, 2021. At yearend, that privilege would have delivered us a profit of $10.5 billion. If it wishes, Berkshire can use its preferred shares to satisfy the $5 billion cost of exercising the warrant.

If the dividend rate on Bank of America common stock – now 30 cents annually – should rise above 44 cents before 2021, we would anticipate making a cashless exchange of our preferred into common. If the common dividend remains below 44 cents, it is highly probable that we will exercise the warrant immediately before it expires.

Many of our investees, including Bank of America, have been repurchasing shares, some quite aggressively. We very much like this behavior because we believe the repurchased shares have in most cases been underpriced. (Undervaluation, after all, is why we own these positions.) When a company grows and outstanding shares shrink, good things happen for shareholders.

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It's important for you to understand that 95% of the $86 billion of "cash and equivalents" (which in my mind includes U.S. Treasury Bills) shown on our balance sheet are held by entities in the United States and, consequently, is not subject to any repatriation tax. Moreover, repatriation of the remaining funds would trigger only minor taxes because much of that money has been earned in countries that themselves impose meaningful corporate taxes. Those payments become an offset to U.S. tax when money is brought home.

These explanations are important because many cash-rich American companies hold a large portion of their funds in jurisdictions imposing very low taxes. Such companies hope – and may well be proved right – that the tax levied for bringing these funds to America will soon be materially reduced. In the meantime, these companies are limited as to how they can use that cash. In other words, off-shore cash is simply not worth as much as cash held at home.

Berkshire has a partial offset to the favorable geographical location of its cash, which is that much of it is held in our insurance subsidiaries. Though we have many alternatives for investing this cash, we do not have the unlimited choices that we would enjoy if the cash were held by the parent company, Berkshire. We *do* have an ability annually to distribute large amounts of cash from our insurers to the parent – though here, too, there are limits. Overall, cash held at our insurers is a very valuable asset, but one slightly less valuable to us than is cash held at the parent level.

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Sometimes the comments of shareholders or media imply that we will own certain stocks "forever." It is true that we own some stocks that I have no intention of selling for as far as the eye can see (and we're talking 20/20 vision). But we have made no *commitment* that Berkshire will hold *any* of its marketable securities forever.

Confusion about this point may have resulted from a too-casual reading of Economic Principle 11 on pages 110 - 111, which has been included in our annual reports since 1983. That principle covers *controlled businesses*, not marketable securities. This year I've added a final sentence to #11 to ensure that our owners understand that we regard any marketable security as available for sale, however unlikely such a sale now seems.

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Before we leave this investment section, a few educational words about dividends and taxes: Berkshire, like most corporations, nets considerably *more* from a dollar of dividends than it reaps from a dollar of capital gains. That will probably surprise those of our shareholders who are accustomed to thinking of capital gains as the route to tax-favored returns.

But here's the *corporate* math. Every $1 of capital gains that a corporation realizes carries with it 35 cents of federal income tax (and often state income tax as well). The tax on dividends received from *domestic* corporations, however, is consistently lower, though rates vary depending on the status of the recipient.

For a non-insurance company – which describes Berkshire Hathaway, the parent – the federal tax rate is effectively 10½ cents per $1 of dividends received. Furthermore, a non-insurance company that owns more than 20% of an investee owes taxes of only 7 cents per $1 of dividends. That rate applies, for example, to the substantial dividends we receive from our 27% ownership of Kraft Heinz, all of it held by the parent company. (The rationale for the low corporate taxes on dividends is that the dividend-paying investee has already paid its own corporate tax on the earnings being distributed.)

Berkshire's insurance subsidiaries pay a tax rate on dividends that is somewhat higher than that applying to non-insurance companies, though the rate is still well below the 35% hitting capital gains. Property/casualty companies owe about 14% in taxes on most dividends they receive. Their tax rate falls, though, to about 11% if they own more than 20% of a U.S.-based investee.

And that's our tax lesson for today.

"The Bet" (or how your money finds its way to Wall Street)

In this section, you will encounter, early on, the story of an investment bet I made nine years ago and, next, some strong opinions I have about investing. As a starter, though, I want to briefly describe Long Bets, a unique establishment that played a role in the bet.

Long Bets was seeded by Amazon's Jeff Bezos and operates as a non-profit organization that administers just what you'd guess: long-term bets. To participate, "proposers" post a proposition at Longbets.org that will be proved right or wrong at a distant date. They then wait for a contrary-minded party to take the other side of the bet. When a "doubter" steps forward, each side names a charity that will be the beneficiary if its side wins; parks its wager with Long Bets; and posts a short essay defending its position on the Long Bets website. When the bet is concluded, Long Bets pays off the winning charity.

Here are examples of what you will find on Long Bets' very interesting site:

In 2002, entrepreneur Mitch Kapor asserted that "By 2029 no computer – or 'machine intelligence' – will have passed the Turing Test," which deals with whether a computer can successfully impersonate a human being. Inventor Ray Kurzweil took the opposing view. Each backed up his opinion with $10,000. I don't know who will win this bet, but I will confidently wager that no computer will ever replicate Charlie.

That same year, Craig Mundie of Microsoft asserted that pilotless planes would routinely fly passengers by 2030, while Eric Schmidt of Google argued otherwise. The stakes were $1,000 each. To ease any heartburn Eric might be experiencing from his outsized exposure, I recently offered to take a piece of his action. He promptly laid off $500 with me. (I like his assumption that I'll be around in 2030 to contribute my payment, should we lose.)

Now, to my bet and its history. In Berkshire's 2005 annual report, I argued that active investment management by professionals – in aggregate – would over a period of years underperform the returns achieved by rank amateurs who simply sat still. I explained that the massive fees levied by a variety of "helpers" would leave their clients – *again in aggregate* – worse off than if the amateurs simply invested in an unmanaged low-cost index fund. (See pages 114 - 115 for a reprint of the argument as I originally stated it in the 2005 report.)

Subsequently, I publicly offered to wager $500,000 that no investment pro could select a set of at least five hedge funds – wildly-popular and high-fee investing vehicles – that would over an extended period match the performance of an unmanaged S&P-500 index fund charging only token fees. I suggested a ten-year bet and named a low-cost Vanguard S&P fund as my contender. I then sat back and waited expectantly for a parade of fund managers – who could include their own fund as one of the five – to come forth and defend their occupation. After all, these managers urged *others* to bet billions on their abilities. Why should they fear putting a little of their own money on the line?

What followed was the sound of silence. Though there are thousands of professional investment managers who have amassed staggering fortunes by touting their stock-selecting prowess, only one man – Ted Seides – stepped up to my challenge. Ted was a co-manager of Protégé Partners, an asset manager that had raised money from limited partners to form a fund-of-funds – in other words, a fund that invests in multiple hedge funds.

I hadn't known Ted before our wager, but I like him and admire his willingness to put his money where his mouth was. He has been both straight-forward with me and meticulous in supplying all the data that both he and I have needed to monitor the bet.

For Protégé Partners' side of our ten-year bet, Ted picked five funds-of-funds whose results were to be averaged and compared against my Vanguard S&P index fund. The five he selected had invested their money in more than 100 hedge funds, which meant that the overall performance of the funds-of-funds would not be distorted by the good or poor results of a single manager.

Each fund-of-funds, of course, operated with a layer of fees that sat above the fees charged by the hedge funds in which it had invested. In this doubling-up arrangement, the larger fees were levied by the underlying hedge funds; each of the fund-of-funds imposed an additional fee for its presumed skills in selecting hedge-fund managers.

Here are the results for the first nine years of the bet – figures leaving no doubt that Girls Inc. of Omaha, the charitable beneficiary I designated to get any bet winnings I earned, will be the organization eagerly opening the mail next January.

Year	Fund of Funds A	Fund of Funds B	Fund of Funds C	Fund of Funds D	Fund of Funds E	S&P Index Fund
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-2.9%	1.7%	-1.4%	2.5%	4.4%	11.9%
Gain to Date	8.7%	28.3%	62.8%	2.9%	7.5%	85.4%

Footnote: Under my agreement with Protégé Partners, the names of these funds-of-funds have never been publicly disclosed. I, however, see their annual audits.

The compounded annual increase to date for the index fund is 7.1%, which is a return that could easily prove typical for the stock market over time. That's an important fact: A particularly weak nine years for the market over the lifetime of this bet would have probably helped the relative performance of the hedge funds, because many hold large "short" positions. Conversely, nine years of exceptionally high returns from stocks would have provided a tailwind for index funds.

Instead we operated in what I would call a "neutral" environment. In it, the five funds-of-funds delivered, through 2016, an average of only 2.2%, compounded annually. That means $1 million invested in those funds would have gained $220,000. The index fund would meanwhile have gained $854,000.

Bear in mind that every one of the 100-plus managers of the underlying hedge funds had a huge financial incentive to do his or her best. Moreover, the five funds-of-funds managers that Ted selected were similarly incentivized to select the best hedge-fund managers possible because the five were entitled to performance fees based on the results of the underlying funds.

I'm certain that in almost all cases the managers at both levels were honest and intelligent people. But the results for their investors were dismal – *really* dismal. And, alas, the huge fixed fees charged by all of the funds and funds-of-funds involved – fees that were totally unwarranted by performance – were such that their managers were showered with compensation over the nine years that have passed. As Gordon Gekko might have put it: "Fees never sleep."

The underlying hedge-fund managers in our bet received payments from their limited partners that likely averaged a bit under the prevailing hedge-fund standard of "2 and 20," meaning a 2% annual fixed fee, payable even when losses are huge, and 20% of profits with no clawback (if good years were followed by bad ones). Under this lopsided arrangement, a hedge fund operator's ability to simply pile up assets under management has made many of these managers extraordinarily rich, even as their investments have performed poorly.

Still, we're not through with fees. Remember, there were the fund-of-funds managers to be fed as well. These managers received an additional fixed amount that was usually set at 1% of assets. Then, despite the terrible overall record of the five funds-of-funds, some experienced a few good years and collected "performance" fees. Consequently, I estimate that over the nine-year period roughly 60% – gulp! – of *all* gains achieved by the five funds-of-funds were diverted to the two levels of managers. That was their misbegotten reward for accomplishing something far short of what their many hundreds of limited partners could have effortlessly – and with virtually *no* cost – achieved on their own.

In my opinion, the disappointing results for hedge-fund investors that this bet exposed are almost certain to recur in the future. I laid out my reasons for that belief in a statement that was posted on the Long Bets website when the bet commenced (and that is still posted there). Here is what I asserted:

> Over a ten-year period commencing on January 1, 2008, and ending on December 31, 2017, the S&P 500 will outperform a portfolio of funds of hedge funds, when performance is measured on a basis net of fees, costs and expenses.
>
> A lot of very smart people set out to do better than average in securities markets. Call them active investors.
>
> Their opposites, passive investors, will by definition do about average. In aggregate their positions will more or less approximate those of an index fund. Therefore, the balance of the universe—the active investors—must do about average as well. However, these investors will incur far greater costs. So, on balance, their aggregate results after these costs will be worse than those of the passive investors.
>
> Costs skyrocket when large annual fees, large performance fees, and active trading costs are all added to the active investor's equation. Funds of hedge funds accentuate this cost problem because their fees are superimposed on the large fees charged by the hedge funds in which the funds of funds are invested.
>
> A number of smart people are involved in running hedge funds. But to a great extent their efforts are self-neutralizing, and their IQ will not overcome the costs they impose on investors. Investors, on average and over time, will do better with a low-cost index fund than with a group of funds of funds.

So that was my argument – and now let me put it into a simple equation. If Group A (active investors) and Group B (do-nothing investors) comprise the total investing universe, and B is destined to achieve average results before costs, so, too, must A. Whichever group has the lower costs will win. (The academic in me requires me to mention that there is a very minor point – not worth detailing – that *slightly* modifies this formulation.) And if Group A has exorbitant costs, its shortfall will be substantial.

There are, of course, some skilled individuals who are highly likely to out-perform the S&P over long stretches. In my lifetime, though, I've identified – *early on* – only ten or so professionals that I expected would accomplish this feat.

There are no doubt many hundreds of people – perhaps thousands – whom I have never met and whose abilities would equal those of the people I've identified. The job, after all, is not impossible. The problem simply is that the great majority of managers who attempt to over-perform will fail. The probability is also very high that the person soliciting your funds will not be the exception who does well. Bill Ruane – a truly wonderful human being and a man whom I identified 60 years ago as almost certain to deliver superior investment returns over the long haul – said it well: "In investment management, the progression is from the innovators to the imitators to the swarming incompetents."

Further complicating the search for the rare high-fee manager who is worth his or her pay is the fact that some investment professionals, just as some amateurs, will be lucky over short periods. If 1,000 managers make a market prediction at the beginning of a year, it's very likely that the calls of at least one will be correct for nine consecutive years. Of course, 1,000 monkeys would be just as likely to produce a seemingly all-wise prophet. But there *would* remain a difference: The lucky monkey would not find people standing in line to invest with him.

Finally, there are three connected realities that cause investing success to breed failure. First, a good record quickly attracts a torrent of money. Second, huge sums invariably act as an anchor on investment performance: What is easy with millions, struggles with billions (sob!). Third, most managers will nevertheless seek new money because of their *personal* equation – namely, the more funds they have under management, the more their fees.

These three points are hardly new ground for me: In January 1966, when I was managing $44 *million*, I wrote my limited partners: "I feel substantially greater size is more likely to harm future results than to help them. This might not be true for my own personal results, but it is likely to be true for your results. Therefore, . . . I intend to admit no additional partners to BPL. I have notified Susie that if we have any more children, it is up to her to find some other partnership for them."

The bottom line: When trillions of dollars are managed by Wall Streeters charging high fees, it will usually be the managers who reap outsized profits, not the clients. Both large and small investors should stick with low-cost index funds.

* * * * * * * * * * * *

If a statue is ever erected to honor the person who has done the most for American investors, the hands-down choice should be Jack Bogle. For decades, Jack has urged investors to invest in ultra-low-cost index funds. In his crusade, he amassed only a tiny percentage of the wealth that has typically flowed to managers who have promised their investors large rewards while delivering them nothing – or, as in our bet, *less* than nothing – of added value.

In his early years, Jack was frequently mocked by the investment-management industry. Today, however, he has the satisfaction of knowing that he helped millions of investors realize far better returns on their savings than they otherwise would have earned. He is a hero to them and to me.

* * * * * * * * * * * *

Over the years, I've often been asked for investment advice, and in the process of answering I've learned a good deal about human behavior. My regular recommendation has been a low-cost S&P 500 index fund. To their credit, my friends who possess only modest means have usually followed my suggestion.

I believe, however, that *none* of the mega-rich individuals, institutions or pension funds has followed that same advice when I've given it to them. Instead, these investors politely thank me for my thoughts and depart to listen to the siren song of a high-fee manager or, in the case of many institutions, to seek out another breed of hyper-helper called a consultant.

That professional, however, faces a problem. Can you imagine an investment consultant telling clients, year after year, to keep adding to an index fund replicating the S&P 500? That would be career suicide. Large fees flow to these hyper-helpers, however, if they recommend small managerial shifts every year or so. That advice is often delivered in esoteric gibberish that explains why fashionable investment "styles" or current economic trends make the shift appropriate.

The wealthy are accustomed to feeling that it is their lot in life to get the best food, schooling, entertainment, housing, plastic surgery, sports ticket, you name it. Their money, they feel, should buy them something superior compared to what the masses receive.

In many aspects of life, indeed, wealth does command top-grade products or services. For that reason, the financial "elites" – wealthy individuals, pension funds, college endowments and the like – have great trouble meekly signing up for a financial product or service that is available as well to people investing only a few thousand dollars. This reluctance of the rich normally prevails even though the product at issue is –on an expectancy basis – clearly the best choice. My calculation, admittedly very rough, is that the search by the elite for superior investment advice has caused it, in aggregate, to waste more than $100 billion over the past decade. Figure it out: Even a 1% fee on a few trillion dollars adds up. Of course, not every investor who put money in hedge funds ten years ago lagged S&P returns. But I believe my calculation of the aggregate shortfall is conservative.

Much of the financial damage befell pension funds for public employees. Many of these funds are woefully underfunded, in part because they have suffered a double whammy: poor investment performance accompanied by huge fees. The resulting shortfalls in their assets will for decades have to be made up by local taxpayers.

Human behavior won't change. Wealthy individuals, pension funds, endowments and the like will continue to feel they deserve something "extra" in investment advice. Those advisors who cleverly play to this expectation will get very rich. This year the magic potion may be hedge funds, next year something else. The likely result from this parade of promises is predicted in an adage: "When a person with money meets a person with experience, the one with experience ends up with the money and the one with money leaves with experience."

Long ago, a brother-in-law of mine, Homer Rogers, was a commission agent working in the Omaha stockyards. I asked him how he induced a farmer or rancher to hire him to handle the sale of their hogs or cattle to the buyers from the big four packers (Swift, Cudahy, Wilson and Armour). After all, hogs were hogs and the buyers were experts who knew to the penny how much any animal was worth. How then, I asked Homer, could any sales agent get a better result than any other?

Homer gave me a pitying look and said: "Warren, it's not how you sell 'em, it's how you tell 'em." What worked in the stockyards continues to work in Wall Street.

* * * * * * * * * * * *

And, finally, let me offer an olive branch to Wall Streeters, many of them good friends of mine. Berkshire *love*s to pay fees – even outrageous fees – to investment bankers who bring us acquisitions. Moreover, we have paid substantial sums for over-performance to our two in-house investment managers – and we hope to make even larger payments to them in the future.

To get biblical (Ephesians 3:18), I know the height and the depth and the length and the breadth of the energy flowing from that simple four-letter word – fees – when it is spoken to Wall Street. And when that energy delivers value to Berkshire, I will cheerfully write a big check.

The Annual Meeting

Last year we partnered with Yahoo to air the first-ever webcast of our annual meeting. Thanks to Andy Serwer and his Yahoo crew, the production was a success in all respects, registering 1.1 million unique visits in real-time viewing and 11.5 million more in replays (many of those, to be sure, called up by viewers interested in only certain segments of the webcast).

Berkshire's thank-you mail for initiating the webcast included many notes from three constituencies: the elderly who find travel difficult; the thrifty who find it expensive to travel to Omaha; and those who cannot attend a Saturday meeting for religious reasons.

The webcast cut attendance at last year's meeting to about 37,000 people (we can't get a precise count), which was down about 10%. Nevertheless, both Berkshire's subsidiaries and Omaha hotels and restaurants racked up huge sales. Nebraska Furniture Mart's sales broke their 2015 record volume by 3%, with the Omaha store recording one-week volume of $45.5 million.

Our Berkshire exhibitors at CenturyLink were open from noon until 5 p.m. on Friday and drew a crowd of 12,000 bargain-hunting shareholders. We will repeat those Friday shopping hours this year on May 5th. Bring money.

The annual meeting falls on May 6th and will again be webcast by Yahoo, whose web address is https://finance.yahoo.com/brklivestream. The webcast will go live at 9 a.m. Central Daylight Time. Yahoo will interview directors, managers, stockholders and celebrities before the meeting and during the lunch break. Both those interviews and meeting will be translated simultaneously into Mandarin.

For those attending the meeting in person, the doors at the CenturyLink will open at 7:00 a.m. on Saturday to facilitate shopping prior to our shareholder movie, which begins at 8:30. The question-and-answer period will start at 9:30 and run until 3:30, with a one-hour lunch break at noon. Finally, at 3:45 we will begin the formal shareholder meeting. It will run an hour or so. That is somewhat longer than usual because three proxy items are to be presented by their proponents, who will be given a reasonable amount of time to state their case.

On Saturday morning, we will have our sixth International Newspaper Tossing Challenge. Our target will again be the porch of a Clayton Home, located precisely 35 feet from the throwing line. When I was a teenager – in my one brief flirtation with honest labor – I delivered about 500,000 papers. So I think I'm pretty good at this game. Challenge me! Humiliate me! Knock me down a peg! The papers will run 36 to 42 pages, and you must fold them yourself (no rubber bands allowed). The competition will begin about 7:45, and I'll take on ten or so competitors selected a few minutes earlier by my assistant, Deb Bosanek.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of our subsidiaries will be for sale. Say hello to the many Berkshire managers who will be captaining their exhibits. And be sure to view the terrific BNSF railroad layout that salutes all of our companies. Your children (and you!) will be enchanted with it.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them on Sunday at our fourth annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that will be sent to you with your meeting credentials. Entrants in the race will find themselves running alongside many of Berkshire's managers, directors and associates. (Charlie and I, however, will sleep in; the fudge and peanut brittle we eat throughout the Saturday meeting takes its toll.) Participation in the 5K grows every year. Help us set another record.

A GEICO booth in the shopping area will be staffed by a number of the company's top counselors from around the country. At last year's meeting, we set a record for policy sales, up 21% from 2015. I predict we will be up again this year.

So stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money. Spend the savings on other Berkshire products.

Be sure to visit the Bookworm. This Omaha-based retailer will carry about 35 books and DVDs, among them a couple of new titles. The best book I read last year was *Shoe Dog*, by Nike's Phil Knight. Phil is a very wise, intelligent and competitive fellow who is also a gifted storyteller. The Bookworm will have piles of *Shoe Dog* as well as several investment classics by Jack Bogle.

The Bookworm will once again offer our history of the highlights (and lowlights) of Berkshire's first 50 years. Non-attendees of the meeting can find the book on eBay. Just type in: *Berkshire Hathaway Inc. Celebrating 50 years of a Profitable Partnership* (2nd Edition).

