BERKSHIRE HATHAWAY

In Search of the "Buffett Premium"

The corporate identity of Berkshire Hathaway will always be inextricably linked to the remarkable career and investment track record of Warren Buffett. Mr. Buffett's tenure at the company has spanned nearly five decades and has transformed a dying textile business into one of the world's largest and most respected conglomerates with operations ranging from insurance, utilities, and railroads to candy, underwear and bricks. Berkshire is not only respected based on its impressive financial results, but also due to the unique business philosophy that often makes the company the only logical buyer for high quality family businesses. While Mr. Buffett has shown no signs of stepping down anytime soon, his 80th birthday last year increased speculation regarding succession.

In this report, we consider succession issues as well as evaluate Berkshire Hathaway's intrinsic value in search for any evidence of a "Buffett Premium". Based on current business fundamentals, we estimate the intrinsic value of Berkshire at between $150,000 and $170,000 per Class A share.

Ravi Nagarajan
The Rational Walk LLC

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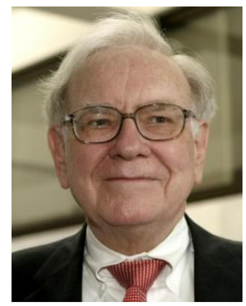
In Search of the "Buffett Premium"

"I think the top guy won't be as smart as Warren. But it's silly to complain: What kind of world is this that gives me Warren Buffett for 40 years and then some bastard comes along who's worse?" [1]

-- Berkshire Hathaway Vice Chairman Charles T. Munger

The typical chief executive of a major American corporation may have a demanding job, but his or her efforts tend to be mostly anonymous from the perspective of the average citizen who does not closely follow business news. The exceptions involve a handful of "celebrity CEOs" who have name recognition similar to the most important political and cultural figures in society. Individuals like Steve Jobs, Bill Gates, Jack Welch, and many others are widely recognized and almost synonymous with the companies they have been associated with.



Warren Buffett is perhaps the most visible example of a CEO who has captured the attention of the public at large. During the height of the financial crisis in the fall of 2008, Mr. Buffett's comments on the economy were accorded as much respect as the pronouncements from the White House, Treasury, or the Federal Reserve, and perhaps more so. Through his investment activities, Mr. Buffett had the power to bestow a "seal of approval" on businesses like Goldman Sachs and General Electric that meant far more to markets and investors than any amount of bailout funds from the government.

Given Mr. Buffett's investment track record, name recognition, and obvious management skills, it is unsurprising that investors viewed his eightieth birthday in August 2010 with trepidation. While Mr. Buffett is reportedly in excellent health and has no plans to step down as Chairman and CEO of Berkshire Hathaway, the human condition makes it obvious that at some point the company's succession plan will be triggered.

While it is self-evident that Mr. Buffett's successor cannot possibly replicate his skill set, it is not satisfactory to simply make this observation and conclude that Berkshire Hathaway will not continue to prosper in the future. While many executives may take satisfaction in the fact that they cannot be replaced, the truly great manager is one who builds a business and corporate culture that can be sustained by successors. Mr. Buffett has certainly attempted to do so, but has he succeeded?

Contrary to popular belief, Berkshire Hathaway is not simply a closed end mutual fund managed by Warren Buffett. While Mr. Buffett's unique skills have created tremendous value for shareholders over the past forty-six years, the company has evolved into a holding company owning subsidiaries engaged in a wide range of activities. Berkshire's most important operating segment is insurance. GEICO, General Re, and Berkshire Hathaway Reinsurance Group form the core of the insurance subsidiaries and generate large amounts of "float" that can be invested on behalf of shareholders. Berkshire's other subsidiaries are engaged in a wide variety of manufacturing, transportation, utility, service, and diverse retail operations.

Berkshire Hathaway's subsidiaries are run as independent entities with managers responsible for operating decisions. Mr. Buffett is responsible for providing oversight for each subsidiary CEO but he has a reputation for having a hands-off management approach when it comes to operations. Capital allocation is another matter. Rather than delegating capital allocation decisions to each subsidiary CEO, Mr. Buffett takes charge of the free cash flow generated by each subsidiary and reallocates capital either across Berkshire's existing operating subsidiaries, to investments in marketable securities, or by purchasing additional operating subsidiaries. This practice is a major competitive advantage, particularly when a capital allocator of Mr. Buffett's caliber is in charge of the process.

We will attempt to shed light on the factors that matter the most when it comes to evaluating Berkshire Hathaway's business operations and estimating intrinsic value. Of course, this involves a careful analysis of Berkshire's historical financial results and future prospects, but a critical variable involves the special skill set that Warren Buffett brings to the table. For the remainder of Mr. Buffett's tenure at Berkshire Hathaway, shareholders will benefit from his unique and irreplaceable talents.