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Keep in mind that airlines have sometimes jacked up prices for the Berkshire weekend – though I must admit I have developed some tolerance, bordering on enthusiasm, for that practice now that Berkshire has made large investments in America's four major carriers. Nevertheless, if you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2 1/2 hours, and it may be that Kansas City can save you significant money. The savings for a couple could run to $1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, May 2nd and Monday, May 8th inclusive, and must also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. During "Berkshire Weekend," NFM will be open from 10 a.m. to 9 p.m. Monday through Friday, 10 a.m. to 9:30 p.m. on Saturday and 10 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is hosting a picnic to which you are all invited.

This year we have good news for shareholders in the Kansas City and Dallas metro markets who can't attend the meeting or perhaps prefer the webcast. From May 2nd through May 8th, shareholders who present meeting credentials or other evidence of their Berkshire ownership (such as brokerage statements) to their local NFM store will receive the same discounts enjoyed by those visiting the Omaha store.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 5th. The second, the main gala, will be held on Sunday, May 7th, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. Remember, the more you buy, the more you save (or so my daughter tells me when we visit the store).

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, May 1st through Saturday, May 13th. During that period, please identify yourself as a shareholder either by presenting your meeting credential or a brokerage statement showing you own our stock.

On Sunday, in the mall outside of Borsheims, Norman Beck, a remarkable magician and motivational speaker from Dallas, will bewilder onlookers. On the upper level, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play with our shareholders on Sunday afternoon. If they suggest wagering on the game, change the subject. I will join them at some point and hope Ajit, Charlie and Bill Gates will do so also.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine, and even then I was unable to score a point against her. Ariel represented the United States in the 2012 Olympics. Now, she's a senior at Princeton (after interning last summer at JPMorgan Chase). If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates did pretty well playing Ariel last year, so he may be ready to again challenge her. (My advice: Bet on Ariel.)

Gorat's will be open exclusively for Berkshire shareholders on Sunday, May 7th, serving from 1 p.m. until 10 p.m. To make a reservation at Gorat's, call 402-551-3733 on April 3rd (*but not before*). Show you are a sophisticated diner by ordering the T-bone with hash browns.

We will have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, the preeminent business journalist of her time, who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of the New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important to shareholders. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

An accompanying set of questions will be asked by three analysts who follow Berkshire. This year the insurance specialist will be Jay Gelb of Barclays. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Since what we will be conducting is a *shareholders'* meeting, our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. Multi-part questions aren't allowed; we want to give as many questioners as possible a shot at us. Our goal is for you to leave the meeting knowing more about Berkshire than when you came and for you to have a good time while in Omaha.

All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and, if possible, should also have adequate time to digest and analyze it before any trading takes place. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday (a day that also eases traffic and parking problems).

We do not follow the common practice of talking one-on-one with large institutional investors or analysts, treating them instead as we do all other shareholders. There is no one more important to us than the shareholder of limited means who trusts us with a substantial portion of his or her savings. As I run the company day-to-day – and as I write this letter – that is the shareholder whose image is in my mind.

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For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I also believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

Equally important, however, are the men and women who work with me at our corporate office. This team efficiently deals with a multitude of SEC and other regulatory requirements, files a 30,450-page Federal income tax return, oversees the filing of 3,580 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities, fact-checks this letter – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year, for example, they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and French fries (smothered in Heinz ketchup, of course) for lunch. In addition, they cheerfully pitch in to help Carrie Sova – our talented ringmaster at the annual meeting – deliver an interesting and entertaining weekend for our shareholders. They are proud to work for Berkshire, and I am proud of them.

I'm a lucky guy, very fortunate in being surrounded by this excellent staff, a team of highly-talented operating managers and a boardroom of very wise and experienced directors. Come to Omaha – the cradle of capitalism – on May 6^{th} and meet the Berkshire Bunch. All of us look forward to seeing you.

February 25, 2017

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change: in Per-Share Book Value of Berkshire	in Per-Share Market Value of Berkshire	in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
2016	10.7	23.4	12.0
2017	23.0	21.9	21.8
Compounded Annual Gain – 1965-2017	19.1%	20.9%	9.9%
Overall Gain – 1964-2017	1,088,029%	2,404,748%	15,508%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire's gain in net worth during 2017 was $65.3 billion, which increased the per-share book value of both our Class A and Class B stock by 23%. Over the last 53 years (that is, since present management took over), per-share book value has grown from $19 to $211,750, a rate of 19.1% compounded annually.*

The format of that opening paragraph has been standard for 30 years. But 2017 was far from standard: A large portion of our gain did *not* come from anything we accomplished at Berkshire.

The $65 billion gain is nonetheless real – rest assured of that. But only $36 billion came from Berkshire's operations. The remaining $29 billion was delivered to us in December when Congress rewrote the U.S. Tax Code. (Details of Berkshire's tax-related gain appear on page K-32 and pages K-89 – K-90.)

After stating those fiscal facts, I would prefer to turn immediately to discussing Berkshire's operations. But, in still another interruption, I must first tell you about a new accounting rule – a generally accepted accounting principle (GAAP) – that in *future* quarterly and annual reports will severely distort Berkshire's net income figures and very often mislead commentators and investors.

The new rule says that the net change in *unrealized* investment gains and losses in stocks we hold must be included in all net income figures we report to you. That requirement will produce some truly wild and capricious swings in our GAAP bottom-line. Berkshire owns $170 billion of marketable stocks (not including our shares of Kraft Heinz), and the value of these holdings can easily swing by $10 billion or more within a quarterly reporting period. Including gyrations of that magnitude in reported net income will swamp the truly important numbers that describe our operating performance. For analytical purposes, Berkshire's "bottom-line" will be useless.

The new rule compounds the communication problems we have long had in dealing with the *realized* gains (or losses) that accounting rules compel us to include in our net income. In past quarterly and annual press releases, we have regularly warned you not to pay attention to these realized gains, because they – just like our unrealized gains – fluctuate randomly.

That's largely because we sell securities when that seems the intelligent thing to do, not because we are trying to influence earnings in any way. As a result, we sometimes have reported substantial realized gains for a period when our portfolio, overall, performed poorly (or the converse).

*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for the A shares.

With the new rule about unrealized gains exacerbating the distortion caused by the existing rules applying to realized gains, we will take pains every quarter to explain the adjustments you need in order to make sense of our numbers. But televised commentary on earnings releases is often instantaneous with their receipt, and newspaper headlines almost always focus on the year-over-year change in GAAP net income. Consequently, media reports sometimes highlight figures that unnecessarily frighten or encourage many readers or viewers.

We will attempt to alleviate this problem by continuing our practice of publishing financial reports late on Friday, well after the markets close, or early on Saturday morning. That will allow you maximum time for analysis and give investment professionals the opportunity to deliver informed commentary before markets open on Monday. Nevertheless, I expect considerable confusion among shareholders for whom accounting is a foreign language.

At Berkshire what counts most are increases in our normalized per-share earning power. That metric is what Charlie Munger, my long-time partner, and I focus on – and we hope that you do, too. Our scorecard for 2017 follows.

Acquisitions

There are four building blocks that add value to Berkshire: (1) sizable stand-alone acquisitions; (2) bolt-on acquisitions that fit with businesses we already own; (3) internal sales growth and margin improvement at our many and varied businesses; and (4) investment earnings from our huge portfolio of stocks and bonds. In this section, we will review 2017 acquisition activity.

In our search for new stand-alone businesses, the key qualities we seek are durable competitive strengths; able and high-grade management; good returns on the net tangible assets required to operate the business; opportunities for internal growth at attractive returns; and, finally, *a sensible purchase price*.

That last requirement proved a barrier to virtually all deals we reviewed in 2017, as prices for decent, but far from spectacular, businesses hit an all-time high. Indeed, price seemed almost irrelevant to an army of optimistic purchasers.

Why the purchasing frenzy? In part, it's because the CEO job self-selects for "can-do" types. If Wall Street analysts or board members urge that brand of CEO to consider possible acquisitions, it's a bit like telling your ripening teenager to be sure to have a normal sex life.

Once a CEO hungers for a deal, he or she will never lack for forecasts that justify the purchase. Subordinates will be cheering, envisioning enlarged domains and the compensation levels that typically increase with corporate size. Investment bankers, smelling huge fees, will be applauding as well. (Don't ask the barber whether you need a haircut.) If the historical performance of the target falls short of validating its acquisition, large "synergies" will be forecast. Spreadsheets never disappoint.

The ample availability of extraordinarily cheap debt in 2017 further fueled purchase activity. After all, even a high-priced deal will usually boost per-share earnings if it is debt-financed. At Berkshire, in contrast, we evaluate acquisitions on an all-equity basis, knowing that our taste for overall debt is very low and that to assign a large portion of our debt to any individual business would generally be fallacious (leaving aside certain exceptions, such as debt dedicated to Clayton's lending portfolio or to the fixed-asset commitments at our regulated utilities). We also never factor in, nor do we often find, synergies.

Our aversion to leverage has dampened our returns over the years. But Charlie and I sleep well. Both of us believe it is insane to risk what you have and need in order to obtain what you don't need. We held this view 50 years ago when we each ran an investment partnership, funded by a few friends and relatives who trusted us. We also hold it today after a million or so "partners" have joined us at Berkshire.

Despite our recent drought of acquisitions, Charlie and I believe that from time to time Berkshire will have opportunities to make very large purchases. In the meantime, we will stick with our simple guideline: The less the prudence with which others conduct their affairs, the greater the prudence with which we must conduct our own.

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We were able to make one sensible stand-alone purchase last year, a 38.6% partnership interest in Pilot Flying J (“PFJ”). With about $20 billion in annual volume, the company is far and away the nation’s leading travel-center operator.

PFJ has been run from the get-go by the remarkable Haslam family. “Big Jim” Haslam began with a dream and a gas station 60 years ago. Now his son, Jimmy, manages 27,000 associates at about 750 locations throughout North America. Berkshire has a contractual agreement to increase its partnership interest in PFJ to 80% in 2023; Haslam family members will then own the remaining 20%. Berkshire is delighted to be their partner.

When driving on the Interstate, drop in. PFJ sells gasoline as well as diesel fuel, and the food is good. If it’s been a long day, remember, too, that our properties have 5,200 showers.

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Let’s move now to bolt-on acquisitions. Some of these were small transactions that I will not detail. Here is an account, however, of a few larger purchases whose closings stretched between late 2016 and early 2018.

- Clayton Homes acquired two builders of conventional homes during 2017, a move that more than doubled our presence in a field we entered only three years ago. With these additions – Oakwood Homes in Colorado and Harris Doyle in Birmingham – I expect our 2018 site built volume will exceed $1 billion.

Clayton’s emphasis, nonetheless, remains manufactured homes, both their construction and their financing. In 2017 Clayton sold 19,168 units through its own retail operation and wholesaled another 26,706 units to independent retailers. All told, Clayton accounted for 49% of the manufactured-home market last year. That industry-leading share – about three times what our nearest competitor did – is a far cry from the 13% Clayton achieved in 2003, the year it joined Berkshire.

Both Clayton Homes and PFJ are based in Knoxville, where the Clayton and Haslam families have long been friends. Kevin Clayton’s comments to the Haslams about the advantages of a Berkshire affiliation, and his admiring comments about the Haslam family to me, helped cement the PFJ deal.

- Near the end of 2016, Shaw Industries, our floor coverings business, acquired U.S. Floors (“USF”), a rapidly growing distributor of luxury vinyl tile. USF’s managers, Piet Dossche and Philippe Erramuzpe, came out of the gate fast, delivering a 40% increase in sales in 2017, during which their operation was integrated with Shaw’s. It’s clear that we acquired both great human assets *and* business assets in making the USF purchase.

Vance Bell, Shaw’s CEO, originated, negotiated and completed this acquisition, which increased Shaw’s sales to $5.7 billion in 2017 and its employment to 22,000. With the purchase of USF, Shaw has substantially strengthened its position as an important and durable source of earnings for Berkshire.

- I have told you several times about HomeServices, our growing real estate brokerage operation. Berkshire backed into this business in 2000 when we acquired a majority interest in MidAmerican Energy (now named Berkshire Hathaway Energy). MidAmerican’s activities were then largely in the electric utility field, and I originally paid little attention to HomeServices.

But, year-by-year, the company added brokers and, by the end of 2016, HomeServices was the second-largest brokerage operation in the country – still ranking, though, far behind the leader, Realogy. In 2017, however, HomeServices' growth exploded. We acquired the industry's third-largest operator, Long and Foster; number 12, Houlihan Lawrence; and Gloria Nilson.

With those purchases we added 12,300 agents, raising our total to 40,950. HomeServices is now close to leading the country in home sales, having participated (including our three acquisitions pro-forma) in $127 billion of "sides" during 2017. To explain that term, there are two "sides" to every transaction; if we represent both buyer and seller, the dollar value of the transaction is counted twice.

Despite its recent acquisitions, HomeServices is on track to do only about 3% of the country's home-brokerage business in 2018. That leaves 97% to go. Given sensible prices, we will keep adding brokers in this most fundamental of businesses.

- Finally, Precision Castparts, a company built through acquisitions, bought Wilhelm Schulz GmbH, a German maker of corrosion resistant fittings, piping systems and components. Please allow me to skip a further explanation. I don't understand manufacturing operations as well as I do the activities of real estate brokers, home builders or truck stops.

Fortunately, I don't need in this instance to bring knowledge to the table: Mark Donegan, CEO of Precision, is an extraordinary manufacturing executive, and any business in his domain is slated to do well. Betting on people can sometimes be more certain than betting on physical assets.

Let's now move on to operations, beginning with property-casualty ("p/c") insurance, a business I *do* understand and the engine that for 51 years has powered Berkshire's growth.

Insurance

Before I discuss our 2017 insurance results, let me remind you of how and why we entered the field. We began by purchasing National Indemnity and a smaller sister company for $8.6 million in early 1967. With our purchase we received $6.7 million of tangible net worth that, by the nature of the insurance business, we were able to deploy in marketable securities. It was easy to rearrange the portfolio into securities we would otherwise have owned at Berkshire itself. In effect, we were "trading dollars" for the net worth portion of the cost.

The $1.9 million premium over net worth that Berkshire paid brought us an insurance business that usually delivered an underwriting profit. Even more important, the insurance operation carried with it $19.4 million of "float" – money that belonged to others but was held by our two insurers.

Ever since, float has been of great importance to Berkshire. When we invest these funds, all dividends, interest and gains from their deployment belong to Berkshire. (If we experience investment losses, those, of course, are on our tab as well.)

Float materializes at p/c insurers in several ways: (1) Premiums are generally paid to the company upfront whereas losses occur over the life of the policy, usually a six-month or one-year period; (2) Though some losses, such as car repairs, are quickly paid, others – such as the harm caused by exposure to asbestos – may take many years to surface and even longer to evaluate and settle; (3) Loss payments are sometimes spread over decades in cases, say, of a person employed by one of our workers' compensation policyholders being permanently injured and thereafter requiring expensive lifetime care.

Float generally grows as premium volume increases. Additionally, certain p/c insurers specialize in lines of business such as medical malpractice or product liability – business labeled "long-tail" in industry jargon – that generate far more float than, say, auto collision and homeowner policies, which require insurers to almost immediately make payments to claimants for needed repairs.

Berkshire has been a leader in long-tail business for many years. In particular, we have specialized in jumbo *reinsurance* policies that leave us assuming long-tail losses already incurred by other p/c insurers. As a result of our emphasizing that sort of business, Berkshire's growth in float has been extraordinary. We are now the country's second largest p/c company measured by premium volume and its leader, by far, in float.

Here's the record:

	(in $ millions)	
Year	Premium Volume	Float
1970	$ 39	$ 39
1980	185	237
1990	582	1,632
2000	19,343	27,871
2010	30,749	65,832
2017	60,597	114,500

Our 2017 volume was boosted by a huge deal in which we reinsured up to $20 billion of long-tail losses that AIG had incurred. Our premium for this policy was $10.2 billion, a world's record and one we won't come close to repeating. Premium volume will therefore fall somewhat in 2018.

Float will probably increase slowly for at least a few years. When we eventually experience a decline, it will be modest – at most 3% or so in any single year. Unlike bank deposits or life insurance policies containing surrender options, p/c float can't be withdrawn. This means that p/c companies can't experience massive "runs" in times of widespread financial stress, a characteristic of prime importance to Berkshire that we factor into our investment decisions.

Charlie and I *never* will operate Berkshire in a manner that depends on the kindness of strangers – or even that of friends who may be facing liquidity problems of their own. During the 2008-2009 crisis, we liked having Treasury Bills – *loads* of Treasury Bills – that protected us from having to rely on funding sources such as bank lines or commercial paper. We have intentionally constructed Berkshire in a manner that will allow it to comfortably withstand economic discontinuities, including such extremes as extended market closures.

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The downside of float is that it comes with risk, sometimes oceans of risk. What looks predictable in insurance can be anything but. Take the famous Lloyds insurance market, which produced decent results for three centuries. In the 1980's, though, huge latent problems from a few long-tail lines of insurance surfaced at Lloyds and, for a time, threatened to destroy its storied operation. (It has, I should add, fully recovered.)

Berkshire's insurance managers are conservative and careful underwriters, who operate in a culture that has long prioritized those qualities. That disciplined behavior has produced underwriting profits in most years, and in such instances, our cost of float was less than zero. In effect, we got *paid* then for holding the huge sums tallied in the earlier table.

I have warned you, however, that we have been fortunate in recent years and that the catastrophe-light period the industry was experiencing was not a new norm. Last September drove home that point, as three significant hurricanes hit Texas, Florida and Puerto Rico.

My guess at this time is that the insured losses arising from the hurricanes are $100 billion or so. That figure, however, could be *far* off the mark. The pattern with most mega-catastrophes has been that initial loss estimates ran low. As well-known analyst V.J. Dowling has pointed out, the loss reserves of an insurer are similar to a self-graded exam. Ignorance, wishful thinking or, occasionally, downright fraud can deliver inaccurate figures about an insurer's financial condition for a very long time.

We currently estimate Berkshire's losses from the three hurricanes to be $3 billion (or about $2 billion after tax). If both that estimate and my industry estimate of $100 billion are close to accurate, our share of the industry loss was about 3%. I believe that percentage is also what we may reasonably expect to be our share of losses in future American mega-cats.

It's worth noting that the $2 billion net cost from the three hurricanes reduced Berkshire's GAAP net worth by less than 1%. Elsewhere in the reinsurance industry there were many companies that suffered losses in net worth ranging from 7% to more than 15%. The damage to them could have been *far* worse: Had Hurricane Irma followed a path through Florida only a bit to the east, insured losses might well have been an additional $100 billion.

We believe that the annual probability of a U.S. mega-catastrophe causing $400 billion or more of insured losses is about 2%. No one, of course, knows the correct probability. We do know, however, that the risk increases over time because of growth in both the number and value of structures located in catastrophe-vulnerable areas.

No company comes close to Berkshire in being financially prepared for a $400 billion mega-cat. Our share of such a loss might be $12 billion or so, an amount far below the annual earnings we expect from our non-insurance activities. Concurrently, much – indeed, perhaps most – of the p/c world would be out of business. Our unparalleled financial strength explains why other p/c insurers come to Berkshire – and *only* Berkshire – when they, themselves, need to purchase huge reinsurance coverages for large payments they may have to make in the far future.

Prior to 2017, Berkshire had recorded 14 consecutive years of underwriting profits, which totaled $28.3 billion pre-tax. I have regularly told you that I expect Berkshire to attain an underwriting profit in a majority of years, but also to experience losses from time to time. My warning became fact in 2017, as we lost $3.2 billion pre-tax from underwriting.

A large amount of additional information about our various insurance operations is included in the 10-K at the back of this report. The only point I will add here is that you have some extraordinary managers working for you at our various p/c operations. This is a business in which there are no trade secrets, patents, or locational advantages. What counts are brains and capital. The managers of our various insurance companies supply the brains and Berkshire provides the capital.

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For many years, this letter has described the activities of Berkshire's many other businesses. That discussion has become both repetitious and partially duplicative of information regularly included in the 10-K that follows the letter. Consequently, this year I will give you a simple summary of our dozens of non-insurance businesses. Additional details can be found on pages K-5 – K-22 and pages K-40 – K-50.

Viewed as a group – *and excluding investment income* – our operations other than insurance delivered pre-tax income of $20 billion in 2017, an increase of $950 million over 2016. About 44% of the 2017 profit came from two subsidiaries. BNSF, our railroad, and Berkshire Hathaway Energy (of which we own 90.2%). You can read more about these businesses on pages K-5 – K-10 and pages K-40 – K-44.

Proceeding down Berkshire's long list of subsidiaries, our next five non-insurance businesses, as ranked by earnings (but presented here alphabetically) Clayton Homes, International Metalworking Companies, Lubrizol, Marmon and Precision Castparts had aggregate pre-tax income in 2017 of $5.5 billion, little changed from the $5.4 billion these companies earned in 2016.

The next five, similarly ranked and listed (Forest River, Johns Manville, MiTek, Shaw and TTI) earned $2.1 billion last year, up from $1.7 billion in 2016.

The remaining businesses that Berkshire owns – and there are many – recorded little change in pre-tax income, which was $3.7 billion in 2017 versus $3.5 billion in 2016.

Depreciation charges for all of these non-insurance operations totaled $7.6 billion; capital expenditures were $11.5 billion. Berkshire is always looking for ways to expand its businesses and regularly incurs capital expenditures that far exceed its depreciation charge. Almost 90% of our investments are made in the United States. America's economic soil remains fertile.