No one can predict how long Mr. Buffett will remain at Berkshire Hathaway, but we can attempt to identify areas where his special talents are adding value for shareholders and will not be easily replicated by his successor. The question of whether Berkshire Hathaway's stock price implies a "Buffett Premium" hinges on whether investors are paying a price today for the incremental value Mr. Buffett will provide to the company for an indeterminate number of years into the future.

We will argue that the value derived from the following activities will be particularly difficult for Berkshire Hathaway to replace once Mr. Buffett is no longer involved in running the company:

1. **Acquisitions of family-run businesses.** Many of Berkshire Hathaway's most successful acquisitions have involved family businesses run by founders who wish to protect their legacy and are attracted to Berkshire rather than to private equity buyers or the pursuit of an initial public offering. Sellers have often been willing to accept less than "top dollar" due to the benefits of selling to Berkshire. While a significant part of the motivation for these family run businesses will remain as long as Berkshire's unique corporate culture remains intact, the intangible benefits of "selling to Warren Buffett" will not likely extend to selling to his successor. When Warren Buffett decides to purchase a business, the decision forever puts a "stamp of approval" on the legacy of the founder. It is nearly certain that this intangible ego-enhancing factor for potential sellers will dissipate once Mr. Buffett is no longer in charge of capital allocation. However, a mitigating factor is that as Berkshire grows, fewer potential acquisitions will involve buying businesses directly from founders or their direct descendants due to increasing minimum purchase sizes.

2. **Opportunistic Investments in Times of Distress.** When Goldman Sachs and General Electric agreed to the terms of Berkshire's investments in the fall of 2008, part of the motivation involved a need for capital but Mr. Buffett's "stamp of approval" was likely to have been an even greater factor. While Mr. Buffett's successor will have the financial wherewithal to make similar commitments, it is questionable whether the intangible benefits of the cash infusion would be as beneficial for the recipients. Therefore, the terms of such investments may be less favorable. In addition, Berkshire's Board of Directors and shareholders may not be willing to give as much latitude to the next CEO when it comes to making such investments. Although the 2008 financial crisis is already receding into the rear view mirror, at the time of Berkshire's cash infusions into Goldman Sachs and General Electric, few perceived the investments as "slam dunks".

3. **Overall Capital Allocation.** Berkshire Hathaway's unique approach to capital allocation allows the company to redirect free cash flow from subsidiaries that lack growth prospects into subsidiaries or new investments where attractive opportunities exist. Mr. Buffett's role at Berkshire will be split into three parts in the future: Chairman, Chief Executive Officer, and Chief Investment Officer. While the selection of Todd Combs to serve as one of potentially many investment managers received a great deal of attention in October 2010, the question of who will succeed Mr. Buffett as CIO is still an open question. While it is very reasonable to assume that a capable individual will take over, it is unreasonable to assume that his or her capabilities will approach Mr. Buffett's when it comes to capital allocation. In addition, the working relationship between the future CEO and CIO is also unknown at this point and close collaboration will be required to optimize results. Good working relationships of this type are rare and often fraught with peril.

Mr. Buffett's 2010 letter to shareholders made it clear that the individual or individuals charged with managing Berkshire's portfolio will be consulted when it comes to capital allocation matters but the Chief Executive, with oversight from the board, would have the final say over all decisions. Some analysts have questioned whether this means that Berkshire will not have a CIO role. However, we interpret the statement simply to mean that any future CIO would report to the CEO which is what we had assumed in the past as well.

An important question facing investors is whether Berkshire Hathaway's current share price implicitly assumes that Warren Buffett's irreplaceable skills will be available to the company for a number of years into the future. While achieving exact mathematical precision for the extent of this added value is not possible, we can use conservative assumptions when evaluating each of Berkshire's areas of value. If investors use conservative assumptions when deciding how much to pay for shares, substantial upside may be realized over the coming years as Mr. Buffett continues to add incremental value beyond what his successor could deliver. Rather than paying a "Buffett Premium", investors may receive a free "Buffett Option" for any superior achievements yet to come in Mr. Buffett's career. We would note that concerns over succession planning at Berkshire have existed for well over a decade and this has not stopped Mr. Buffett from continuing to add value well beyond normal retirement age.