Amortization charges were an additional $1.3 billion. I believe that in large part this item is not a true economic cost. Partially offsetting this good news is the fact that BNSF (like all other railroads) records depreciation charges that fall well short of the sums regularly needed to keep the railroad in first-class shape.

Berkshire's goal is to substantially increase the earnings of its non-insurance group. For that to happen, we will need to make one or more huge acquisitions. We certainly have the resources to do so. At yearend Berkshire held $116.0 billion in cash and U.S. Treasury Bills (whose average maturity was 88 days), up from $86.4 billion at yearend 2016. This extraordinary liquidity earns only a pittance and is far beyond the level Charlie and I wish Berkshire to have. Our smiles will broaden when we have redeployed Berkshire's excess funds into more productive assets.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding – 325,442,152 shares – because Berkshire is part of a control group and therefore must account for this investment on the "equity" method. On its balance sheet, Berkshire carries its Kraft Heinz holding at a GAAP figure of $17.6 billion. The shares had a yearend market value of $25.3 billion, and a cost basis of $9.8 billion.

			12/31/17	
*Shares**	*Company*	*Percentage of Company Owned*	*Cost***	*Market*
			(in millions)	
151,610,700	American Express Company	17.6	$ 1,287	$ 15,056
166,713,209	Apple Inc.	3.3	20,961	28,213
700,000,000	Bank of America Corporation	6.8	5,007	20,664
53,307,534	The Bank of New York Mellon Corporation	5.3	2,230	2,871
225,000,000	BYD Company Ltd.	8.2	232	1,961
6,789,054	Charter Communications, Inc.	2.8	1,210	2,281
400,000,000	The Coca-Cola Company	9.4	1,299	18,352
53,110,395	Delta Airlines Inc.	7.4	2,219	2,974
44,527,147	General Motors Company	3.2	1,343	1,825
11,390,582	The Goldman Sachs Group, Inc.	3.0	654	2,902
24,669,778	Moody's Corporation	12.9	248	3,642
74,587,892	Phillips 66	14.9	5,841	7,545
47,659,456	Southwest Airlines Co.	8.1	1,997	3,119
103,855,045	U.S. Bancorp	6.3	3,343	5,565
482,544,468	Wells Fargo & Company	9.9	11,837	29,276
	Others		14,968	24,294
	Total Common Stocks Carried at Market		$ 74,676	$ 170,540

* Excludes shares held by pension funds of Berkshire subsidiaries.

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

Some of the stocks in the table are the responsibility of either Todd Combs or Ted Weschler, who work with me in managing Berkshire's investments. Each, *independently of me*, manages more than $12 billion; I usually learn about decisions they have made by looking at monthly portfolio summaries. Included in the $25 billion that the two manage is more than $8 billion of pension trust assets of certain Berkshire subsidiaries. As noted, pension investments are not included in the preceding tabulation of Berkshire holdings.

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Charlie and I view the marketable common stocks that Berkshire owns as interests in *businesses*, not as ticker symbols to be bought or sold based on their "chart" patterns, the "target" prices of analysts or the opinions of media pundits. Instead, we simply believe that if the businesses of the investees are successful (as we believe most will be) our investments will be successful as well. Sometimes the payoffs to us will be modest; occasionally the cash register will ring loudly. And sometimes I will make expensive mistakes. Overall – and over time – we should get decent results. In America, equity investors have the wind at their back.

From our stock portfolio – call our holdings "minority interests" in a diversified group of publicly-owned businesses – Berkshire received $3.7 billion of dividends in 2017. That's the number included in our GAAP figures, as well as in the "operating earnings" we reference in our quarterly and annual reports.

That dividend figure, however, *far* understates the "true" earnings emanating from our stock holdings. For decades, we have stated in Principle 6 of our "Owner-Related Business Principles" (page 19) that we expect *undistributed* earnings of our investees to deliver us at least equivalent earnings by way of subsequent capital gains.

Our recognition of capital gains (and losses) will be lumpy, particularly as we conform with the new GAAP rule requiring us to constantly record *unrealized* gains or losses in our earnings. I feel confident, however, that the earnings retained by our investees will over time, and with our investees viewed as a group, translate into commensurate capital gains for Berkshire.

The connection of value-building to retained earnings that I've just described will be impossible to detect in the short term. Stocks surge and swoon, seemingly untethered to any year-to-year buildup in their underlying value. Over time, however, Ben Graham's oft-quoted maxim proves true: "In the short run, the market is a voting machine; in the long run, however, it becomes a weighing machine."

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Berkshire, itself, provides some vivid examples of how price randomness in the short term can obscure long-term growth in value. For the last 53 years, the company has built value by reinvesting its earnings and letting compound interest work its magic. Year by year, we have moved forward. Yet Berkshire shares have suffered four truly major dips. Here are the gory details:

Period	High	Low	Percentage Decrease
March 1973-January 1975	93	38	(59.1%)
10/2/87-10/27/87	4,250	2,675	(37.1%)
6/19/98-3/10/2000	80,900	41,300	(48.9%)
9/19/08-3/5/09	147,000	72,400	(50.7%)

This table offers the strongest argument I can muster against ever using borrowed money to own stocks. There is simply no telling how far stocks can fall in a short period. Even if your borrowings are small and your positions aren't immediately threatened by the plunging market, your mind may well become rattled by scary headlines and breathless commentary. And an unsettled mind will not make good decisions.

In the next 53 years our shares (and others) will experience declines resembling those in the table. *No one* can tell you when these will happen. The light can at *any time* go from green to red without pausing at yellow.

When major declines occur, however, they offer extraordinary opportunities to those who are not handicapped by debt. That's the time to heed these lines from Kipling's *If*:

> "If you can keep your head when all about you are losing theirs . . .
> If you can wait and not be tired by waiting . . .
> If you can think – and not make thoughts your aim . . .
> If you can trust yourself when all men doubt you . . .
> Yours is the Earth and everything that's in it."

"The Bet" is Over and Has Delivered an Unforeseen Investment Lesson

Last year, at the 90% mark, I gave you a detailed report on a ten-year bet I had made on December 19, 2007. (The full discussion from last year's annual report is reprinted on pages 24 – 26.) Now I have the final tally – and, in several respects, it's an eye-opener.

I made the bet for two reasons: (1) to leverage my outlay of $318,250 into a disproportionately larger sum that – if things turned out as I expected – would be distributed in early 2018 to Girls Inc. of Omaha; and (2) to publicize my conviction that my pick – a virtually cost-free investment in an unmanaged S&P 500 index fund – would, over time, deliver better results than those achieved by most investment professionals, however well-regarded and incentivized those "helpers" may be.

Addressing this question is of enormous importance. American investors pay staggering sums annually to advisors, often incurring several layers of consequential costs. In the aggregate, do these investors get their money's worth? Indeed, again in the aggregate, do investors get *anything* for their outlays?

Protégé Partners, my counterparty to the bet, picked five "funds-of-funds" that it expected to overperform the S&P 500. That was *not* a small sample. Those five funds-of-funds in turn owned interests in more than 200 hedge funds.

Essentially, Protégé, an advisory firm that knew its way around Wall Street, selected five investment experts who, in turn, employed several hundred other investment experts, each managing his or her own hedge fund. This assemblage was an elite crew, loaded with brains, adrenaline and confidence.

The managers of the five funds-of-funds possessed a further advantage: They could – and did – rearrange their portfolios of hedge funds during the ten years, investing with new "stars" while exiting their positions in hedge funds whose managers had lost their touch.

Every actor on Protégé's side was highly incentivized: Both the fund-of-funds managers and the hedge-fund managers they selected significantly shared in gains, even those achieved simply because the market generally moves upwards. (In *100%* of the 43 ten-year periods since we took control of Berkshire, years with gains by the S&P 500 exceeded loss years.)

Those performance incentives, it should be emphasized, were frosting on a huge and tasty cake: Even if the funds *lost* money for their investors during the decade, their managers could grow very rich. That would occur because *fixed* fees averaging a staggering 2½% of assets or so were paid *every year* by the fund-of-funds' investors, with part of these fees going to the managers at the five funds-of-funds and the balance going to the 200-plus managers of the underlying hedge funds.

Here's the final scorecard for the bet:

Year	Fund-of-Funds A	Fund-of-Funds B	Fund-of-Funds C	Fund-of-Funds D	Fund-of-Funds E	S&P Index Fund
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-3.2%	1.9%	-1.7%	2.5%	4.4%	11.9%
2017	12.2%	10.6%	15.6%	N/A	18.0%	21.8%
Final Gain	21.7%	42.3%	87.7%	2.8%	27.0%	125.8%
Average Annual Gain	2.0%	3.6%	6.5%	0.3%	2.4%	8.5%

Footnote: Under my agreement with Protégé Partners, the names of these funds-of-funds have never been publicly disclosed. I, however, have received their annual audits from Protégé. The 2016 figures for funds A, B and C were revised slightly from those originally reported last year. Fund D was liquidated in 2017; its average annual gain is calculated for the nine years of its operation.

The five funds-of-funds got off to a fast start, each beating the index fund in 2008. Then the roof fell in. In *every one* of the nine years that followed, the funds-of-funds as a whole trailed the index fund.

Let me emphasize that there was nothing aberrational about stock-market behavior over the ten-year stretch. If a poll of investment "experts" had been asked late in 2007 for a forecast of long-term common-stock returns, their guesses would have likely averaged close to the 8.5% actually delivered by the S&P 500. Making money in that environment should have been easy. Indeed, Wall Street "helpers" earned staggering sums. While this group prospered, however, many of their investors experienced a lost decade.

Performance comes, performance goes. Fees never falter.

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The bet illuminated another important investment lesson: Though markets are generally rational, they occasionally do crazy things. Seizing the opportunities then offered does *not* require great intelligence, a degree in economics or a familiarity with Wall Street jargon such as alpha and beta. What investors then need instead is an ability to both disregard mob fears or enthusiasms and to focus on a few simple fundamentals. A willingness to look unimaginative for a sustained period – or even to look foolish – is also essential.

Originally, Protégé and I each funded our portion of the ultimate $1 million prize by purchasing $500,000 face amount of zero-coupon U.S. Treasury bonds (sometimes called "strips"). These bonds cost each of us $318,250 – a bit less than 64¢ on the dollar – with the $500,000 payable in ten years.

As the name implies, the bonds we acquired paid no interest, but (because of the discount at which they were purchased) delivered a 4.56% annual return if held to maturity. Protégé and I originally intended to do no more than tally the annual returns and distribute $1 million to the winning charity when the bonds matured late in 2017.

After our purchase, however, some very strange things took place in the bond market. By November 2012, our bonds – now with about five years to go before they matured – were selling for *95.7%* of their face value. At *that* price, their annual yield to maturity was less than 1%. Or, to be precise, *.88%*.

Given that pathetic return, our bonds had become a dumb – a *really* dumb – investment compared to American equities. Over time, the S&P 500 – which mirrors a huge cross-section of American business, appropriately weighted by market value – has earned *far* more than 10% annually on shareholders' equity (net worth).

In November 2012, as we were considering all this, the *cash* return from dividends on the S&P 500 was 2½% annually, about triple the yield on our U.S. Treasury bond. These dividend payments were almost certain to grow. Beyond that, huge sums were being retained by the companies comprising the 500. These businesses would use their retained earnings to expand their operations and, frequently, to repurchase their shares as well. Either course would, over time, substantially increase earnings-per-share. And – as has been the case since 1776 – whatever its problems of the minute, the American economy was going to move forward.

Presented late in 2012 with the extraordinary valuation mismatch between bonds and equities, Protégé and I agreed to sell the bonds we had bought five years earlier and use the proceeds to buy 11,200 Berkshire "B" shares. The result: Girls Inc. of Omaha found itself receiving $2,222,279 last month rather than the $1 million it had originally hoped for.

Berkshire, it should be emphasized, has not performed brilliantly since the 2012 substitution. But brilliance wasn't needed: After all, Berkshire's gain only had to beat that annual .88% bond bogey – hardly a Herculean achievement.

The only risk in the bonds-to-Berkshire switch was that yearend 2017 would coincide with an exceptionally weak stock market. Protégé and I felt this possibility (which *always* exists) was very low. Two factors dictated this conclusion: The reasonable price of Berkshire in late 2012, and the large asset build-up that was almost certain to occur at Berkshire during the five years that remained before the bet would be settled. Even so, to eliminate *all* risk to the charities from the switch, I agreed to make up any shortfall if sales of the 11,200 Berkshire shares at yearend 2017 didn't produce at least $1 million.

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Investing is an activity in which consumption today is foregone in an attempt to allow greater consumption at a later date. "Risk" is the possibility that this objective won't be attained.

By that standard, purportedly "risk-free" long-term bonds in 2012 were a *far* riskier investment than a long-term investment in common stocks. At that time, even a 1% annual rate of inflation between 2012 and 2017 would have decreased the purchasing-power of the government bond that Protégé and I sold.

I want to quickly acknowledge that in *any* upcoming day, week or even year, stocks will be riskier – far riskier – than short-term U.S. bonds. As an investor's investment horizon lengthens, however, a diversified portfolio of U.S. equities becomes progressively *less* risky than bonds, assuming that the stocks are purchased at a sensible multiple of earnings relative to then-prevailing interest rates.

It is a terrible mistake for investors with long-term horizons – among them, pension funds, college endowments and savings-minded individuals – to measure their investment "risk" by their portfolio's ratio of bonds to stocks. Often, high-grade bonds in an investment portfolio *increase* its risk.

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A final lesson from our bet: Stick with big, "easy" decisions and eschew activity. During the ten-year bet, the 200-plus hedge-fund managers that were involved almost certainly made tens of thousands of buy and sell decisions. Most of those managers undoubtedly thought hard about their decisions, each of which they believed would prove advantageous. In the process of investing, they studied 10-Ks, interviewed managements, read trade journals and conferred with Wall Street analysts.

Protégé and I, meanwhile, leaning neither on research, insights nor brilliance, made only one investment decision during the ten years. We simply decided to sell our bond investment at a price of more than 100 times earnings (95.7 sale price/.88 yield), those being "earnings" that could not increase during the ensuing five years.

We made the sale in order to move our money into a single security – Berkshire – that, in turn, owned a diversified group of solid businesses. Fueled by retained earnings, Berkshire's growth in value was unlikely to be less than 8% annually, even if we were to experience a so-so economy.

After that kindergarten-like analysis, Protégé and I made the switch and relaxed, confident that, over time, 8% was certain to beat .88%. By a lot.

The Annual Meeting

The annual meeting falls on May 5th and will again be webcast by Yahoo!, whose web address is https://finance.yahoo.com/brklivestream. The webcast will go live at 8:45 a.m. Central Daylight Time. Yahoo! will interview directors, managers, stockholders and celebrities before the meeting and during the lunch break. Both the interviews and meeting will be translated simultaneously into Mandarin.

Our partnership with Yahoo! began in 2016 and shareholders have responded enthusiastically. Last year, real-time viewership increased 72% to about 3.1 million and replays of short segments totaled 17.1 million.

For those attending the meeting in person, the doors at the CenturyLink will open at 7:00 a.m. on Saturday to facilitate shopping prior to our shareholder movie, which begins at 8:30. The question-and-answer period will start at 9:15 and run until 3:30, with a one-hour lunch break at noon. Finally, at 3:45 we will begin the formal shareholder meeting, which usually runs from 15 to 45 minutes. Shopping will end at 4:30.

On Friday, May 4th, our Berkshire exhibitors at CenturyLink will be open from noon until 5 p.m. We added that extra shopping time in 2015, and serious shoppers love it. Last year about 12,000 people came through the doors in the five hours we were open on Friday.

Your venue for shopping will be the 194,300-square-foot hall that adjoins the meeting and in which products from dozens of our subsidiaries will be *for sale*. (Your Chairman discourages freebies.) Say hello to the many Berkshire managers who will be captaining their exhibits. And be sure to view the terrific BNSF railroad layout that salutes all of our companies.

Brooks, our running-shoe company, will again have a special commemorative shoe to offer at the meeting. After you purchase a pair, wear them on Sunday at our sixth annual "Berkshire 5K," an 8 a.m. race starting at the CenturyLink. Full details for participating will be included in the Visitor's Guide that will be sent to you with your meeting credentials. Entrants in the race will find themselves running alongside many of Berkshire's managers, directors and associates. (Charlie and I, however, will sleep in; even with Brooks running shoes, our times would be embarrassing.) Participation in the 5K grows every year. Help us set another record.

A GEICO booth in the shopping area will be staffed by a number of the company's top counselors from around the country. At last year's meeting, we set a record for policy sales, up 43% from 2016.

So stop by for a quote. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another discount, such as that available to certain groups.) Bring the details of your existing insurance and check out our price. We can save many of you real money. Spend the savings on other Berkshire products.

Be sure to visit the Bookworm. This Omaha-based retailer will carry more than 40 books and DVDs, among them a couple of new titles. Berkshire shareholders are a bookseller's dream: When *Poor Charlie's Almanack* (yes, *our* Charlie) made its debut some years ago, we sold 3,500 copies at the meeting. The book weighed 4.85 pounds. Do the math: Our shareholders left the building that day carrying about 8 ½ tons of Charlie's wisdom.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to both the meeting and other events. Keep in mind that most airlines substantially increase prices for the Berkshire weekend. If you are coming from far away, compare the cost of flying to Kansas City vs. Omaha. The drive between the two cities is about 2 ½ hours, and it may be that Kansas City can save you significant money. The savings for a couple could run to $1,000 or more. Spend that money with us.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. To obtain the Berkshire discount at NFM, you must make your purchases between Tuesday, May 1st and Monday, May 7th inclusive, and must also present your meeting credential. Last year, the one-week volume for the store was a staggering $44.6 million. Bricks and mortar are alive and well at NFM.

The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. During "Berkshire Weekend," NFM will be open from 10 a.m. to 9 p.m. Monday through Saturday and 11 a.m. to 8 p.m. on Sunday. From 5:30 p.m. to 8 p.m. on Saturday, NFM is hosting a picnic to which you are all invited.

NFM will again extend its shareholder's discount offerings to our Kansas City and Dallas stores. From May 1st through May 7th, shareholders who present meeting credentials or other evidence of their Berkshire ownership (such as brokerage statements) to those NFM stores will receive the same discounts enjoyed by those visiting the Omaha store.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 9 p.m. on Friday, May 4th. The second, the main gala, will be held on Sunday, May 6th, from 9 a.m. to 4 p.m. On Saturday, we will remain open until 6 p.m. Remember, the more you buy, the more you save (or so my daughter tells me when we visit the store).

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 30th through Saturday, May 12th. During that period, please identify yourself as a shareholder either by presenting your meeting credential or a brokerage statement showing you own our stock.

On Sunday afternoon, on the upper level above Borsheims, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play with our shareholders. If they suggest wagering on the game, change the subject. Ajit, Charlie, Bill Gates and I will likely drop by as well.

My friend, Ariel Hsing, will be in the mall as well on Sunday, taking on challengers at table tennis. I met Ariel when she was nine, and even then I was unable to score a point against her. Ariel represented the United States in the 2012 Olympics. If you don't mind embarrassing yourself, test your skills against her, beginning at 1 p.m. Bill Gates did pretty well playing Ariel last year, so he may be ready to again challenge her. (My advice: Bet on Ariel.) I will participate on an advisory basis only.

Gorat's will be open exclusively for Berkshire shareholders on Sunday, May 6th, serving from 12 p.m. until 10 p.m. To make a reservation at Gorat's, call 402-551-3733 on April 2nd (*but not before*). Show you are a sophisticated diner by ordering the T-bone with hash browns.

We will have the same three financial journalists lead the question-and-answer period at the meeting, asking Charlie and me questions that shareholders have submitted to them by e-mail. The journalists and their e-mail addresses are: Carol Loomis, the preeminent business journalist of her time, who may be e-mailed at loomisbrk@gmail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com; and Andrew Ross Sorkin, of the New York Times, at arsorkin@nytimes.com.

From the questions submitted, each journalist will choose the six he or she decides are the most interesting and important to shareholders. The journalists have told me your question has the best chance of being selected if you keep it concise, avoid sending it in at the last moment, make it Berkshire-related and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is asked.)

An accompanying set of questions will be asked by three analysts who follow Berkshire. This year the insurance specialist will be Gary Ransom of Dowling & Partners. Questions that deal with our non-insurance operations will come from Jonathan Brandt of Ruane, Cunniff & Goldfarb and Gregg Warren of Morningstar. Since what we will be conducting is a *shareholders'* meeting, our hope is that the analysts and journalists will ask questions that add to our owners' understanding and knowledge of their investment.

Neither Charlie nor I will get so much as a clue about the questions headed our way. Some will be tough, for sure, and that's the way we like it. Multi-part questions aren't allowed; we want to give as many questioners as possible a shot at us. Our goal is for you to leave the meeting knowing more about Berkshire than when you came and for you to have a good time while in Omaha.

All told, we expect at least 54 questions, which will allow for six from each analyst and journalist and for 18 from the audience. After the 54th, all questions come from the audience. Charlie and I have often tackled more than 60 by 3:30.

The questioners from the audience will be chosen by means of 11 drawings that will take place at 8:15 a.m. on the morning of the annual meeting. Each of the 11 microphones installed in the arena and main overflow room will host, so to speak, a drawing.

While I'm on the subject of our owners' gaining knowledge, let me remind you that Charlie and I believe all shareholders should simultaneously have access to new information that Berkshire releases and, if possible, should also have adequate time to digest and analyze that information before any trading takes place. That's why we try to issue financial data late on Fridays or early on Saturdays and why our annual meeting is always held on a Saturday (a day that also eases traffic and parking problems).