At recent market prices, Berkshire Hathaway appears to be undervalued when evaluated using multiple valuation models. We will argue that there is no "Buffett Premium" in Berkshire's current quotation. Additionally, we will explain why Berkshire Hathaway is more prepared for eventual management succession than most large companies. However, first we will take a step back and briefly look at Warren Buffett's investment philosophy as it developed during his early years. We will then evaluate Berkshire Hathaway's key drivers of value and come up with a range of intrinsic value using three valuation models.

The following table presents our estimate of Berkshire Hathaway's intrinsic value per A share based on three valuation models:

Valuation Method	Intrinsic Value per A Share
Float Based Approach	$170,000
"Two Column" Approach	$154,000
Multiple of Book Value Approach	$150,000

Exhibit 1: Valuation Summary

While we believe that the float based valuation approach is the most appropriate measure of Berkshire Hathaway's intrinsic value, the "two column" and multiple of book value approaches are presented as well in an attempt to provide a range of value. We estimate Berkshire Hathaway's range of intrinsic value at $150,000 to $170,000 per Class A share or $100 to $113 per Class B share. Class B shares have the economic rights of 1/1500 of a Class A share.

Based on the closing quotation of Berkshire Hathaway Class A stock of $131,300 on February 28, 2011, the company is trading moderately below our low range of intrinsic value and significantly below the high range. Since we consider the float based approach to most accurately measure intrinsic value, we view the low end of the range as the lowest conceivable estimate of fair value. In our view, a substantial margin of safety exists for shareholders based on Berkshire's current quotation.

From Cigar Butts to Business Supermodels

There are numerous books and publications that provide detailed accounts of the history of Berkshire Hathaway as well as Warren Buffett's life and career. Additionally, it is impossible to fully understand Berkshire without studying the life and career of Vice Chairman Charles T. Munger. A list of resources for those interested in a comprehensive history of the company and its leaders is provided as an appendix to this report. This section attempts to provide some context regarding the remarkable early history of Berkshire Hathaway and the evolution of Warren Buffett's investment approach.

Warren Buffett's Early Investment Philosophy

Warren Buffett's early investment philosophy was largely based on the principles developed by Benjamin Graham. Mr. Buffett has stated on many occasions that his view of investing changed dramatically when he first read Mr. Graham's book, *The Intelligent Investor*, in early 1950[1]. Up to that point, Mr. Buffett had read every book on investing available at the Omaha public library but none were as compelling as Mr. Graham's straight forward approach summarized in the phrase: "Margin of Safety".

Benjamin Graham's approach is more fully documented in *Security Analysis* which, in contrast to *The Intelligent Investor,* is primarily aimed at professional investors. Mr. Graham's process involves examining securities from a quantitative perspective and making purchases only when downside risks are minimized. This approach rarely involved speaking to management since doing so could adversely influence the analyst's impartial view of the data. In particular, Mr. Graham was a proponent of purchasing stocks selling well under "net-net current asset value" arrived at by taking a company's current assets and subtracting *all liabilities*. In such cases, the buyer was paying nothing for the business as a going concern and had some downside protection due to liquid assets far in excess of all liabilities.

Mr. Buffett was able to leverage the "deep value" approach advocated by Benjamin Graham throughout the 1950s. In the five year period ending in 1961, the Buffett Partnerships trounced the Dow Jones Industrial average with a cumulative return of 251 percent compared to 74.3 percent for the Dow[2]. While Mr. Buffett employed multiple strategies, one approach involved finding companies that fit the "cigar butt" mold, meaning that they had "one puff left" and could be purchased at a deep bargain price. Companies such as Sanborn Map and Dempster Mill Manufacturing were textbook cases where Benjamin Graham's investment approach could be applied.

Mr. Buffett began to acquire shares of Berkshire Hathaway, a struggling New England textile manufacturer, in late 1962. While Berkshire Hathaway was trading well under book value at the time, Mr. Buffett would later say that book value "considerably overstated" intrinsic value[3]. In this section we take a brief look at Dempster Mill and Berkshire Hathaway as examples of the "cigar butts" Mr. Buffett favored at the outset of his career and then turn our attention to Berkshire's transformation with the purchase of National Indemnity in 1967 and a shift to higher quality businesses with the purchase of See's Candies in 1972. While the merits of investing in "cigar butts" cannot be denied, it is safe to say that Berkshire Hathaway would be a fraction of its current size had Mr. Buffett not turned his attention to higher quality "business supermodels" by the early 1970s.

Tilting At Windmills

Warren Buffett was at least fifty years ahead of the times if his goal was to buy into a "trendy" business when his partnership began to accumulate shares of Dempster Mill Manufacturing Company in 1956. Dempster was in the business of manufacturing and selling windmills and various types of farm equipment and was headquartered in Beatrice, Nebraska, a small town not far from Omaha. The company was a classic "cigar butt" and was selling for $18 per share at a time when book value was $72 per share[4].

The Buffett Partnership continued to slowly accumulate shares of Dempster until Mr. Buffett controlled more than 70 percent of the outstanding shares by the middle of 1961. The stake accounted for a fifth of the partnership's total assets. Although Dempster was a cheap business from a price to book value basis, the company was struggling to generate an acceptable return on invested capital. After Mr. Buffett assumed the Chairman role at Dempster, he was faced with decision to either liquidate the business or to fix the company as a going concern. Faced with uncooperative management that appeared unwilling to change course, Mr. Buffett recruited Harry Bottle, an experienced operating manager, to implement a number of changes that dramatically reduced the capital requirements of the ongoing business. As a result, the company was significantly overcapitalized by mid-1963.

The goal of the reorganization was to allow Mr. Buffett to redeploy assets from an underperforming manufacturing business with a poor return on capital toward more productive uses. In 1963, Dempster's operating business was sold and excess cash and securities not required to run the business were distributed to shareholders. Ultimately, the Buffett Partnership nearly tripled its investment and netted a $2.3 million profit[5].

While the final result turned out to be highly profitable for the partnership, by all accounts the process of achieving this result was unpleasant for Mr. Buffett for a number of reasons. First, the outcome depended in part on "fixing" a business that had been underperforming for years. It was only after hiring Mr. Bottle that a turnaround took place. Second, the process involved layoffs and led to heavy criticism of Mr. Buffett in Beatrice since Dempster was a large employer[6]. Although these layoffs and other cost cutting measures almost certainly prevented a bankruptcy and a loss of *all* of Dempster's jobs, the reputational damage of taking the steps to fix an ailing business could not have been pleasant. One of the unpleasant tasks associated with fixing a business often involves making changes at the top, and by all accounts this was a bruising process at Dempster. The process apparently did not go smoothly because Mr. Buffett later received a letter from the wife of the former CEO accusing him of being "abrupt and unethical" and destroying her husband's self confidence. Mr. Buffett's long standing aversion to firing employees may date back to this incident.[7]

It is often possible to fix a business that is fundamentally sound and suffers from poor management, but sometimes any attempt to do so ends up simply "tilting at windmills". At the end of the restructuring process, Dempster survived, many jobs were saved, and the partnership had funds to redeploy elsewhere[8]. However, Mr. Buffett would soon take control of another manufacturing business where the problems ultimately could not be fixed: Berkshire Hathaway.

Berkshire Hathaway: A $200 Billion Mistake?

Berkshire Hathaway, as it existed in 1963 when the Buffett Partnership became the company's largest shareholder, was a *cheap company* from a quantitative perspective but it was not a *good company* in terms of operating a business that had durable competitive advantages. In fact, over the next two decades, Berkshire Hathaway continued to make modest investments in the textile mills but would never gain sufficient traction to face off against overseas competitors with lower cost structures.

Textiles are a commodity business and the low cost producer has the advantage. Mr. Buffett later characterized his purchase of Berkshire Hathaway as a significant mistake, perhaps not so much because of the initial purchase as the decision to continue operating the mills for another two decades in the face of high opportunity costs[9]. However, while Berkshire's textile mills were doomed to eventual failure, a period of profitability appeared in the mid to late 1960s that presented Mr. Buffett with the opportunity to reinvest cash flows into more attractive opportunities[10].

Above all else, Mr. Buffett is a master *capital allocator*. He could see the troubles brewing in textiles and, despite attempts by Berkshire's textile managers to obtain capital for new investments, Mr. Buffett chose to deploy the funds elsewhere. This approach was controversial, but the history of Berkshire's competitors shows that aggressive capital expenditures would only have delayed a decline temporarily and at great cost to shareholders. Large capital outlays could provide a cost advantage for a short time, but eventually competitors purchased similar equipment and the real benefits flowed to the customer in the form of lower prices. This never ending cycle could only end in value destruction for shareholders.

National Indemnity – The Turning Point

Berkshire Hathaway's entry into the insurance business with the purchase of National Indemnity in 1967 was a transformational event for the company[11]. The textile business, despite the temporary period of profitability, required significant capital investments to continue to remain competitive. In contrast, insurance operations that are well run generate significant cash in the form of "float".

Float represents funds that are held by an insurance business between the time when policyholders submit payment and when funds are eventually paid out to settle claims. As long as underwriting practices are sound, float represents a low cost means of funding investments. Exceptional insurance businesses routinely generate cost free or negative cost float. By purchasing National Indemnity, Berkshire was on its way to transforming from a textile manufacturer *consuming* large amounts of capital at low to negative rates of return into an insurance powerhouse *generating* large amounts of float for investment in other businesses offering better prospects of high returns.