We do not follow the common practice of talking one-on-one with large institutional investors or analysts, treating them instead as we do all other shareholders. There is no one more important to us than the shareholder of limited means who trusts us with a substantial portion of his or her savings. As I run the company day-to-day – and as I write this letter – that is the shareholder whose image is in my mind.

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For good reason, I regularly extol the accomplishments of our operating managers. They are truly All-Stars who run their businesses as if they were the only asset owned by their families. I also believe the mindset of our managers to be as shareholder-oriented as can be found in the universe of large publicly-owned companies. Most of our managers have no financial need to work. The joy of hitting business "home runs" means as much to them as their paycheck.

If managers (or directors) own Berkshire shares – and many do – it's from open-market purchases they have made or because they received shares when they sold their businesses to us. *None*, however, gets the upside of ownership without risking the downside. Our directors and managers stand in your shoes.

We continue to have a wonderful group at headquarters. This team efficiently deals with a multitude of SEC and other regulatory requirements, files a 32,700-page Federal income tax return, oversees the filing of 3,935 state tax returns, responds to countless shareholder and media inquiries, gets out the annual report, prepares for the country's largest annual meeting, coordinates the Board's activities, fact-checks this letter – and the list goes on and on.

They handle all of these business tasks cheerfully and with unbelievable efficiency, making my life easy and pleasant. Their efforts go beyond activities strictly related to Berkshire: Last year, for example, they dealt with the 40 universities (selected from 200 applicants) who sent students to Omaha for a Q&A day with me. They also handle all kinds of requests that I receive, arrange my travel, and even get me hamburgers and French fries (smothered in Heinz ketchup, of course) for lunch. In addition, they cheerfully pitch in to help at the annual meeting in whatever way they are needed. They are proud to work for Berkshire, and I am proud of them.

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I've saved the best for last. Early in 2018, Berkshire's board elected Ajit Jain and Greg Abel as directors of Berkshire and also designated each as Vice Chairman. Ajit is now responsible for insurance operations, and Greg oversees the rest of our businesses. Charlie and I will focus on investments and capital allocation.

You and I are lucky to have Ajit and Greg working for us. Each has been with Berkshire for decades, and Berkshire's blood flows through their veins. The character of each man matches his talents. And that says it all.

Come to Omaha – the cradle of capitalism – on May 5th and meet the Berkshire Bunch. All of us look forward to your visit.

February 24, 2018

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change in Per-Share Book Value of Berkshire	Annual Percentage Change in Per-Share Market Value of Berkshire	Annual Percentage Change in S&P 500 with Dividends Included
1965	23.8	49.5	10.0
1966	20.3	(3.4)	(11.7)
1967	11.0	13.3	30.9
1968	19.0	77.8	11.0
1969	16.2	19.4	(8.4)
1970	12.0	(4.6)	3.9
1971	16.4	80.5	14.6
1972	21.7	8.1	18.9
1973	4.7	(2.5)	(14.8)
1974	5.5	(48.7)	(26.4)
1975	21.9	2.5	37.2
1976	59.3	129.3	23.6
1977	31.9	46.8	(7.4)
1978	24.0	14.5	6.4
1979	35.7	102.5	18.2
1980	19.3	32.8	32.3
1981	31.4	31.8	(5.0)
1982	40.0	38.4	21.4
1983	32.3	69.0	22.4
1984	13.6	(2.7)	6.1
1985	48.2	93.7	31.6
1986	26.1	14.2	18.6
1987	19.5	4.6	5.1
1988	20.1	59.3	16.6
1989	44.4	84.6	31.7
1990	7.4	(23.1)	(3.1)
1991	39.6	35.6	30.5
1992	20.3	29.8	7.6
1993	14.3	38.9	10.1
1994	13.9	25.0	1.3
1995	43.1	57.4	37.6
1996	31.8	6.2	23.0
1997	34.1	34.9	33.4
1998	48.3	52.2	28.6
1999	0.5	(19.9)	21.0
2000	6.5	26.6	(9.1)
2001	(6.2)	6.5	(11.9)
2002	10.0	(3.8)	(22.1)
2003	21.0	15.8	28.7
2004	10.5	4.3	10.9
2005	6.4	0.8	4.9
2006	18.4	24.1	15.8
2007	11.0	28.7	5.5
2008	(9.6)	(31.8)	(37.0)
2009	19.8	2.7	26.5
2010	13.0	21.4	15.1
2011	4.6	(4.7)	2.1
2012	14.4	16.8	16.0
2013	18.2	32.7	32.4
2014	8.3	27.0	13.7
2015	6.4	(12.5)	1.4
2016	10.7	23.4	12.0
2017	23.0	21.9	21.8
2018	0.4	2.8	(4.4)
Compounded Annual Gain – 1965-2018	18.7%	20.5%	9.7%
Overall Gain – 1964-2018	1,091,899%	2,472,627%	15,019%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported. The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire earned \$4.0 billion in 2018 utilizing generally accepted accounting principles (commonly called "GAAP"). The components of that figure are \$24.8 billion in operating earnings, a \$3.0 billion non-cash loss from an impairment of intangible assets (arising almost entirely from our equity interest in Kraft Heinz), \$2.8 billion in realized capital gains from the sale of investment securities and a \$20.6 billion *loss* from a reduction in the amount of unrealized capital gains that existed in our investment holdings.

A new GAAP rule requires us to include that last item in earnings. As I emphasized in the 2017 annual report, neither Berkshire's Vice Chairman, Charlie Munger, nor I believe that rule to be sensible. Rather, both of us have consistently thought that at Berkshire this mark-to-market change would produce what I described as "wild and capricious swings in our bottom line."

The accuracy of that prediction can be suggested by our quarterly results during 2018. In the first and fourth quarters, we reported GAAP *losses* of \$1.1 billion and \$25.4 billion respectively. In the second and third quarters, we reported *profits* of \$12 billion and \$18.5 billion. In complete contrast to these gyrations, the many businesses that Berkshire owns delivered consistent and satisfactory operating earnings in *all* quarters. For the year, those earnings exceeded their 2016 high of \$17.6 billion by 41%.

Wide swings in our quarterly GAAP earnings will inevitably continue. That's because our huge equity portfolio – valued at nearly \$173 billion at the end of 2018 – will often experience one-day price fluctuations of \$2 billion or more, all of which the new rule says must be dropped immediately to our bottom line. Indeed, in the fourth quarter, a period of high volatility in stock prices, we experienced several days with a "profit" or "loss" of more than \$4 billion.

Our advice? Focus on operating earnings, paying little attention to gains or losses of any variety. My saying that in no way diminishes the importance of our investments to Berkshire. Over time, Charlie and I expect them to deliver substantial gains, albeit with highly irregular timing.

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Long-time readers of our annual reports will have spotted the different way in which I opened this letter. For nearly three decades, the initial paragraph featured the percentage change in Berkshire's per-share book value. It's now time to abandon that practice.

The fact is that the annual change in Berkshire's book value – which makes its farewell appearance on page 2 – is a metric that has lost the relevance it once had. Three circumstances have made that so. First, Berkshire has gradually morphed from a company whose assets are concentrated in marketable stocks into one whose major value resides in operating businesses. Charlie and I expect that reshaping to continue in an irregular manner. Second, while our *equity holdings* are valued at market prices, accounting rules require our collection of *operating companies* to be included in book value at an amount far below their current value, a mismark that has grown in recent years. Third, it is likely that – over time – Berkshire will be a significant repurchaser of its shares, transactions that will take place at prices above book value but below our estimate of intrinsic value. The math of such purchases is simple: Each transaction makes per-share intrinsic value go up, while per-share book value goes down. That combination causes the book-value scorecard to become increasingly out of touch with economic reality.

In future tabulations of our financial results, we expect to focus on Berkshire's market price. Markets can be extremely capricious: Just look at the 54-year history laid out on page 2. Over time, however, Berkshire's stock price will provide the best measure of business performance.

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Before moving on, I want to give you some good news – *really* good news – that is not reflected in our financial statements. It concerns the management changes we made in early 2018, when Ajit Jain was put in charge of all insurance activities and Greg Abel was given authority over all other operations. These moves were overdue. Berkshire is now far better managed than when I alone was supervising operations. Ajit and Greg have rare talents, and Berkshire blood flows through their veins.

Now let's take a look at what you own.

Focus on the Forest – Forget the Trees

Investors who evaluate Berkshire sometimes obsess on the details of our many and diverse businesses – our economic "trees," so to speak. Analysis of that type can be mind-numbing, given that we own a vast array of specimens, ranging from twigs to redwoods. A few of our trees are diseased and unlikely to be around a decade from now. Many others, though, are destined to grow in size and beauty.

Fortunately, it's not necessary to evaluate each tree individually to make a rough estimate of Berkshire's intrinsic business value. That's because our forest contains five "groves" of major importance, each of which can be appraised, with reasonable accuracy, in its entirety. Four of those groves are differentiated clusters of businesses and financial assets that are easy to understand. The fifth – our huge and diverse insurance operation – delivers great value to Berkshire in a less obvious manner, one I will explain later in this letter.

Before we look more closely at the first four groves, let me remind you of our prime goal in the deployment of your capital: to buy ably-managed businesses, *in whole or part*, that possess favorable and durable economic characteristics. We also need to make these purchases at sensible prices.

Sometimes we can buy control of companies that meet our tests. Far more often, we find the attributes we seek in publicly-traded businesses, in which we normally acquire a 5% to 10% interest. Our two-pronged approach to huge-scale capital allocation is rare in corporate America and, at times, gives us an important advantage.

In recent years, the sensible course for us to follow has been clear: Many stocks have offered far more for our money than we could obtain by purchasing businesses in their entirety. That disparity led us to buy about $43 billion of marketable equities last year, while selling only $19 billion. Charlie and I believe the companies in which we invested offered excellent value, far exceeding that available in takeover transactions.

Despite our recent additions to marketable equities, the most valuable grove in Berkshire's forest remains the many dozens of non-insurance businesses that Berkshire controls (usually with 100% ownership and never with less than 80%). Those subsidiaries earned $16.8 billion last year. When we say "earned," moreover, we are describing what remains after *all* income taxes, interest payments, managerial compensation (whether cash or stock-based), restructuring expenses, depreciation, amortization and home-office overhead.

That brand of earnings is a far cry from that frequently touted by Wall Street bankers and corporate CEOs. Too often, their presentations feature "adjusted EBITDA," a measure that redefines "earnings" to exclude a variety of all-too-real costs.

For example, managements sometimes assert that their company's stock-based compensation shouldn't be counted as an expense. (What else could it be – a *gift* from shareholders?) And restructuring expenses? Well, maybe last year's exact rearrangement won't recur. But restructurings of one sort or another are common in business – Berkshire has gone down that road dozens of times, and our shareholders have always borne the costs of doing so.

Abraham Lincoln once posed the question: "If you call a dog's tail a leg, how many legs does it have?" and then answered his own query: "Four, because calling a tail a leg doesn't make it one." Abe would have felt lonely on Wall Street.

Charlie and I do contend that our acquisition-related amortization expenses of $1.4 billion (detailed on page K-84) are not a true economic cost. We add back such amortization "costs" to GAAP earnings when we are evaluating both private businesses and marketable stocks.

In contrast, Berkshire's $8.4 billion depreciation charge understates our true economic cost. In fact, we need to spend *more* than this sum annually to simply remain competitive in our many operations. Beyond those "maintenance" capital expenditures, we spend large sums in pursuit of growth. Overall, Berkshire invested a record $14.5 billion last year in plant, equipment and other fixed assets, with 89% of that spent in America.

Berkshire's runner-up grove by value is its collection of equities, typically involving a 5% to 10% ownership position in a very large company. As noted earlier, our equity investments were worth nearly $173 billion at yearend, an amount far above their cost. If the portfolio had been sold at its yearend valuation, federal income tax of about $14.7 billion would have been payable on the gain. In all likelihood, we will hold most of these stocks for a long time. Eventually, however, gains generate taxes at whatever rate prevails at the time of sale.

Our investees paid us dividends of $3.8 billion last year, a sum that will increase in 2019. Far more important than the dividends, though, are the huge earnings that are annually retained by these companies. Consider, as an indicator, these figures that cover only our five largest holdings.

Company	Yearend Ownership	Berkshire's Share in $ millions of Dividends(1)	Retained Earnings(2)
American Express	17.9%	$ 237	$ 997
Apple	5.4%	745	2,502
Bank of America	9.5%	551	2,096
Coca-Cola	9.4%	624	(21)
Wells Fargo	9.8%	809	1,263
Total		$2,966	$6,837

(1) Based on current annual rate.
(2) Based on 2018 earnings minus common and preferred dividends paid.

GAAP – which dictates the earnings we report – does not allow us to include the retained earnings of investees in our financial accounts. But those earnings are of enormous value to us: Over the years, earnings retained by our investees (viewed as a group) have eventually delivered capital gains to Berkshire that totaled more than one dollar for each dollar these companies reinvested for us.

All of our major holdings enjoy excellent economics, and most use a portion of their retained earnings to repurchase their shares. We very much like that: If Charlie and I think an investee's stock is underpriced, we rejoice when management employs some of its earnings to increase Berkshire's ownership percentage.

Here's one example drawn from the table above: Berkshire's holdings of American Express have remained unchanged over the past eight years. Meanwhile, our ownership increased from 12.6% to 17.9% because of repurchases made by the company. Last year, Berkshire's portion of the $6.9 billion earned by American Express was $1.2 billion, about 96% of the $1.3 billion we paid for our stake in the company. When earnings increase and shares outstanding decrease, owners – over time – usually do well.

A third category of Berkshire's business ownership is a quartet of companies in which we share control with other parties. Our portion of the after-tax operating earnings of these businesses – 26.7% of Kraft Heinz, 50% of Berkadia and Electric Transmission Texas, and 38.6% of Pilot Flying J – totaled about $1.3 billion in 2018.

In our fourth grove, Berkshire held $112 billion at yearend in U.S. Treasury bills and other cash equivalents, and another $20 billion in miscellaneous fixed-income instruments. We consider a portion of that stash to be untouchable, having pledged to always hold at least $20 billion in cash equivalents to guard against external calamities. We have also promised to avoid *any* activities that could threaten our maintaining that buffer.

Berkshire will forever remain a financial fortress. In managing, I will make expensive mistakes of commission and will also miss many opportunities, some of which should have been obvious to me. At times, our stock will tumble as investors flee from equities. But I will never risk getting caught short of cash.

In the years ahead, we hope to move much of our excess liquidity into businesses that Berkshire will permanently own. The immediate prospects for that, however, are not good: Prices are sky-high for businesses possessing decent long-term prospects.

That disappointing reality means that 2019 will likely see us again expanding our holdings of marketable equities. We continue, nevertheless, to hope for an elephant-sized acquisition. Even at our ages of 88 and 95 – *I'm the young one* – that prospect is what causes my heart and Charlie's to beat faster. (Just writing about the possibility of a huge purchase has caused my pulse rate to soar.)

My expectation of more stock purchases is *not* a market call. Charlie and I have no idea as to how stocks will behave next week or next year. Predictions of that sort have *never* been a part of our activities. Our thinking, rather, is focused on calculating whether a portion of an attractive business is worth more than its market price.

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I believe Berkshire's intrinsic value can be *approximate*d by summing the values of our four asset-laden groves and then subtracting an appropriate amount for taxes eventually payable on the sale of marketable securities.

You may ask whether an allowance should not also be made for the major tax costs Berkshire would incur if we were to sell certain of our wholly-owned businesses. Forget that thought: It would be foolish for us to sell any of our wonderful companies even if *no* tax would be payable on its sale. Truly good businesses are exceptionally hard to find. Selling any you are lucky enough to own makes no sense at all.

The interest cost on *all* of our debt has been deducted as an expense in calculating the earnings at Berkshire's non-insurance businesses. Beyond that, much of our ownership of the first four groves is financed by funds generated from Berkshire's fifth grove – a collection of exceptional insurance companies. We call those funds "float," a source of financing that we expect to be cost-free – or maybe even better than that – over time. We will explain the characteristics of float later in this letter.

Finally, a point of key and lasting importance: Berkshire's value is maximized by our having assembled the five groves into a single entity. This arrangement allows us to seamlessly and objectively allocate major amounts of capital, eliminate enterprise risk, avoid insularity, fund assets at exceptionally low cost, occasionally take advantage of tax efficiencies, and minimize overhead.

At Berkshire, the whole is greater – considerably greater – than the sum of the parts.

Repurchases and Reporting

Earlier I mentioned that Berkshire will from time to time be repurchasing its own stock. Assuming that we buy at a discount to Berkshire's intrinsic value – which certainly will be our intention – repurchases will benefit both those shareholders leaving the company and those who stay.

True, the upside from repurchases is very slight for those who are leaving. That's because careful buying by us will minimize any impact on Berkshire's stock price. Nevertheless, there is *some* benefit to sellers in having an extra buyer in the market.

For continuing shareholders, the advantage is obvious: If the market prices a departing partner's interest at, say, 90¢ on the dollar, continuing shareholders reap an increase in per-share intrinsic value with every repurchase by the company. Obviously, repurchases should be price-sensitive: Blindly buying an overpriced stock is value-destructive, a fact lost on many promotional or ever-optimistic CEOs.

When a company says that it contemplates repurchases, it's vital that all shareholder-partners be given the information they need to make an intelligent estimate of value. Providing that information is what Charlie and I try to do in this report. We do not want a partner to sell shares back to the company because he or she has been misled or inadequately informed.

Some sellers, however, may disagree with our calculation of value and others may have found investments that they consider more attractive than Berkshire shares. Some of that second group will be right: There are unquestionably many stocks that will deliver far greater gains than ours.

In addition, certain shareholders will simply decide it's time for them or their families to become net consumers rather than continuing to build capital. Charlie and I have no current interest in joining that group. Perhaps we will become big spenders in our old age.

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For 54 years our managerial decisions at Berkshire have been made from the viewpoint of the shareholders who are staying, not those who are leaving. Consequently, Charlie and I have *never* focused on current-quarter results.

Berkshire, in fact, may be the only company in the Fortune 500 that does not prepare monthly earnings reports or balance sheets. I, of course, regularly view the monthly financial reports of most subsidiaries. But Charlie and I learn of Berkshire's overall earnings and financial position only on a quarterly basis.

Furthermore, Berkshire has no company-wide budget (though many of our subsidiaries find one useful). Our lack of such an instrument means that the parent company has *never* had a quarterly "number" to hit. Shunning the use of this bogey sends an important message to our many managers, reinforcing the culture we prize.

Over the years, Charlie and I have seen all sorts of bad corporate behavior, both accounting and operational, induced by the desire of management to meet Wall Street expectations. What starts as an "innocent" fudge in order to not disappoint "the Street" – say, trade-loading at quarter-end, turning a blind eye to rising insurance losses, or drawing down a "cookie-jar" reserve – can become the first step toward full-fledged fraud. Playing with the numbers "just this once" may well be the CEO's intent; it's seldom the end result. And if it's okay for the boss to cheat a little, it's easy for subordinates to rationalize similar behavior.

At Berkshire, our audience is neither analysts nor commentators: Charlie and I are working for our shareholder-partners. The numbers that flow up to us will be the ones we send on to you.

Non-Insurance Operations – From Lollipops to Locomotives

Let's now look further at Berkshire's most valuable grove – our collection of non-insurance businesses – keeping in mind that we do not wish to unnecessarily hand our competitors information that might be useful to them. Additional details about individual operations can be found on pages K-5 – K-22 and pages K-40 – K-51.

Viewed as a group, these businesses earned pre-tax income in 2018 of $20.8 billion, a 24% increase over 2017. Acquisitions we made in 2018 delivered only a trivial amount of that gain.

I will stick with pre-tax figures in this discussion. But our after-tax gain in 2018 from these businesses was *far* greater – 47% – thanks in large part to the cut in the corporate tax rate that became effective at the beginning of that year. Let's look at why the impact was so dramatic.

Begin with an economic reality: Like it or not, the U.S. Government "owns" an interest in Berkshire's earnings of a size determined by Congress. In effect, our country's Treasury Department holds a special class of our stock – call this holding the AA shares – that receives large "dividends" (that is, tax payments) from Berkshire. In 2017, as in many years before, the corporate tax rate was 35%, which meant that the Treasury was doing very well with its AA shares. Indeed, the Treasury's "stock," which was paying nothing when we took over in 1965, had evolved into a holding that delivered billions of dollars annually to the federal government.

Last year, however, 40% of the government's "ownership" (14/35$^{\text{ths}}$) was returned to Berkshire – free of charge – when the corporate tax rate was reduced to 21%. Consequently, our "A" and "B" shareholders received a major boost in the earnings attributable to *their* shares.

This happening materially increased the intrinsic value of the Berkshire shares you and I own. The same dynamic, moreover, enhanced the intrinsic value of almost all of the stocks Berkshire holds.

Those are the headlines. But there are other factors to consider that tempered our gain. For example, the tax benefits garnered by our large utility operation get passed along to its customers. Meanwhile, the tax rate applicable to the substantial dividends we receive from domestic corporations is little changed at about 13%. (This lower rate has long been logical because our investees have already paid tax on the earnings that they pay to us.) Overall, however, the new law made our businesses and the stocks we own *considerably* more valuable.

Which suggests that we return to the performance of our non-insurance businesses. Our two towering redwoods in this grove are BNSF and Berkshire Hathaway Energy (90.9% owned). Combined, they earned $9.3 billion before tax last year, up 6% from 2017. You can read more about these businesses on pages K-5 – K-10 and pages K-40 – K-45.

Our next five non-insurance subsidiaries, as ranked by earnings (but presented here alphabetically), Clayton Homes, International Metalworking, Lubrizol, Marmon and Precision Castparts, had aggregate pre-tax income in 2018 of $6.4 billion, up from the $5.5 billion these companies earned in 2017.

The next five, similarly ranked and listed (Forest River, Johns Manville, MiTek, Shaw and TTI) earned $2.4 billion pre-tax last year, up from $2.1 billion in 2017.

The remaining non-insurance businesses that Berkshire owns – and there are many – had pre-tax income of $3.6 billion in 2018 vs. $3.3 billion in 2017.

Insurance, "Float," and the Funding of Berkshire

Our property/casualty ("P/C") insurance business – our fifth grove – has been the engine propelling Berkshire's growth since 1967, the year we acquired National Indemnity and its sister company, National Fire & Marine, for $8.6 million. Today, National Indemnity is the largest property/casualty company in the world as measured by net worth.

One reason we were attracted to the P/C business was the industry's business model: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as claims arising from exposure to asbestos, or severe workplace accidents, payments can stretch over many decades.

This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* it has grown, as the following table shows:

Year	*Float (in millions)**
1970	$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2018	122,732

* *Includes float arising from life, annuity and health insurance businesses*.

We may in time experience a decline in float. If so, the decline will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. That structure is by design and is a key component in the unequaled financial strength of our insurance companies. That strength will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, our insurance operation registers an underwriting profit that adds to the investment income the float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that it sometimes causes the P/C industry as a whole to operate at a significant underwriting *loss*. That loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses.

Nevertheless, I like our own prospects. Berkshire's unrivaled financial strength allows us far more flexibility in investing our float than that generally available to P/C companies. The many alternatives available to us are always an advantage and occasionally offer major opportunities. When other insurers are constrained, our choices expand.

Moreover, our P/C companies have an excellent underwriting record. Berkshire has now operated at an underwriting profit for 15 of the past 16 years, the exception being 2017, when our pre-tax loss was $3.2 billion. For the entire 16-year span, our pre-tax gain totaled $27 billion, of which $2 billion was recorded in 2018.

That record is no accident: Disciplined risk evaluation is the daily focus of our insurance managers, who know that the benefits of float can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

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In most cases, the funding of a business comes from two sources – debt and equity. At Berkshire, we have two additional arrows in the quiver to talk about, but let's first address the conventional components.

We use debt sparingly. Many managers, it should be noted, will disagree with this policy, arguing that significant debt juices the returns for equity owners. And these more venturesome CEOs will be right *most* of the time.

At rare and unpredictable intervals, however, credit vanishes and debt becomes financially fatal. A Russian-roulette equation – usually win, occasionally die – may make financial sense for someone who gets a piece of a company's upside but does not share in its downside. But that strategy would be madness for Berkshire. Rational people don't risk what they have and need for what they don't have and don't need.

Most of the debt you see on our consolidated balance sheet – see page K-65 – resides at our railroad and energy subsidiaries, both of them asset-heavy companies. During recessions, the cash generation of these businesses remains bountiful. The debt they use is both appropriate for their operations and *not* guaranteed by Berkshire.

Our level of equity capital is a different story: Berkshire's $349 billion is unmatched in corporate America. By retaining all earnings for a very long time, and allowing compound interest to work its magic, we have amassed funds that have enabled us to purchase and develop the valuable groves earlier described. Had we instead followed a 100% payout policy, we would still be working with the $22 *million* with which we began fiscal 1965.

Beyond using debt and equity, Berkshire has benefitted in a major way from two less-common sources of corporate funding. The larger is the float I have described. So far, those funds, though they are recorded as a huge net *liability* on our balance sheet, have been of more utility to us than an equivalent amount of equity. That's because they have usually been accompanied by underwriting earnings. In effect, we have been *paid* in most years for holding and using other people's money.

As I have often done before, I will emphasize that this happy outcome is far from a sure thing: Mistakes in assessing insurance risks can be huge and can take many years to surface. (Think asbestos.) A major catastrophe that will dwarf hurricanes Katrina and Michael *will* occur – perhaps tomorrow, perhaps many decades from now. "The Big One" may come from a traditional source, such as a hurricane or earthquake, or it may be a total surprise involving, say, a cyber attack having disastrous consequences beyond anything insurers now contemplate. When such a mega-catastrophe strikes, we will get our share of the losses and they will be big – *very* big. Unlike many other insurers, however, we will be looking to add business the next day.

The final funding source – which again Berkshire possesses to an unusual degree – is deferred income taxes. These are liabilities that we will eventually pay but that are meanwhile interest-free.

As I indicated earlier, about $14.7 billion of our $50.5 billion of deferred taxes arises from the unrealized gains in our equity holdings. These liabilities are accrued in our financial statements at the current 21% corporate tax rate but will be paid at the rates prevailing when our investments are sold. Between now and then, we in effect have an interest-free "loan" that allows us to have more money working for us in equities than would otherwise be the case.

A further $28.3 billion of deferred tax results from our being able to accelerate the depreciation of assets such as plant and equipment in calculating the tax we must currently pay. The front-ended savings in taxes that we record gradually reverse in future years. We regularly purchase additional assets, however. As long as the present tax law prevails, this source of funding should trend upward.

Over time, Berkshire's funding base – that's the right-hand side of our balance sheet – should grow, primarily through the earnings we retain. Our job is to put the money retained to good use on the left-hand side, by adding attractive assets.

GEICO and Tony Nicely

That title says it all: The company and the man are inseparable.

Tony joined GEICO in 1961 at the age of 18; I met him in the mid-1970s. At that time, GEICO, after a four-decade record of both rapid growth and outstanding underwriting results, suddenly found itself near bankruptcy. A recently-installed management had grossly underestimated GEICO's loss costs and consequently underpriced its product. It would take many months until those loss-generating policies on GEICO's books – there were no less than 2.3 million of them – would expire and could then be repriced. The company's net worth in the meantime was rapidly approaching zero.

In 1976, Jack Byrne was brought in as CEO to rescue GEICO. Soon after his arrival, I met him, concluded that he was the perfect man for the job, and began to aggressively buy GEICO shares. Within a few months, Berkshire bought about ⅓ of the company, a portion that later grew to roughly ½ without our spending a dime. That stunning accretion occurred because GEICO, after recovering its health, consistently repurchased its shares. All told, this half-interest in GEICO cost Berkshire $47 million, about what you might pay today for a trophy apartment in New York.

Let's now fast-forward 17 years to 1993, when Tony Nicely was promoted to CEO. At that point, GEICO's reputation and profitability had been restored – but not its growth. Indeed, at yearend 1992 the company had only 1.9 million auto policies on its books, far less than its pre-crisis high. In sales volume among U.S. auto insurers, GEICO then ranked an undistinguished seventh.

Late in 1995, after Tony had re-energized GEICO, Berkshire made an offer to buy the remaining 50% of the company for $2.3 billion, about 50 times what we had paid for the first half (and people say I never pay up!). Our offer was successful and brought Berkshire a wonderful, but underdeveloped, company and an equally wonderful CEO, who would move GEICO forward beyond my dreams.

GEICO is now America's Number Two auto insurer, with sales 1,200% greater than it recorded in 1995. Underwriting profits have totaled $15.5 billion (pre-tax) since our purchase, and float available for investment has grown from $2.5 billion to $22.1 billion.

By my estimate, Tony's management of GEICO has increased Berkshire's intrinsic value by more than $50 billion. On top of that, he is a model for everything a manager should be, helping his 40,000 associates to identify and polish abilities they didn't realize they possessed.

Last year, Tony decided to retire as CEO, and on June 30th he turned that position over to Bill Roberts, his long-time partner. I've known and watched Bill operate for several decades, and once again Tony made the right move. Tony remains Chairman and will be helpful to GEICO for the rest of his life. He's incapable of doing less.

All Berkshire shareholders owe Tony their thanks. *I* head the list.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding – 325,442,152 shares – because Berkshire is part of a control group and therefore must account for this investment on the "equity" method. On its balance sheet, Berkshire carries its Kraft Heinz holding at a GAAP figure of $13.8 billion, an amount reduced by our share of the large write-off of intangible assets taken by Kraft Heinz in 2018. At yearend, our Kraft Heinz holding had a market value of $14 billion and a cost basis of $9.8 billion.

			12/31/18	
*Shares**	*Company*	*Percentage of Company Owned*	*Cost***	*Market*
			(in millions)	
151,610,700	American Express Company	17.9	$ 1,287	$ 14,452
255,300,329	Apple Inc.	5.4	36,044	40,271
918,919,000	Bank of America Corp.	9.5	11,650	22,642
84,488,751	The Bank of New York Mellon Corp.	8.8	3,860	3,977
6,789,054	Charter Communications, Inc.	3.0	1,210	1,935
400,000,000	The Coca-Cola Company	9.4	1,299	18,940
65,535,000	Delta Air Lines, Inc.	9.6	2,860	3,270
18,784,698	The Goldman Sachs Group, Inc.	4.9	2,380	3,138
50,661,394	JPMorgan Chase & Co.	1.5	5,605	4,946
24,669,778	Moody's Corporation	12.9	248	3,455
47,890,899	Southwest Airlines Co.	8.7	2,005	2,226
21,938,642	United Continental Holdings Inc.	8.1	1,195	1,837
146,346,999	U.S. Bancorp	9.1	5,548	6,688
43,387,980	USG Corporation	31.0	836	1,851
449,349,102	Wells Fargo & Company	9.8	10,639	20,706
	Others		16,201	22,423
	Total Common Stocks Carried at Market		$ 102,867	$ 172,757

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis.

Charlie and I do *not* view the $172.8 billion detailed above as a collection of ticker symbols – a financial dalliance to be terminated because of downgrades by "the Street," expected Federal Reserve actions, possible political developments, forecasts by economists or whatever else might be the subject *du jour*.

What we see in our holdings, rather, is an assembly of companies that we partly own and that, on a weighted basis, are earning about *20%* on the net tangible equity capital required to run their businesses. These companies, also, earn their profits without employing excessive levels of debt.

Returns of that order by large, established and understandable businesses are remarkable under any circumstances. They are truly mind-blowing when compared against the return that many investors have accepted on bonds over the last decade – 3% or less on 30-year U.S. Treasury bonds, for example.

On occasion, a ridiculously-high purchase price for a given stock will cause a splendid business to become a poor investment – if not permanently, at least for a painfully long period. Over time, however, investment performance converges with business performance. And, as I will next spell out, the record of American business has been extraordinary.

The American Tailwind

On March 11th, it will be 77 years since I first invested in an American business. The year was 1942, I was 11, and I went all in, investing $114.75 I had begun accumulating at age six. What I bought was three shares of Cities Service preferred stock. I had become a capitalist, and it felt good.

Let's now travel back through the two 77-year periods that preceded my purchase. That leaves us starting in 1788, a year prior to George Washington's installation as our first president. Could anyone then have imagined what their new country would accomplish in only three 77-year lifetimes?

During the two 77-year periods prior to 1942, the United States had grown from four million people – about ½ of 1% of the world's population – into the most powerful country on earth. In that spring of 1942, though, it faced a crisis: The U.S. and its allies were suffering heavy losses in a war that we had entered only three months earlier. Bad news arrived daily.

Despite the alarming headlines, almost all Americans believed on that March 11th that the war would be won. Nor was their optimism limited to that victory. Leaving aside congenital pessimists, Americans believed that their children and generations beyond would live far better lives than they themselves had led.

The nation's citizens understood, of course, that the road ahead would not be a smooth ride. It never had been. Early in its history our country was tested by a Civil War that killed 4% of all American males and led President Lincoln to openly ponder whether "a nation so conceived and so dedicated could long endure." In the 1930s, America suffered through the Great Depression, a punishing period of massive unemployment.

Nevertheless, in 1942, when I made my purchase, the nation expected post-war growth, a belief that proved to be well-founded. In fact, the nation's achievements can best be described as breathtaking.

Let's put numbers to that claim: If my $114.75 had been invested in a no-fee S&P 500 index fund, and all dividends had been reinvested, my stake would have grown to be worth (pre-taxes) $606,811 on January 31, 2019 (the latest data available before the printing of this letter). That is a gain of *5,288 for 1.* Meanwhile, a $1 million investment by a tax-free institution of that time – say, a pension fund or college endowment – would have grown to about $5.3 *billion*.

Let me add one additional calculation that I believe will shock you: If that hypothetical institution had paid only *1%* of assets annually to various "helpers," such as investment managers and consultants, its gain would have been *cut in half*, to $2.65 billion. That's what happens over 77 years when the 11.8% annual return actually achieved by the S&P 500 is recalculated at a 10.8% rate.

Those who regularly preach doom because of government budget deficits (as I regularly did myself for many years) might note that our country's national debt has increased roughly 400-fold during the last of my 77-year periods. That's 40,000%! Suppose you had foreseen this increase and panicked at the prospect of runaway deficits and a worthless currency. To "protect" yourself, you might have eschewed stocks and opted instead to buy 3 ¼ ounces of gold with your $114.75.

And what would that supposed protection have delivered? You would now have an asset worth about $4,200, *less than 1% of what* would have been realized from a simple unmanaged investment in American business. The magical metal was no match for the American mettle.

Our country's almost unbelievable prosperity has been gained in a bipartisan manner. Since 1942, we have had seven Republican presidents and seven Democrats. In the years they served, the country contended at various times with a long period of viral inflation, a 21% prime rate, several controversial and costly wars, the resignation of a president, a pervasive collapse in home values, a paralyzing financial panic and a host of other problems. All engendered scary headlines; all are now history.

Christopher Wren, architect of St. Paul's Cathedral, lies buried within that London church. Near his tomb are posted these words of description (translated from Latin): "If you would seek my monument, look around you." Those skeptical of America's economic playbook should heed his message.

In 1788 – to go back to our starting point – there really wasn't much here *except* for a small band of ambitious people and an embryonic governing framework aimed at turning their dreams into reality. Today, the Federal Reserve estimates our household wealth at $108 *trillion*, an amount almost impossible to comprehend.

Remember, earlier in this letter, how I described retained earnings as having been the key to Berkshire's prosperity? So it has been with America. In the nation's accounting, the comparable item is labeled "savings." And save we have. If our forefathers had instead consumed all they produced, there would have been no investment, no productivity gains and no leap in living standards.

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Charlie and I happily acknowledge that much of Berkshire's success has simply been a product of what I think should be called *The American Tailwind*. It is beyond arrogance for American businesses or individuals to boast that they have "done it alone." The tidy rows of simple white crosses at Normandy should shame those who make such claims.

There are also many other countries around the world that have bright futures. About that, we should rejoice: Americans will be both more prosperous and safer if *all* nations thrive. At Berkshire, we hope to invest significant sums across borders.

Over the next 77 years, however, the major source of our gains will almost certainly be provided by The American Tailwind. We are lucky – gloriously lucky – to have that force at our back.

The Annual Meeting

Berkshire's 2019 annual meeting will take place on Saturday, May 4th. If you are thinking about attending – and Charlie and I hope you come – check out the details on pages A-2 – A-3. They describe the same schedule we've followed for some years.

If you can't join us in Omaha, attend via Yahoo's webcast. Andy Serwer and his Yahoo associates do an outstanding job, both in covering the entire meeting and interviewing many Berkshire managers, celebrities, financial experts and shareholders from the U.S. and abroad. The world's knowledge of what goes on in Omaha the first Saturday of every May has grown dramatically since Yahoo came on board. Its coverage begins at 8:45 a.m. CDT and provides Mandarin translation.

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For 54 years, Charlie and I have loved our jobs. Daily, we do what we find interesting, working with people we like and trust. And now our new management structure has made our lives even more enjoyable.

With the whole ensemble – that is, with Ajit and Greg running operations, a great collection of businesses, a Niagara of cash-generation, a cadre of talented managers and a rock-solid culture – your company is in good shape for whatever the future brings.

February 23, 2019

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change in Per-Share Market Value of Berkshire	Annual Percentage Change in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
Compounded Annual Gain – 1965-2019	20.3%	10.0%
Overall Gain – 1964-2019	2,744,062%	19,784%

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

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire earned $81.4 billion in 2019 according to generally accepted accounting principles (commonly called "GAAP"). The components of that figure are $24 billion of operating earnings, $3.7 billion of realized capital gains and a $53.7 billion gain from an increase in the amount of net *unrealized* capital gains that exist in the stocks we hold. Each of those components of earnings is stated on an after-tax basis.

That $53.7 billion gain requires comment. It resulted from a new GAAP rule, imposed in 2018, that requires a company holding equity securities to include in earnings the net change in the *unrealized* gains and losses of those securities. As we stated in last year's letter, neither Charlie Munger, my partner in managing Berkshire, nor I agree with that rule.

The adoption of the rule by the accounting profession, in fact, was a monumental shift in its own thinking. Before 2018, GAAP insisted – with an exception for companies whose business was to trade securities – that unrealized *gains* within a portfolio of stocks were *never* to be included in earnings and unrealized *losses* were to be included *only* if they were deemed "other than temporary." Now, Berkshire must enshrine in each quarter's bottom line – a key item of news for many investors, analysts and commentators – every up and down movement of the stocks it owns, however capricious those fluctuations may be.

Berkshire's 2018 and 2019 years glaringly illustrate the argument we have with the new rule. In 2018, a down year for the stock market, our net unrealized gains *decreased* by $20.6 billion, and we therefore reported GAAP earnings of only $4 billion. In 2019, *rising* stock prices increased net unrealized gains by the aforementioned $53.7 billion, pushing GAAP earnings to the $81.4 billion reported at the beginning of this letter. Those market gyrations led to a crazy 1,900% increase in GAAP earnings!

Meanwhile, in what we might call the real world, as opposed to accounting-land, Berkshire's equity holdings averaged about $200 billion during the two years, and the *intrinsic value* of the stocks we own grew steadily and substantially throughout the period.

Charlie and I urge you to focus on operating earnings – which were little changed in 2019 – and to ignore both quarterly and annual gains or losses from investments, whether these are realized or unrealized.

Our advising that *in no way* diminishes the importance of these investments to Berkshire. Over time, Charlie and I expect our equity holdings – as a group – to deliver *major* gains, albeit in an unpredictable and highly irregular manner. To see why we are optimistic, move on to the next discussion.

The Power of Retained Earnings

In 1924, Edgar Lawrence Smith, an obscure economist and financial advisor, wrote *Common Stocks as Long Term Investments*, a slim book that changed the investment world. Indeed, writing the book changed Smith himself, forcing him to reassess his own investment beliefs.

Going in, he planned to argue that stocks would perform better than bonds during inflationary periods and that bonds would deliver superior returns during deflationary times. That seemed sensible enough. But Smith was in for a shock.

His book began, therefore, with a confession: “These studies are the record of a failure – the failure of facts to sustain a preconceived theory.” Luckily for investors, that failure led Smith to think more deeply about how stocks should be evaluated.

For the crux of Smith’s insight, I will quote an early reviewer of his book, none other than John Maynard Keynes: “I have kept until last what is perhaps Mr. Smith’s most important, and is certainly his most novel, point. Well-managed industrial companies do not, as a rule, distribute to the shareholders the whole of their earned profits. In good years, if not in all years, they retain a part of their profits and put them back into the business. Thus *there is an element of compound interest* (Keynes’ italics) operating in favour of a sound industrial investment. Over a period of years, the real value of the property of a sound industrial is increasing at compound interest, quite apart from the dividends paid out to the shareholders.”

And with that sprinkling of holy water, Smith was no longer obscure.

It’s difficult to understand why retained earnings were unappreciated by investors before Smith’s book was published. After all, it was no secret that mind-boggling wealth had earlier been amassed by such titans as Carnegie, Rockefeller and Ford, all of whom had retained a huge portion of their business earnings to fund growth and produce ever-greater profits. Throughout America, also, there had long been small-time capitalists who became rich following the same playbook.

Nevertheless, when business ownership was sliced into small pieces – “stocks” – buyers in the pre-Smith years usually thought of their shares as a short-term gamble on market movements. Even at their best, stocks were considered speculations. *Gentlemen* preferred bonds.

Though investors were slow to wise up, the math of retaining and reinvesting earnings is now well understood. Today, school children learn what Keynes termed “novel”: combining savings with compound interest works wonders.

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At Berkshire, Charlie and I have long focused on using retained earnings advantageously. Sometimes this job has been easy – at other times, more than difficult, particularly when we began working with huge and ever-growing sums of money.

In our deployment of the funds we retain, we first seek to invest in the many and diverse businesses we already own. During the past decade, Berkshire’s depreciation charges have aggregated $65 billion whereas the company’s *internal* investments in property, plant and equipment have totaled $121 billion. Reinvestment in productive operational assets will forever remain our top priority.

In addition, we constantly seek to buy new businesses that meet three criteria. First, they must earn good returns on the net tangible capital required in their operation. Second, they must be run by able and honest managers. Finally, they must be available at a sensible price.

When we spot such businesses, our preference would be to buy 100% of them. But the opportunities to make major acquisitions possessing our required attributes are rare. Far more often, a fickle stock market serves up opportunities for us to buy large, *but non-controlling*, positions in publicly-traded companies that meet our standards.

Whichever way we go – controlled companies or only a major stake by way of the stock market – Berkshire’s financial results from the commitment will in large part be determined by the future earnings of the business we have purchased. Nonetheless, there is between the two investment approaches a hugely important accounting difference, essential for you to understand.

In our controlled companies, (defined as those in which Berkshire owns more than 50% of the shares), the earnings of each business flow directly into the operating earnings that we report to you. What you see is what you get.

In the non-controlled companies, in which we own marketable stocks, *only* the dividends that Berkshire receives are recorded in the operating earnings we report. The retained earnings? They're working hard and creating much added value, but *not* in a way that deposits those gains directly into Berkshire's reported earnings.

At almost all major companies other than Berkshire, investors would *not* find what we'll call this "non-recognition of earnings" important. For us, however, it is a standout omission, of a magnitude that we lay out for you below.

Here, we list our 10 largest stock-market holdings of businesses. The list distinguishes between their earnings that are reported to you under GAAP accounting – these are the dividends Berkshire receives from those 10 investees – and our share, so to speak, of the earnings the investees retain and put to work. Normally, those companies use retained earnings to expand their business and increase its efficiency. Or sometimes they use those funds to repurchase significant portions of their own stock, an act that enlarges Berkshire's share of the company's future earnings.

		Berkshire's Share (in millions)	
Company	*Yearend Ownership*	*Dividends(1)*	*Retained Earnings(2)*
American Express	18.7%	$ 261	$ 998
Apple	5.7%	773	2,519
Bank of America	10.7%	682	2,167
Bank of New York Mellon	9.0%	101	288
Coca-Cola	9.3%	640	194
Delta Airlines	11.0%	114	416
J.P. Morgan Chase	1.9%	216	476
Moody's	13.1%	55	137
U.S. Bancorp	9.7%	251	407
Wells Fargo	8.4%	705	730
Total		$3,798	$8,332

(1) Based on current annual rate.
(2) Based on 2019 earnings minus common and preferred dividends paid.

Obviously, the realized gains we will eventually record from partially owning each of these companies will not neatly correspond to "our" share of their retained earnings. Sometimes, alas, retentions produce nothing. But both logic and our past experience indicate that from the *group* we will realize capital gains at least equal to – and probably better than – the earnings of ours that they retained. (When we sell shares and realize gains, we will pay income tax on the gain at whatever rate then prevails. Currently, the federal rate is 21%.)

It is certain that Berkshire's rewards from these 10 companies, as well as those from our many other equity holdings, will manifest themselves in a highly irregular manner. Periodically, there will be losses, sometimes company-specific, sometimes linked to stock-market swoons. At other times – last year was one of those – our gain will be outsized. Overall, the retained earnings of our investees are certain to be of *major* importance in the growth of Berkshire's value.

Mr. Smith got it right.

Non-Insurance Operations

Tom Murphy, a valued director of Berkshire and an all-time great among business managers, long ago gave me some important advice about acquisitions: "To achieve a reputation as a good manager, just be sure you buy good businesses."

Over the years Berkshire has acquired many dozens of companies, all of which I initially regarded as "good businesses." Some, however, proved disappointing; more than a few were outright disasters. A reasonable number, on the other hand, have exceeded my hopes.

In reviewing my uneven record, I've concluded that acquisitions are similar to marriage: They start, of course, with a joyful wedding – but then reality tends to diverge from pre-nuptial expectations. Sometimes, wonderfully, the new union delivers bliss beyond either party's hopes. In other cases, disillusionment is swift. Applying those images to corporate acquisitions, I'd have to say it is usually the buyer who encounters unpleasant surprises. It's easy to get dreamy-eyed during corporate courtships.

Pursuing that analogy, I would say that our marital record remains largely acceptable, with all parties happy with the decisions they made long ago. Some of our tie-ups have been positively idyllic. A meaningful number, however, have caused me all too quickly to wonder what I was thinking when I proposed.

Fortunately, the fallout from many of my errors has been reduced by a characteristic shared by most businesses that disappoint: As the years pass, the "poor" business tends to stagnate, thereupon entering a state in which its operations require an ever-smaller *percentage* of Berkshire's capital. Meanwhile, our "good" businesses often tend to grow and find opportunities for investing additional capital at attractive rates. Because of these contrasting trajectories, the assets employed at Berkshire's winners gradually become an expanding portion of our total capital.

As an extreme example of those financial movements, witness Berkshire's original textile business. When we acquired control of the company in early 1965, this beleaguered operation required nearly *all* of Berkshire's capital. For some time, therefore, Berkshire's non-earning textile assets were a huge drag on our overall returns. Eventually, though, we acquired a spread of "good" businesses, a shift that by the early 1980s caused the dwindling textile operation to employ only a tiny portion of our capital.

Today, we have most of your money deployed in controlled businesses that achieve good-to-excellent returns on the net tangible assets each requires for its operations. Our insurance business has been the superstar. That operation has special characteristics that give it a unique metric for calibrating success, one unfamiliar to many investors. We will save that discussion for the next section.

In the paragraphs that follow, we group our wide array of non-insurance businesses by size of earnings, *after* interest, depreciation, taxes, non-cash compensation, restructuring charges – all of those pesky, but very real, costs that CEOs and Wall Street sometimes urge investors to ignore. Additional information about these operations can be found on pages K-6 – K-21 and pages K-40 – K-52.

Our BNSF railroad and Berkshire Hathaway Energy ("BHE") – the two lead dogs of Berkshire's non-insurance group – earned a combined \$8.3 billion in 2019 (including only our 91% share of BHE), an increase of 6% from 2018.

Our next five non-insurance subsidiaries, as ranked by earnings (but presented here alphabetically), Clayton Homes, International Metalworking, Lubrizol, Marmon and Precision Castparts, had aggregate earnings in 2019 of \$4.8 billion, little changed from what these companies earned in 2018.

The next five, similarly ranked and listed (Berkshire Hathaway Automotive, Johns Manville, NetJets, Shaw and TTI) earned \$1.9 billion last year, up from the \$1.7 billion earned by this tier in 2018.

The remaining non-insurance businesses that Berkshire owns – and there are many – had aggregate earnings of $2.7 billion in 2019, down from $2.8 billion in 2018.

Our total net income in 2019 from the non-insurance businesses we control amounted to $17.7 billion, an increase of 3% from the $17.2 billion this group earned in 2018. Acquisitions and dispositions had almost no net effect on these results.

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I must add one final item that underscores the wide scope of Berkshire's operations. Since 2011, we have owned Lubrizol, an Ohio-based company that produces and markets oil additives throughout the world. On September 26, 2019, a fire originating at a small next-door operation spread to a large French plant owned by Lubrizol.

The result was significant property damage and a major disruption in Lubrizol's business. Even so, both the company's property loss and business-interruption loss will be mitigated by substantial insurance recoveries that Lubrizol will receive.

But, as the late Paul Harvey was given to saying in his famed radio broadcasts, "Here's the rest of the story." One of the largest insurers of Lubrizol was a company owned by . . . uh, Berkshire.

In Matthew 6:3, the Bible instructs us to "Let not the left hand know what the right hand doeth." Your chairman has clearly behaved as ordered.

Property/Casualty Insurance

Our property/casualty ("P/C") insurance business has been the engine propelling Berkshire's growth since 1967, the year we acquired National Indemnity and its sister company, National Fire & Marine, for $8.6 million. Today, National Indemnity is the largest P/C company in the world as measured by net worth. Insurance is a business of promises, and Berkshire's ability to honor its commitments is unmatched.

One reason we were attracted to the P/C business was the industry's business model: P/C insurers receive premiums upfront and pay claims later. In extreme cases, such as claims arising from exposure to asbestos, or severe workplace accidents, payments can stretch over many decades.

This collect-now, pay-later model leaves P/C companies holding large sums – money we call "float" – that will eventually go to others. Meanwhile, insurers get to invest this float for their own benefit. Though individual policies and claims come and go, the amount of float an insurer holds usually remains fairly stable in relation to premium volume. Consequently, as our business grows, so does our float. And *how* it has grown, as the following table shows:

Year	*Float (in millions)*
1970	$ 39
1980	237
1990	1,632
2000	27,871
2010	65,832
2018	122,732
2019	129,423

We may in time experience a decline in float. If so, the decline will be *very* gradual – at the outside no more than 3% in any year. The nature of our insurance contracts is such that we can *never* be subject to immediate or near-term demands for sums that are of significance to our cash resources. That structure is by design and is a key component in the unequaled financial strength of our insurance companies. That strength will *never* be compromised.

If our premiums exceed the total of our expenses and eventual losses, our insurance operation registers an underwriting profit that adds to the investment income the float produces. When such a profit is earned, we enjoy the use of free money – and, better yet, get *paid* for holding it.

For the P/C industry as a whole, the financial value of float is now far less than it was for many years. That's because the standard investment strategy for almost all P/C companies is heavily – and *properly* – skewed toward high-grade bonds. Changes in interest rates therefore matter enormously to these companies, and during the last decade the bond market has offered pathetically low rates.

Consequently, insurers suffered, as year by year they were forced – by maturities or issuer-call provisions – to recycle their "old" investment portfolios into new holdings providing much lower yields. Where once these insurers could safely earn 5 cents or 6 cents on each dollar of float, they now take in only 2 cents or 3 cents (or even less if their operations are concentrated in countries mired in the never-never land of negative rates).

Some insurers may try to mitigate their loss of revenue by buying lower-quality bonds or non-liquid "alternative" investments promising higher yields. But those are dangerous games and activities that most institutions are ill-equipped to play.

Berkshire's situation is more favorable than that of insurers in general. Most important, our unrivaled mountain of capital, abundance of cash and a huge and diverse stream of non-insurance earnings allow us far more investment flexibility than is generally available to other companies in the industry. The many choices open to us are always advantageous – and sometimes have presented us with major opportunities.

Our P/C companies have meanwhile had an excellent underwriting record. Berkshire has now operated at an underwriting profit for 16 of the last 17 years, the exception being 2017, when our pre-tax loss was a whopping $3.2 billion. For the entire 17-year span, our pre-tax gain totaled $27.5 billion, of which $400 million was recorded in 2019.

That record is no accident: Disciplined risk evaluation is the daily focus of our insurance managers, who know that the rewards of float can be drowned by poor underwriting results. All insurers give that message lip service. At Berkshire it is a religion, Old Testament style.

As I have repeatedly done in the past, I will emphasize now that happy outcomes in insurance are far from a sure thing: We will most certainly not have an underwriting profit in 16 of the next 17 years. Danger always lurks.

Mistakes in assessing insurance risks can be huge and can take many years – even decades – to surface and ripen. (Think asbestos.) A major catastrophe that will dwarf hurricanes Katrina and Michael *will* occur – perhaps tomorrow, perhaps many decades from now. "The Big One" may come from a traditional source, such as wind or earthquake, or it may be a total surprise involving, say, a cyber attack having disastrous consequences beyond anything insurers now contemplate. When such a mega-catastrophe strikes, Berkshire will get its share of the losses and they will be big – *very* big. Unlike many other insurers, however, handling the loss will not come close to straining our resources, and we will be eager to *add* to our business the next day.

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Close your eyes for a moment and try to envision a locale that might spawn a dynamic P/C insurer. New York? London? Silicon Valley?

How about Wilkes-Barre?

Late in 2012, Ajit Jain, the invaluable manager of our insurance operations, called to tell me that he was buying a tiny company – GUARD Insurance Group – in that small Pennsylvania city for $221 million (roughly its net worth at the time). He added that Sy Foguel, GUARD's CEO, was going to be a star at Berkshire. Both GUARD and Sy were new names to me.

Bingo and bingo: In 2019, GUARD had premium volume of $1.9 billion, up 379% since 2012, and also delivered a satisfactory underwriting profit. Since joining Berkshire, Sy has led the company into both new products and new regions of the country and has increased GUARD's float by 265%.

In 1967, Omaha seemed an unlikely launching pad for a P/C giant. Wilkes-Barre may well deliver a similar surprise.

Berkshire Hathaway Energy

Berkshire Hathaway Energy is now celebrating its 20th year under our ownership. That anniversary suggests that we should be catching up with the company's accomplishments.

We'll start with the topic of electricity rates. When Berkshire entered the utility business in 2000, purchasing 76% of BHE, the company's residential customers in Iowa paid an average of 8.8 cents per kilowatt-hour (kWh). Prices for residential customers have since risen less than 1% a year, and we have promised that there will be no base rate price increases through 2028. In contrast, here's what is happening at the other large investor-owned Iowa utility: Last year, the rates it charged its residential customers were 61% higher than BHE's. Recently, that utility received a rate increase that will widen the gap to 70%.

The extraordinary differential between our rates and theirs is largely the result of our huge accomplishments in converting wind into electricity. In 2021, we expect BHE's operation to generate about 25.2 million megawatt-hours of electricity (MWh) in Iowa from wind turbines that it both owns and operates. That output will totally cover the annual needs of its Iowa customers, which run to about 24.6 million MWh. In other words, our utility will have attained wind self-sufficiency in the state of Iowa.

In still another contrast, that other Iowa utility generates less than 10% of its power from wind. Furthermore, we know of no other investor-owned utility, wherever located, that by 2021 will have achieved a position of wind self-sufficiency. In 2000, BHE was serving an agricultural-based economy; today, three of its five largest customers are high-tech giants. I believe their decisions to site plants in Iowa were in part based upon BHE's ability to deliver renewable, low-cost energy.

Of course, wind is intermittent, and our blades in Iowa turn only part of the time. In certain periods, when the air is still, we look to our non-wind generating capacity to secure the electricity we need. At opposite times, we sell the excess power that wind provides us to other utilities, serving them through what's called "the grid." The power we sell them supplants their need for a carbon resource – coal, say, or natural gas.

Berkshire Hathaway now owns 91% of BHE in partnership with Walter Scott, Jr. and Greg Abel. BHE has never paid Berkshire Hathaway a dividend since our purchase and has, as the years have passed, retained $28 billion of earnings. That pattern is an outlier in the world of utilities, whose companies customarily pay big dividends – sometimes reaching, or even exceeding, 80% of earnings. Our view: The more we can invest, the more we like it.

Today, BHE has the operating talent and experience to manage truly huge utility projects – requiring investments of $100 billion or more – that could support infrastructure benefitting our country, our communities and our shareholders. We stand ready, willing and able to take on such opportunities.

Investments

Below we list our fifteen common stock investments that at yearend had the largest market value. We exclude our Kraft Heinz holding – 325,442,152 shares – because Berkshire is part of a control group and therefore must account for this investment on the "equity" method. On its balance sheet, Berkshire carries the Kraft Heinz holding at a GAAP figure of $13.8 billion, an amount that represents Berkshire's share of the audited net worth of Kraft Heinz at December 31, 2019. Please note, though, that the market value of our shares on that date was only $10.5 billion.

			12/31/19	
*Shares**	*Company*	*Percentage of Company Owned*	*Cost***	*Market*
			(in millions)	
151,610,700	American Express Company	18.7	$ 1,287	$ 18,874
250,866,566	Apple Inc.	5.7	35,287	73,667
947,760,000	Bank of America Corp.	10.7	12,560	33,380
81,488,751	The Bank of New York Mellon Corp.	9.0	3,696	4,101
5,426,609	Charter Communications, Inc.	2.6	944	2,632
400,000,000	The Coca-Cola Company	9.3	1,299	22,140
70,910,456	Delta Air Lines, Inc.	11.0	3,125	4,147
12,435,814	The Goldman Sachs Group, Inc.	3.5	890	2,859
60,059,932	JPMorgan Chase & Co.	1.9	6,556	8,372
24,669,778	Moody's Corporation	13.1	248	5,857
46,692,713	Southwest Airlines Co.	9.0	1,940	2,520
21,938,642	United Continental Holdings Inc.	8.7	1,195	1,933
149,497,786	U.S. Bancorp	9.7	5,709	8,864
10,239,160	Visa Inc.	0.6	349	1,924
345,688,918	Wells Fargo & Company	8.4	7,040	18,598
	Others***		28,215	38,159
	Total Equity Investments Carried at Market		$110,340	$248,027

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis.

*** Includes $10 billion investment in Occidental Petroleum Corporation consisting of preferred stock and warrants to buy common stock.

Charlie and I do *not* view the $248 billion detailed above as a collection of stock market wagers – dalliances to be terminated because of downgrades by "the Street," an earnings "miss," expected Federal Reserve actions, possible political developments, forecasts by economists or whatever else might be the subject *du jour*.

What we see in our holdings, rather, is an assembly of companies that we partly own and that, on a weighted basis, are earning more than *20%* on the net tangible equity capital required to run their businesses. These companies, also, earn their profits without employing excessive levels of debt.

Returns of that order by large, established and understandable businesses are remarkable under any circumstances. They are truly mind-blowing when compared to the returns that many investors have accepted on bonds over the last decade – 2½% or even less on 30-year U.S. Treasury bonds, for example.

Forecasting interest rates has never been our game, and Charlie and I have *no* idea what rates will average over the next year, or ten or thirty years. Our perhaps jaundiced view is that the pundits who opine on these subjects reveal, by that very behavior, far more about themselves than they reveal about the future.

What we *can* say is that *if* something close to current rates should prevail over the coming decades and *if* corporate tax rates also remain near the low level businesses now enjoy, it is almost certain that equities will *over time* perform far better than long-term, fixed-rate debt instruments.

That rosy prediction comes with a warning: *Anything* can happen to stock prices tomorrow. Occasionally, there will be major drops in the market, perhaps of 50% magnitude or even greater. But the combination of The American Tailwind, about which I wrote last year, and the compounding wonders described by Mr. Smith, will make equities the much better long-term choice for the individual who does not use borrowed money and who can control his or her emotions. Others? Beware!

The Road Ahead

Three decades ago, my Midwestern friend, Joe Rosenfield, then in his 80s, received an irritating letter from his local newspaper. In blunt words, the paper asked for biographical data it planned to use in Joe's obituary. Joe didn't respond. So? A month later, he got a second letter from the paper, this one labeled "URGENT."

Charlie and I long ago entered the urgent zone. That's not exactly great news for us. But Berkshire shareholders need not worry: Your company is 100% prepared for our departure.

The two of us base our optimism upon five factors. First, Berkshire's assets are deployed in an extraordinary variety of wholly or partly-owned businesses that, averaged out, earn attractive returns on the capital they use. Second, Berkshire's positioning of its "controlled" businesses within a single entity endows it with some important and enduring economic advantages. Third, Berkshire's financial affairs will unfailingly be managed in a manner allowing the company to withstand external shocks of an extreme nature. Fourth, we possess skilled and *devoted* top managers for whom running Berkshire is far more than simply having a high-paying and/or prestigious job. Finally, Berkshire's directors – your guardians – are constantly focused on both the welfare of owners and the nurturing of a culture that is rare among giant corporations. (The value of this culture is explored in *Margin of Trust*, a new book by Larry Cunningham and Stephanie Cuba that will be available at our annual meeting.)

Charlie and I have very pragmatic reasons for wanting to assure Berkshire's prosperity in the years following our exit: The Mungers have Berkshire holdings that dwarf any of the family's other investments, and I have a full 99% of my net worth lodged in Berkshire stock. I have never sold any shares and have no plans to do so. My only disposal of Berkshire shares, aside from charitable donations and minor personal gifts, took place in 1980, when I, along with other Berkshire stockholders who elected to participate, exchanged some of our Berkshire shares for the shares of an Illinois bank that Berkshire had purchased in 1969 and that, in 1980, needed to be offloaded because of changes in the bank holding company law.

Today, my will specifically directs its executors – as well as the trustees who will succeed them in administering my estate after the will is closed – not to sell *any* Berkshire shares. My will also absolves both the executors and the trustees from liability for maintaining what obviously will be an extreme concentration of assets.

The will goes on to instruct the executors – and, in time, the trustees – to each year convert a portion of my A shares into B shares and then distribute the Bs to various foundations. Those foundations will be required to deploy their grants promptly. In all, I estimate that it will take 12 to 15 years for the entirety of the Berkshire shares I hold at my death to move into the market.

Absent my will's directive that all my Berkshire shares should be held until their scheduled distribution dates, the "safe" course for both my executors and trustees would be to sell the Berkshire shares under their temporary control and reinvest the proceeds in U.S. Treasury bonds with maturities matching the scheduled dates for distributions. That strategy would leave the fiduciaries immune from both public criticism and the possibility of personal liability for failure to act in accordance with the "prudent man" standard.

I myself feel comfortable that Berkshire shares will provide a safe and rewarding investment during the disposal period. There is always a chance – unlikely, but not negligible – that events will prove me wrong. I believe, however, that there is a high probability that my directive will deliver substantially greater resources to society than would result from a conventional course of action.

Key to my "Berkshire-only" instructions is my faith in the future judgment and fidelity of Berkshire directors. They will regularly be tested by Wall Streeters bearing fees. At many companies, these super-salesmen might win. I do not, however, expect that to happen at Berkshire.

Boards of Directors

In recent years, both the composition of corporate boards and their purpose have become hot topics. Once, debate about the responsibilities of boards was largely limited to lawyers; today, institutional investors and politicians have weighed in as well.

My credentials for discussing corporate governance include the fact that, over the last 62 years, I have served as a director of 21 publicly-owned companies (listed below). In all but two of them, I have represented a substantial holding of stock. In a few cases, I have tried to implement important change.

During the first 30 or so years of my services, it was rare to find a woman in the room unless she represented a family controlling the enterprise. This year, it should be noted, marks the 100th anniversary of the 19th Amendment, which guaranteed American women the right to have their voices heard in a voting booth. Their attaining similar status in a board room remains a work in progress.

Over the years, many new rules and guidelines pertaining to board composition and duties have come into being. The bedrock challenge for directors, nevertheless, remains constant: Find and retain a talented CEO – possessing integrity, for sure – who will be *devoted* to the company for his/her business lifetime. Often, that task is hard. When directors get it right, though, they need to do little else. But when they mess it up, ...

Audit committees now work much harder than they once did and almost always view the job with appropriate seriousness. Nevertheless, these committees remain no match for managers who wish to game numbers, an offense that has been encouraged by the scourge of earnings "guidance" and the desire of CEOs to "hit the number." My direct experience (limited, thankfully) with CEOs who have played with a company's numbers indicates that they were more often prompted by ego than by a desire for financial gain.

Compensation committees now rely much more heavily on consultants than they used to. Consequently, compensation arrangements have become more complicated – what committee member wants to explain paying large fees year after year for a *simple* plan? – and the reading of proxy material has become a mind-numbing experience.

One *very* important improvement in corporate governance has been mandated: a regularly-scheduled "executive session" of directors at which the CEO is barred. Prior to that change, truly frank discussions of a CEO's skills, acquisition decisions and compensation were rare.

Acquisition proposals remain a particularly vexing problem for board members. The legal orchestration for making deals has been refined and expanded (a word aptly describing attendant costs as well). But I have yet to see a CEO who craves an acquisition bring in an informed and articulate critic to argue against it. And yes, include me among the guilty.

Berkshire, Blue Chip Stamps, Cap Cities-ABC, Coca-Cola, Data Documents, Dempster, General Growth, Gillette, Kraft Heinz, Maracaibo Oil, Munsingwear, Omaha National Bank, Pinkerton's, Portland Gas Light, Salomon, Sanborn Map, Tribune Oil, U.S. Air, Vornado, Washington Post, Wesco Financial

Overall, the deck is stacked in favor of the deal that's coveted by the CEO and his/her obliging staff. It would be an interesting exercise for a company to hire two "expert" acquisition advisors, one pro and one con, to deliver his or her views on a proposed deal to the board – with the winning advisor to receive, say, ten times a token sum paid to the loser. Don't hold your breath awaiting this reform: The current system, whatever its shortcomings for shareholders, works magnificently for CEOs and the many advisors and other professionals who feast on deals. A venerable caution will forever be true when advice from Wall Street is contemplated: Don't ask the barber whether you need a haircut.

Over the years, board "independence" has become a new area of emphasis. One key point relating to this topic, though, is almost invariably overlooked: Director compensation has now soared to a level that inevitably makes pay a subconscious factor affecting the behavior of many non-wealthy members. Think, for a moment, of the director earning $250,000-300,000 for board meetings consuming a pleasant couple of days six or so times a year. Frequently, the possession of one such directorship bestows on its holder three to four times the *annual* median income of U.S. households. (I missed much of this gravy train: As a director of Portland Gas Light in the early 1960s, I received $100 *annually* for my service. To earn this princely sum, I commuted to Maine four times a year.)

And job security now? It's fabulous. Board members may get politely ignored, but they seldom get fired. Instead, generous age limits – usually 70 or higher – act as the standard method for the genteel ejection of directors.

Is it any wonder that a non-wealthy director ("NWD") now hopes – or even yearns – to be asked to join a second board, thereby vaulting into the $500,000-600,000 class? To achieve this goal, the NWD will need help. The CEO of a company searching for board members will almost certainly check with the NWD's current CEO as to whether NWD is a "good" director. "Good," of course, is a code word. If the NWD has seriously challenged his/her present CEO's compensation or acquisition dreams, his or her candidacy will silently die. When seeking directors, CEOs don't look for pit bulls. It's the cocker spaniel that gets taken home.

Despite the illogic of it all, the director for whom fees are important – indeed, craved – is almost universally classified as "independent" while many directors possessing fortunes very substantially linked to the welfare of the corporation are deemed lacking in independence. Not long ago, I looked at the proxy material of a large American company and found that *eight* directors had never purchased a share of the company's stock *using their own money*. (They, of course, had received *grants* of stock as a supplement to their generous cash compensation.) This particular company had long been a laggard, but the directors were doing wonderfully.

Paid-with-my-own-money ownership, of course, does *not* create wisdom or ensure business smarts. Nevertheless, I feel better when directors of our portfolio companies have had the experience of purchasing shares with their savings, rather than simply having been the recipients of grants.

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Here, a pause is due: I'd like you to know that almost all of the directors I have met over the years have been decent, likable and intelligent. They dressed well, made good neighbors and were fine citizens. I've enjoyed their company. Among the group are some men and women that I would not have met except for our mutual board service and who have become close friends.

Nevertheless, many of these good souls are people whom I would never have chosen to handle money or business matters. It simply was not their game.

They, in turn, would never have asked me for help in removing a tooth, decorating their home or improving their golf swing. Moreover, if I were ever scheduled to appear on *Dancing With the Stars*, I would immediately seek refuge in the Witness Protection Program. We are all duds at one thing or another. For most of us, the list is long. The important point to recognize is that if you are Bobby Fischer, you must play *only* chess for money.

At Berkshire, we will continue to look for business-savvy directors who are owner-oriented and arrive with a strong specific interest in our company. Thought and principles, not robot-like "process," will guide their actions. In representing *your* interests, they will, of course, seek managers whose goals include delighting their customers, cherishing their associates and acting as good citizens of both their communities and our country.

Those objectives are not new. They were the goals of able CEOs sixty years ago and remain so. Who would have it otherwise?

Short Subjects

In past reports, we've discussed both the sense and nonsense of stock repurchases. Our thinking, boiled down: Berkshire will buy back its stock only if a) Charlie and I believe that it is selling for less than it is worth and b) the company, upon completing the repurchase, is left with ample cash.

Calculations of intrinsic value are far from precise. Consequently, neither of us feels any urgency to buy an *estimated* $1 of value for a very real 95 cents. In 2019, the Berkshire price/value equation was *modestly* favorable at times, and we spent $5 billion in repurchasing about 1% of the company.

Over time, we want Berkshire's share count to go *down*. If the price-to-value discount (as we estimate it) widens, we will likely become more aggressive in purchasing shares. We will not, however, prop the stock at any level.

Shareholders having at least $20 million in value of A or B shares and an inclination to sell shares to Berkshire may wish to have their broker contact Berkshire's Mark Millard at 402-346-1400. We request that you phone Mark between 8:00-8:30 a.m. or 3:00-3:30 p.m. Central Time, calling only if you are ready to sell.

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In 2019, Berkshire sent $3.6 billion to the U.S. Treasury to pay its current income tax. The U.S. government collected $243 billion from corporate income tax payments during the same period. From these statistics, you can take pride that your company delivered 1 ½% of the federal income taxes paid by *all* of corporate America.

Fifty-five years ago, when Berkshire entered its current incarnation, the company paid *nothing* in federal income tax. (For good reason, too: Over the previous decade, the struggling business had recorded a net loss.) Since then, as Berkshire retained nearly all of its earnings, the beneficiaries of that policy became not only the company's shareholders but also the federal government. In most future years, we both hope and expect to send *far* larger sums to the Treasury.

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On pages A-2 – A-3, you will find details about our annual meeting, which will be held on May 2, 2020. Yahoo, as usual, will be streaming the event worldwide. There will be one important change, however, in our format: I've had suggestions from shareholders, media and board members that Ajit Jain and Greg Abel – our two key operating managers – be given more exposure at the meeting. That change makes great sense. They are outstanding individuals, both as managers and as human beings, and you should hear more from them.

Shareholders who this year send a question to be asked by our three long-serving journalists may specify that it be posed to Ajit or Greg. They, like Charlie and me, will not have even a hint of what the questions will be.

The journalists will alternate questions with those from the audience, who also can direct questions to any of the four of us. So polish up your zingers.

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On May 2nd, come to Omaha. Meet your fellow capitalists. Buy some Berkshire products. Have fun. Charlie and I – along with the entire Berkshire gang – are looking forward to seeing you.

February 22, 2020

Warren E. Buffett
Chairman of the Board

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change in Per-Share Market Value of Berkshire	Annual Percentage Change in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
Compounded Annual Gain – 1965-2020	20.0%	10.2%
Overall Gain – 1964-2020	2,810,526%	23,454%

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

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Berkshire earned $42.5 billion in 2020 according to generally accepted accounting principles (commonly called "GAAP"). The four components of that figure are $21.9 billion of operating earnings, $4.9 billion of realized capital gains, a $26.7 billion gain from an increase in the amount of net *unrealized* capital gains that exist in the stocks we hold and, finally, an $11 billion *loss* from a write-down in the value of a few subsidiary and affiliate businesses that we own. All items are stated on an after-tax basis.

Operating earnings are what count most, even during periods when they are *not* the largest item in our GAAP total. Our focus at Berkshire is both to increase this segment of our income and to acquire large and favorably-situated businesses. Last year, however, we met neither goal: Berkshire made no sizable acquisitions and operating earnings *fell* 9%. We did, though, increase Berkshire's per-share intrinsic value by both retaining earnings and repurchasing about 5% of our shares.

The two GAAP components pertaining to capital gains or losses (whether realized or unrealized) fluctuate capriciously from year to year, reflecting swings in the stock market. Whatever *today's* figures, Charlie Munger, my long-time partner, and I firmly believe that, over time, Berkshire's capital gains from its investment holdings will be substantial.

As I've emphasized many times, Charlie and I view Berkshire's holdings of marketable stocks – at yearend worth $281 billion – as a collection of *businesses*. We don't control the operations of those companies, but we do share proportionately in their long-term prosperity. From an accounting standpoint, however, our portion of their *earnings* is *not* included in Berkshire's income. Instead, only what these investees pay us in dividends is recorded on our books. Under GAAP, the huge sums that investees retain on our behalf become invisible.

What's out of sight, however, should *not* be out of mind: Those unrecorded retained earnings are usually building value – *lots* of value – for Berkshire. Investees use the withheld funds to expand their business, make acquisitions, pay off debt and, often, to repurchase their stock (an act that increases our share of their future earnings). As we pointed out in these pages last year, retained earnings have propelled American business throughout our country's history. What worked for Carnegie and Rockefeller has, over the years, worked its magic for millions of shareholders as well.

Of course, some of our investees will disappoint, adding little, if anything, to the value of their company by retaining earnings. But others will over-deliver, a few spectacularly. In aggregate, we expect our share of the huge pile of earnings retained by Berkshire's non-controlled businesses (what others would label our equity portfolio) to eventually deliver us an equal or greater amount of capital gains. Over our 56-year tenure, that expectation has been met.

The final component in our GAAP figure – that ugly $11 billion write-down – is almost entirely the quantification of a mistake I made in 2016. That year, Berkshire purchased Precision Castparts (“PCC”), and I paid too much for the company.

No one misled me in any way – I was simply too optimistic about PCC’s normalized profit potential. Last year, my miscalculation was laid bare by adverse developments throughout the aerospace industry, PCC’s most important source of customers.

In purchasing PCC, Berkshire bought a fine company – the best in its business. Mark Donegan, PCC’s CEO, is a passionate manager who consistently pours the same energy into the business that he did before we purchased it. We are lucky to have him running things.

I believe I was right in concluding that PCC would, over time, earn good returns on the net tangible assets deployed in its operations. I was wrong, however, in judging the *average* amount of future earnings and, consequently, wrong in my calculation of the proper price to pay for the business.

PCC is far from my first error of that sort. But it’s a big one.

Two Strings to Our Bow

Berkshire is often labeled a conglomerate, a negative term applied to holding companies that own a hodge-podge of unrelated businesses. And, yes, that describes Berkshire – but only in part. To understand how and why we differ from the prototype conglomerate, let’s review a little history.

Over time, conglomerates have generally limited themselves to buying businesses *in their entirety*. That strategy, however, came with two major problems. One was unsolvable: Most of the truly great businesses had no interest in having *anyone* take them over. Consequently, deal-hungry conglomerateurs had to focus on so-so companies that lacked important and durable competitive strengths. That was not a great pond in which to fish.

Beyond that, as conglomerateurs dipped into this universe of mediocre businesses, they often found themselves required to pay staggering “control” premiums to snare their quarry. Aspiring conglomerateurs knew the answer to this “overpayment” problem: They simply needed to manufacture a vastly overvalued stock of their own that could be used as a “currency” for pricey acquisitions. (“I’ll pay you $10,000 for your dog by giving you two of my $5,000 cats.”)

Often, the tools for fostering the overvaluation of a conglomerate’s stock involved promotional techniques and “imaginative” accounting maneuvers that were, at best, deceptive and that sometimes crossed the line into fraud. When these tricks were “successful,” the conglomerate pushed its own stock to, say, 3x its business value in order to offer the target 2x *its* value.

Investing illusions can continue for a surprisingly long time. Wall Street loves the fees that deal-making generates, and the press loves the stories that colorful promoters provide. At a point, also, the soaring price of a promoted stock can itself become the “proof” that an illusion is reality.

Eventually, of course, the party ends, and many business “emperors” are found to have no clothes. Financial history is replete with the names of famous conglomerateurs who were initially lionized as business geniuses by journalists, analysts and investment bankers, but whose creations ended up as business junkyards.

Conglomerates *earned* their terrible reputation.

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Charlie and I want our conglomerate to *own* all or part of a diverse group of businesses with good economic characteristics and good managers. Whether Berkshire *controls* these businesses, however, is unimportant to us.

It took me a while to wise up. But Charlie – and also my 20-year struggle with the textile operation I inherited at Berkshire – finally convinced me that owning a non-controlling portion of a wonderful business is more profitable, more enjoyable and *far* less work than struggling with 100% of a marginal enterprise.

For those reasons, *our* conglomerate will remain a collection of controlled *and* non-controlled businesses. Charlie and I will simply deploy your capital into whatever we believe makes the most sense, based on a company’s durable competitive strengths, the capabilities and character of its management, and price.

If that strategy requires little or no effort on our part, so much the better. In contrast to the scoring system utilized in diving competitions, you are awarded *no* points in business endeavors for “degree of difficulty.” Furthermore, as Ronald Reagan cautioned: “It’s said that hard work never killed anyone, but *I* say why take the chance?”

The Family Jewels and How We Increase Your Share of These Gems

On page A-1 we list Berkshire’s subsidiaries, a smorgasbord of businesses employing 360,000 at yearend. You can read much more about these controlled operations in the 10-K that fills the back part of this report. Our major positions in companies that we partly own and *don’t* control are listed on page 7 of this letter. That portfolio of businesses, too, is large and diverse.

Most of Berkshire’s value, however, resides in four businesses, three controlled and one in which we have only a 5.4% interest. All four are jewels.

The largest in value is our property/casualty insurance operation, which for 53 years has been the core of Berkshire. Our family of insurers is unique in the insurance field. So, too, is its manager, Ajit Jain, who joined Berkshire in 1986.

Overall, the insurance fleet operates with *far* more capital than is deployed by any of its competitors worldwide. That financial strength, coupled with the huge flow of *cash* Berkshire annually receives from its *non-insurance* businesses, allows our insurance companies to safely follow an equity-heavy investment strategy not feasible for the overwhelming majority of insurers. Those competitors, for both regulatory and credit-rating reasons, *must* focus on bonds.

And bonds are *no*t the place to be these days. Can you believe that the income recently available from a 10-year U.S. Treasury bond – the yield was 0.93% at yearend – had fallen *94%* from the 15.8% yield available in September 1981? In certain large and important countries, such as Germany and Japan, investors earn a *negative* return on trillions of dollars of sovereign debt. Fixed-income investors worldwide – whether pension funds, insurance companies or retirees – face a bleak future.

Some insurers, as well as other bond investors, may try to juice the pathetic returns now available by shifting their purchases to obligations backed by shaky borrowers. Risky loans, however, are *not* the answer to inadequate interest rates. Three decades ago, the once-mighty savings and loan industry destroyed itself, partly by ignoring that maxim.

Berkshire now enjoys $138 billion of insurance "float" – funds that do not belong to us, but are nevertheless ours to deploy, whether in bonds, stocks or cash equivalents such as U.S. Treasury bills. Float has some similarities to bank deposits: cash flows in and out daily to insurers, with the total they hold changing very little. The massive sum held by Berkshire is likely to remain near its present level for many years and, on a cumulative basis, has been *costless* to us. That happy result, of course, could change – but, over time, I like our odds.

I have repetitiously – some might say endlessly – explained our insurance operation in my annual letters to you. Therefore, I will this year ask new shareholders who wish to learn more about our insurance business and "float" to read the pertinent section of the 2019 report, reprinted on page A-2. It's important that you understand the risks, as well as the opportunities, existing in our insurance activities.

Our second and third most valuable assets – it's pretty much a toss-up at this point – are Berkshire's 100% ownership of BNSF, America's largest railroad measured by freight volume, and our 5.4% ownership of Apple. And in the fourth spot is our 91% ownership of Berkshire Hathaway Energy ("BHE"). What we have here is a very unusual utility business, whose annual earnings have grown from $122 million to $3.4 *billion* during our 21 years of ownership.

I'll have more to say about BNSF and BHE later in this letter. For now, however, I would like to focus on a practice Berkshire will periodically use to enhance *your* interest in both its "Big Four" as well as the many other assets Berkshire owns.

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Last year we demonstrated our enthusiasm for Berkshire's spread of properties by repurchasing the equivalent of 80,998 "A" shares, spending $24.7 billion in the process. That action increased *your* ownership in *all* of Berkshire's businesses by 5.2% *without* requiring you to so much as touch your wallet.

Following criteria Charlie and I have long recommended, we made those purchases because we believed they would both enhance the intrinsic value per share for continuing shareholders *and* would leave Berkshire with more than ample funds for any opportunities or problems it might encounter.

In no way do we think that Berkshire shares should be repurchased at simply any price. I emphasize that point because American CEOs have an embarrassing record of devoting more company funds to repurchases when prices have risen than when they have tanked. Our approach is exactly the reverse.

Berkshire's investment in Apple vividly illustrates the power of repurchases. We began buying Apple stock late in 2016 and by early July 2018, owned slightly more than one billion Apple shares (split-adjusted). Saying that, I'm referencing the investment held in Berkshire's general account and am excluding a very small and separately-managed holding of Apple shares that was subsequently sold. When we finished our purchases in mid-2018, Berkshire's general account owned 5.2% of Apple.

Our cost for that stake was $36 billion. Since then, we have both enjoyed regular dividends, averaging about $775 million annually, and have also – in 2020 – pocketed an additional $11 billion by selling a small portion of our position.

Despite that sale – voila! – Berkshire now owns 5.4% of Apple. That increase was *costless* to us, coming about because Apple has continuously repurchased its shares, thereby substantially shrinking the number it now has outstanding.

But that's far from all of the good news. Because we also repurchased *Berkshire* shares during the 2½ years, *you* now indirectly own a full 10% more of Apple's assets and future earnings than you did in July 2018.

This agreeable dynamic continues. Berkshire has repurchased more shares since yearend and is likely to further reduce its share count in the future. Apple has publicly stated an intention to repurchase its shares as well. As these reductions occur, Berkshire shareholders will not only own a greater interest in our insurance group and in BNSF and BHE, but will also find their indirect ownership of Apple increasing as well.

The math of repurchases grinds away slowly, but can be powerful over time. The process offers a simple way for investors to own an ever-expanding portion of exceptional businesses.

And as a sultry Mae West assured us: "Too much of a good thing can be . . . wonderful."

Investments

Below we list our fifteen common stock investments that at yearend were our largest in market value. We exclude our Kraft Heinz holding — 325,442,152 shares — because Berkshire is part of a control group and therefore must account for that investment using the "equity" method. On its balance sheet, Berkshire carries the Kraft Heinz holding at a GAAP figure of $13.3 billion, an amount that represents Berkshire's share of the audited net worth of Kraft Heinz on December 31, 2020. Please note, though, that the market value of our shares on that date was only $11.3 billion.

			12/31/20	
*Shares**	*Company*	*Percentage of Company Owned*	*Cost***	*Market*
			(in millions)	
25,533,082	AbbVie Inc.	1.4	$ 2,333	$ 2,736
151,610,700	American Express Company	18.8	1,287	18,331
907,559,761	Apple Inc.	5.4	31,089	120,424
1,032,852,006	Bank of America Corp.	11.9	14,631	31,306
66,835,615	The Bank of New York Mellon Corp.	7.5	2,918	2,837
225,000,000	BYD Co. Ltd.	8.2	232	5,897
5,213,461	Charter Communications, Inc.	2.7	904	3,449
48,498,965	Chevron Corporation	2.5	4,024	4,096
400,000,000	The Coca-Cola Company	9.3	1,299	21,936
52,975,000	General Motors Company	3.7	1,616	2,206
81,304,200	Itochu Corporation	5.1	1,862	2,336
28,697,435	Merck & Co., Inc.	1.1	2,390	2,347
24,669,778	Moody's Corporation	13.2	248	7,160
148,176,166	U.S. Bancorp	9.8	5,638	6,904
146,716,496	Verizon Communications Inc.	3.5	8,691	8,620
	Others***		29,458	40,585
	Total Equity Investments Carried at Market		$ 108,620	$ 281,170

* Excludes shares held by pension funds of Berkshire subsidiaries.

** This is our actual purchase price and also our tax basis.

*** Includes a $10 billion investment in Occidental Petroleum, consisting of preferred stock and warrants to buy common stock, a combination now being valued at $9 billion.

A Tale of Two Cities

Success stories abound throughout America. Since our country's birth, individuals with an idea, ambition and often just a pittance of capital have succeeded beyond their dreams by creating something new or by improving the customer's experience with something old.

Charlie and I journeyed throughout the nation to join with many of these individuals or their families. On the West Coast, we began the routine in 1972 with our purchase of See's Candy. A full century ago, Mary See set out to deliver an age-old product that she had reinvented with special recipes. Added to her business plan were quaint stores staffed by friendly salespeople. Her first small outlet in Los Angeles eventually led to several hundred shops, spread throughout the West.

Today, Mrs. See's creations continue to delight customers while providing life-long employment for thousands of women and men. Berkshire's job is simply not to meddle with the company's success. When a business manufactures and distributes a non-essential consumer product, the *customer* is the boss. And, after 100 years, the customer's message to Berkshire remains clear: "Don't mess with *my* candy." (The website is https://www.sees.com/; try the peanut brittle.)

Let's move across the continent to Washington, D.C. In 1936, Leo Goodwin, along with his wife, Lillian, became convinced that auto insurance – a standardized product customarily purchased from agents – could be sold directly at a much lower price. Armed with $100,000, the pair took on giant insurers possessing 1,000 times or more their capital. Government Employees Insurance Company (later shortened to GEICO) was on its way.

By luck, I was exposed to the company's potential a full 70 years ago. It instantly became my first love (of an investment sort). You know the rest of the story: Berkshire eventually became the 100% owner of GEICO, which at 84 years of age is constantly fine-tuning – but not changing – the vision of Leo and Lillian.

There has been, however, a change in the company's size. In 1937, its first full year of operation, GEICO did $238,288 of business. Last year the figure was $35 billion.

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Today, with much of finance, media, government and tech located in coastal areas, it's easy to overlook the many miracles occurring in middle America. Let's focus on two communities that provide stunning illustrations of the talent and ambition existing *throughout* our country.

You will not be surprised that I begin with Omaha.

In 1940, Jack Ringwalt, a graduate of Omaha's Central High School (the alma mater as well of Charlie, my dad, my first wife, our three children and two grandchildren), decided to start a property/casualty insurance company funded by $125,000 in capital.

Jack's dream was preposterous, requiring his pipsqueak operation – somewhat pompously christened as National Indemnity – to compete with giant insurers, all of which operated with abundant capital. Additionally, those competitors were solidly entrenched with nationwide networks of well-funded and long-established local agents. Under Jack's plan, National Indemnity, unlike GEICO, would itself use whatever agencies deigned to accept it and consequently enjoy *no* cost advantage in its acquisition of business. To overcome those formidable handicaps, National Indemnity focused on "odd-ball" risks, which were deemed unimportant by the "big boys." And, improbably, the strategy succeeded.

Jack was honest, shrewd, likeable and a bit quirky. In particular, he disliked regulators. When he periodically became annoyed with their supervision, he would feel an urge to sell his company.

Fortunately, I was nearby on one of those occasions. Jack liked the idea of joining Berkshire, and we made a deal in 1967, taking all of 15 minutes to reach a handshake. I never asked for an audit.

Today National Indemnity is the *only* company in the world prepared to insure certain giant risks. And, yes, it remains based in Omaha, a few miles from Berkshire's home office.

Over the years, we have purchased four additional businesses from Omaha families, the best known among them being Nebraska Furniture Mart ("NFM"). The company's founder, Rose Blumkin ("Mrs. B"), arrived in Seattle in 1915 as a Russian emigrant, unable to read or speak English. She settled in Omaha several years later and by 1936 had saved $2,500 with which to start a furniture store.

Competitors and suppliers ignored her, and for a time their judgment seemed correct: World War II stalled her business, and at yearend 1946, the company's net worth had grown to only $72,264. Cash, both in the till and on deposit, totaled $50 (that's not a typo).

One invaluable asset, however, went unrecorded in the 1946 figures: Louie Blumkin, Mrs. B's only son, had rejoined the store after four years in the U.S. Army. Louie fought at Normandy's Omaha Beach following the D-Day invasion, earned a Purple Heart for injuries sustained in the Battle of the Bulge, and finally sailed home in November 1945.

Once Mrs. B and Louie were reunited, there was no stopping NFM. Driven by their dream, mother and son worked days, nights and weekends. The result was a retailing miracle.

By 1983, the pair had created a business worth $60 million. That year, on my birthday, Berkshire purchased 80% of NFM, again without an audit. I counted on Blumkin family members to run the business; the third and fourth generation do so today. Mrs. B, it should be noted, worked daily until she was 103 – a ridiculously premature retirement age as judged by Charlie and me.

NFM now owns the three largest home-furnishings stores in the U.S. Each set a sales record in 2020, a feat achieved despite the closing of NFM's stores for more than six weeks because of COVID-19.

A post-script to this story says it all: When Mrs. B's large family gathered for holiday meals, she always asked that they sing a song before eating. Her selection never varied: Irving Berlin's "God Bless America."

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Let's move somewhat east to Knoxville, the third largest city in Tennessee. There, Berkshire has ownership in *two* remarkable companies – Clayton Homes (100% owned) and Pilot Travel Centers (38% owned now, but headed for 80% in 2023).

Each company was started by a young man who had graduated from the University of Tennessee and stayed put in Knoxville. Neither had a meaningful amount of capital nor wealthy parents.

But, so what? Today, Clayton and Pilot each have *annual* pre-tax earnings of more than *$1 billion*. Together they employ about 47,000 men and women.

Jim Clayton, after several other business ventures, founded Clayton Homes on a shoestring in 1956, and "Big Jim" Haslam started what became Pilot Travel Centers in 1958 by purchasing a service station for $6,000. Each of the men later brought into the business a son with the same passion, values and brains as his father. Sometimes there is a magic to genes.

"Big Jim" Haslam, now 90, has recently authored an inspirational book in which he relates how Jim *Clayton*'s son, Kevin, encouraged the Haslams to sell a large portion of Pilot to Berkshire. Every retailer knows that satisfied customers are a store's best salespeople. That's true when businesses are changing hands as well.

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When you next fly over Knoxville or Omaha, tip your hat to the Claytons, Haslams and Blumkins as well as to the army of successful entrepreneurs who populate every part of our country. These builders needed America's framework for prosperity – a unique experiment when it was crafted in 1789 – to achieve their potential. In turn, America needed citizens like Jim C., Jim H., Mrs. B and Louie to accomplish the miracles our founding fathers sought.

Today, many people forge similar miracles *throughout* the world, creating a spread of prosperity that benefits *all* of humanity. In its brief 232 years of existence, however, there has been *no* incubator for unleashing human potential like America. Despite some severe interruptions, our country's economic progress has been breathtaking.

Beyond that, we retain our constitutional aspiration of becoming "a more perfect union." Progress on that front has been slow, uneven and often discouraging. We have, however, moved forward and will continue to do so.

Our unwavering conclusion: *Never* bet against America.

The Berkshire Partnership

Berkshire is a Delaware corporation, and our directors must follow the state's laws. Among them is a requirement that board members *must* act in the best interest of the corporation and its stockholders. Our directors embrace that doctrine.

In addition, of course, Berkshire directors want the company to delight its customers, to develop and reward the talents of its 360,000 associates, to behave honorably with lenders and to be regarded as a good citizen of the many cities and states in which we operate. We value these four important constituencies.

None of these groups, however, have a *vote* in determining such matters as dividends, strategic direction, CEO selection, or acquisitions and divestitures. Responsibilities like those fall *solely* on Berkshire's directors, who must faithfully represent the long-term interests of the corporation and its *owners*.

Beyond legal requirements, Charlie and I feel a special obligation to the many *individual* shareholders of Berkshire. A bit of personal history may help you to understand our unusual attachment and how it shapes our behavior.

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Before my Berkshire years, I managed money for many individuals through a series of partnerships, the first three of those formed in 1956. As time passed, the use of multiple entities became unwieldy and, in 1962, we amalgamated 12 partnerships into a single unit, Buffett Partnership Ltd. ("BPL").

By that year, virtually all of my own money, and that of my wife as well, had become invested alongside the funds of my many limited partners. I received no salary or fees. Instead, as the general partner, I was compensated by my limited partners only after they secured returns above an annual threshold of 6%. If returns failed to meet that level, the shortfall was to be carried forward against my share of future profits. (Fortunately, that never happened: Partnership returns always exceeded the 6% "bogey.") As the years went by, a large part of the resources of my parents, siblings, aunts, uncles, cousins and in-laws became invested in the partnership.

Charlie formed his partnership in 1962 and operated much as I did. Neither of us had *any* institutional investors, and very few of our partners were financially sophisticated. The people who joined our ventures simply trusted us to treat their money as we treated our own. These individuals – either intuitively or by relying on the advice of friends – correctly concluded that Charlie and I had an extreme aversion to permanent loss of capital and that we would not have accepted their money unless we expected to do reasonably well with it.

I stumbled into *business* management after BPL acquired control of Berkshire in 1965. Later still, in 1969, we decided to dissolve BPL. After yearend, the partnership distributed, pro-rata, all of its cash along with three stocks, the largest by value being BPL's 70.5% interest in Berkshire.

Charlie, meanwhile, wound up his operation in 1977. Among the assets he distributed to partners was a major interest in Blue Chip Stamps, a company his partnership, Berkshire and I jointly controlled. Blue Chip was also among the three stocks my partnership had distributed upon its dissolution.

In 1983, Berkshire and Blue Chip merged, thereby expanding Berkshire's base of registered shareholders from 1,900 to 2,900. Charlie and I wanted everyone – old, new and *prospective* shareholders – to be on the same page.

Therefore, the 1983 annual report – up front – laid out Berkshire's "major business principles." The *first* principle began: "Although our form is corporate, our attitude is partnership." That defined our relationship in 1983; it defines it today. Charlie and I – and our directors as well – believe this dictum will serve Berkshire well for many decades to come.

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Ownership of Berkshire now resides in five large "buckets," one occupied by me as a "founder" of sorts. That bucket is certain to empty as the shares I own are annually distributed to various philanthropies.

Two of the remaining four buckets are filled by institutional investors, each handling *other people's money*. That, however, is where the similarity between those buckets ends: Their investing procedures could not be more different.

In one institutional bucket are index funds, a large and mushrooming segment of the investment world. These funds simply mimic the index that they track. The favorite of index investors is the S&P 500, of which Berkshire is a component. Index funds, it should be emphasized, own Berkshire shares simply because they are *required* to do so. They are on automatic pilot, buying and selling *only* for "weighting" purposes.

In the other institutional bucket are professionals who *manage* their clients' money, whether those funds belong to wealthy individuals, universities, pensioners or whomever. These professional managers have a mandate to move funds from one investment to another based on their judgment as to valuation and prospects. That is an honorable, though difficult, occupation.

We are happy to work for this "active" group, while they meanwhile search for a better place to deploy the funds of their clientele. Some managers, to be sure, have a long-term focus and trade very infrequently. Others use computers employing algorithms that may direct the purchase or sale of shares in a nano-second. Some professional investors will come and go based upon their macro-economic judgments.

Our fourth bucket consists of individual shareholders who operate in a manner similar to the active institutional managers I've just described. These owners, understandably, think of their Berkshire shares as a possible source of funds when they see another investment that excites them. We have no quarrel with that attitude, which is similar to the way we look at *some* of the equities we own at Berkshire.

All of that said, Charlie and I would be less than human if we did not feel a special kinship with our fifth bucket: the million-plus *individual* investors who simply trust us to represent their interests, whatever the future may bring. They have joined us with no intent to leave, adopting a mindset similar to that held by our original partners. Indeed, many investors from our partnership years, and/or their descendants, remain substantial owners of Berkshire.

A prototype of those veterans is Stan Truhlsen, a cheerful and generous Omaha ophthalmologist as well as personal friend, who turned 100 on November 13, 2020. In 1959, Stan, along with 10 other young Omaha doctors, formed a partnership with me. The docs creatively labeled their venture Emdee, Ltd. Annually, they joined my wife and me for a celebratory dinner at our home.

When our partnership distributed its Berkshire shares in 1969, *all* of the doctors kept the stock they received. They may not have known the ins and outs of investing or accounting, but they *did* know that at Berkshire they would be treated as partners.

Two of Stan's comrades from Emdee are now in their high-90s and continue to hold Berkshire shares. This group's startling durability – along with the fact that Charlie and I are 97 and 90, respectively – serves up an interesting question: Could it be that Berkshire ownership fosters longevity?

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Berkshire's unusual and valued family of individual shareholders may add to your understanding of our reluctance to court Wall Street analysts and institutional investors. We *already have* the investors we want and don't think that they, on balance, would be upgraded by replacements.

There are only so many seats – that is, shares outstanding – available for Berkshire ownership. And we very much like the people already occupying them.

Of course, some turnover in "partners" will occur. Charlie and I hope, however, that it will be minimal. Who, after all, seeks rapid turnover in friends, neighbors or marriage?

In 1958, Phil Fisher wrote a superb book on investing. In it, he analogized running a public company to managing a restaurant. If you are seeking diners, he said, you can attract a clientele and prosper featuring *either* hamburgers served with a Coke *or* a French cuisine accompanied by exotic wines. But you must not, Fisher warned, capriciously switch from one to the other: Your message to potential customers must be consistent with what they will find upon entering your premises.

At Berkshire, we have been serving hamburgers and Coke for 56 years. We cherish the clientele this fare has attracted.

The tens of millions of other investors and speculators in the United States and elsewhere have a wide variety of equity choices to fit *their* tastes. They will find CEOs and market gurus with enticing ideas. If they want price targets, managed earnings and "stories," they will not lack suitors. "Technicians" will confidently instruct them as to what some wiggles on a chart portend for a stock's next move. The calls for action will never stop.

Many of those investors, I should add, will do quite well. After all, ownership of stocks is very much a "positive-sum" game. Indeed, a patient and level-headed monkey, who constructs a portfolio by throwing 50 darts at a board listing all of the S&P 500, will – *over time* – enjoy dividends and capital gains, just as long as it *never* gets tempted to make changes in its original "selections."

Productive assets such as farms, real estate and, yes, business ownership *produce* wealth – lots of it. Most owners of such properties will be rewarded. All that's required is the passage of time, an inner calm, ample diversification and a minimization of transactions and fees. Still, investors must never forget that their *expenses* are Wall Street's *income*. And, unlike my monkey, Wall Streeters do not work for peanuts.

When seats open up at Berkshire – and we hope they are few – we want them to be occupied by newcomers who understand and desire what we offer. After decades of management, Charlie and I remain unable to promise results. We *can* and *do*, however, pledge to treat you as partners.

And so, too, will our successors.

A Berkshire Number that May Surprise You

Recently, I learned a fact about our company that I had never suspected: Berkshire owns *American-based* property, plant and equipment – the sort of assets that make up the "business infrastructure" of our country – with a GAAP valuation exceeding the amount owned by *any* other U.S. company. Berkshire's depreciated cost of these *domestic* "fixed assets" is $154 billion. Next in line on this list is AT&T, with property, plant and equipment of $127 billion.

Our leadership in fixed-asset ownership, I should add, does *not*, in itself, signal an investment triumph. The *best* results occur at companies that require *minimal* assets to conduct high-margin businesses – *and* offer goods or services that will expand their sales volume with only minor needs for additional capital. We, in fact, own a few of these exceptional businesses, but they are relatively small and, at best, grow slowly.

Asset-heavy companies, however, can be *good* investments. Indeed, we are delighted with our two giants – BNSF and BHE: In 2011, Berkshire's first full year of BNSF ownership, the two companies had combined earnings of $4.2 billion. In 2020, a tough year for many businesses, the pair earned $8.3 billion.

BNSF and BHE will require major capital expenditures for decades to come. The good news is that both are likely to deliver appropriate returns on the incremental investment.

Let's look first at BNSF. Your railroad carries about 15% of all non-local ton-miles (a ton of freight moved one mile) of goods that move in the United States, whether by rail, truck, pipeline, barge or aircraft. By a significant margin, BNSF's loads top those of any other carrier.

The history of American railroads is fascinating. After 150 years or so of frenzied construction, skullduggery, overbuilding, bankruptcies, reorganizations and mergers, the railroad industry finally emerged a few decades ago as mature and rationalized.

BNSF began operations in 1850 with a 12-mile line in northeastern Illinois. Today, it has 390 antecedents whose railroads have been purchased or merged. The company's extensive lineage is laid out at http://www.bnsf.com/bnsf-resources/pdf/about-bnsf/History_and_Legacy.pdf.

Berkshire acquired BNSF early in 2010. Since our purchase, the railroad has invested $41 billion in fixed assets, an outlay $20 billion in excess of its depreciation charges. Railroading is an outdoor sport, featuring mile-long trains obliged to reliably operate in both extreme cold and heat, as they all the while encounter every form of terrain from deserts to mountains. Massive flooding periodically occurs. BNSF owns 23,000 miles of track, spread throughout 28 states, and must spend whatever it takes to maximize safety and service throughout its vast system.

Nevertheless, BNSF has paid substantial dividends to Berkshire – $41.8 billion in total. The railroad pays us, however, only what remains after it both fulfills the needs of its business and maintains a cash balance of about $2 billion. This conservative policy allows BNSF to borrow at low rates, independent of any guarantee of its debt by Berkshire.

One further word about BNSF: Last year, Carl Ice, its CEO, and his number two, Katie Farmer, did an extraordinary job in controlling expenses while navigating a significant downturn in business. Despite a 7% decline in the volume of goods carried, the two actually increased BNSF's profit margin by 2.9 percentage points. Carl, as long planned, retired at yearend and Katie took over as CEO. Your railroad is in good hands.

BHE, unlike BNSF, pays *no* dividends on its common stock, a highly-unusual practice in the electric-utility industry. That Spartan policy has been the case throughout our 21 years of ownership. Unlike railroads, our country's electric utilities need a massive makeover in which the ultimate costs will be staggering. The effort will absorb all of BHE's earnings for decades to come. We welcome the challenge and believe the added investment will be appropriately rewarded.

Let me tell you about one of BHE's endeavors – its $18 billion commitment to rework and expand a substantial portion of the outdated grid that now transmits electricity throughout the West. BHE began this project in 2006 and expects it to be completed by 2030 – yes, 2030.

The advent of renewable energy made our project a societal necessity. Historically, the coal-based generation of electricity that long prevailed was located close to huge centers of population. The best sites for the new world of wind and solar generation, however, are often in remote areas. When BHE assessed the situation in 2006, it was no secret that a huge investment in western transmission lines had to be made. Very few companies or governmental entities, however, were in a financial position to raise their hand after they tallied the project's cost.

BHE's decision to proceed, it should be noted, was based upon its trust in America's political, economic and judicial systems. Billions of dollars needed to be invested before meaningful revenue would flow. Transmission lines had to cross the borders of states and other jurisdictions, each with its own rules and constituencies. BHE would also need to deal with hundreds of landowners and execute complicated contracts with both the suppliers that generated renewable power and the far-away utilities that would distribute the electricity to their customers. Competing interests and defenders of the old order, along with unrealistic visionaries desiring an instantly-new world, had to be brought on board.

Both surprises and delays were certain. Equally certain, however, was the fact that BHE had the managerial talent, the institutional commitment and the financial wherewithal to fulfill its promises. Though it will be many years before our western transmission project is completed, we are today searching for other projects of similar size to take on.

Whatever the obstacles, BHE will be a leader in delivering ever-cleaner energy.

The Annual Meeting

Last year, on February 22nd, I wrote you about our plans for a gala annual meeting. Within a month, the schedule was junked.

Our home office group, led by Melissa Shapiro and Marc Hamburg, Berkshire's CFO, quickly regrouped. Miraculously, their improvisations worked. Greg Abel, one of Berkshire's Vice Chairmen, joined me on stage facing a dark arena, 18,000 empty seats and a camera. There was no rehearsal: Greg and I arrived about 45 minutes before "showtime."

Debbie Bosanek, my incredible assistant who joined Berkshire 47 years ago at age 17, had put together about 25 slides displaying various facts and figures that I had assembled at home. An anonymous but highly-capable team of computer and camera operators projected the slides onto the screen in proper order.

Yahoo streamed the proceedings to a record-sized international audience. Becky Quick of CNBC, operating from her home in New Jersey, selected questions from thousands that shareholders had earlier submitted or that viewers had emailed to her during the four hours Greg and I were on stage. See's peanut brittle and fudge, along with Coca-Cola, provided us with nourishment.

This year, on May 1st, we are planning to go one better. Again, we will rely on Yahoo and CNBC to perform flawlessly. Yahoo will go live at 1 p.m. Eastern Daylight Time ("EDT"). Simply navigate to https://finance.yahoo.com/brklivestream.

Our formal meeting will commence at 5:00 p.m. EDT and should finish by 5:30 p.m. Earlier, between 1:30-5:00, we will answer your questions as relayed by Becky. As always, we will have no foreknowledge as to what questions will be asked. Send your zingers to BerkshireQuestions@cnbc.com. Yahoo will wrap things up after 5:30.

And now – drum roll, please – a surprise. This year our meeting will be held in Los Angeles . . . and *Charlie will be on stage with me* offering answers and observations throughout the 3 ½-hour question period. I missed him last year and, more important, *you* clearly missed him. Our other invaluable vice-chairmen, Ajit Jain and Greg Abel, will be with us to answer questions relating to their domains.

Join us via Yahoo. Direct your really tough questions to Charlie! We will have fun, and we hope you will as well.

Better yet, of course, will be the day when we see you face to face. I hope and expect that will be in 2022. The citizens of Omaha, our exhibiting subsidiaries and all of us at the home office can't wait to get you back for an honest-to-God annual meeting, *Berkshire-style*.

February 27, 2021

Warren E. Buffett
Chairman of the Board