In late 2010, Mr. Buffett reflected on purchasing National Indemnity for Berkshire Hathaway rather than setting up a new entity. While the great transformation of Berkshire Hathaway from a dying textile manufacturer to an immense conglomerate had begun, buying Berkshire to begin with was still a mistake. In fact, at the time of the interview, Mr. Buffett estimated that Berkshire would be worth *twice* its then-$200 Billion value without the "textile anchor":

> ***"But the truth is I had now committed a major amount of money to a terrible business. And Berkshire Hathaway became the base for everything pretty much that I've done since. So in 1967, when a good insurance company came along, I bought it for Berkshire Hathaway. I really should—should have bought it for a new entity.***
>
> ***Because Berkshire Hathaway was carrying this anchor, all these textile assets. So initially, it was all textile assets that weren't any good. And then, gradually, we built more things on to it. But always, we were carrying this anchor. And for 20 years, I fought the textile business before I gave up. If instead of putting that money into the textile business originally, we just started out with the insurance company, Berkshire would be worth twice as much as it is now."***[12]

See's Candies – Adjusting Graham's Approach

Few Californians can recall a holiday season when See's Candies were not a prominent part of the festivities. The brand is so powerful in California and other western states that many consumers would never think of buying a competing product. See's Candies is a textbook example of a company with a formidable economic "moat". Such companies have built up brand identity that simply cannot be replicated by new entrants even in cases where significant capital investments are made[13].

Berkshire Hathaway Vice Chairman Charles Munger has been widely credited with convincing Warren Buffett that there are certain situations where deviating from Benjamin Graham's "deep value" approach can be justified. Mr. Munger has rebutted[14] the notion that his influence was a deciding factor in Mr. Buffett's overall record, but many accounts of the events surrounding the See's Candies purchase supports the conclusion that Mr. Munger deserves much credit for shifting Berkshire's bias from cigar butts selling at a "bargain price" to excellent businesses selling at a "fair price" [15].

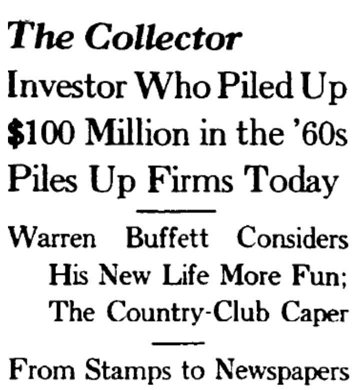
See's Candies is the perfect example of a business that produces an excellent return on equity year after year but requires very little capital investment in order to sustain the "moat" that makes such returns possible. When Berkshire purchased See's Candies for $25 million in 1972, the company only had $8 million of net tangible assets. However, See's was earning approximately $2 million after tax at the time[16]. $17 million of the $25 million purchase price could not be accounted for by assets on See's balance sheet but represented the value attributed to intangible "brand equity". Brand equity is not an asset that a strict practitioner of Benjamin Graham's investing approach would be willing to pay for. However, the presence of brand equity simply cannot be denied based on the results that would follow after Berkshire's acquisition.

Over the first twenty years of Berkshire's ownership of See's Candies, sales increased from $29 million to $196 million while pre-tax profits grew from $4.2 million to $42.4 million. However, that is not even the most amazing part of the story. What is more remarkable is that Berkshire Hathaway only had to reinvest $18 million of retained earnings over that twenty year period while $410 million of cumulative pre-tax earnings were sent back to Berkshire for redeployment in other investments[17]. Fast forward to 2007, the latest year for which data has been provided: See's sales were $383 million with pre-tax profits of $82 million. Total capital employed to run the business was $40 million, meaning that only $32 million of retained earnings had to be invested over 35 years. Pre-tax earnings from 1972 to 2007 amounted to a total of $1.35 billion[18].

There have been many other key turning points in the history of Berkshire Hathaway but the decision to pay a "premium price" for See Candies in 1972 may best symbolize the transformation of Mr. Buffett's approach toward investing. This is perfectly summarized in Mr. Buffett's 1992 Letter to Shareholders[19]:

> ***"In my early days as a manager I, too, dated a few toads. They were cheap dates - I've never been much of a sport - but my results matched those of acquirers who courted higher-priced toads. I kissed and they croaked.***
>
> ***After several failures of this type, I finally remembered some useful advice I once got from a golf pro (who, like all pros who have had anything to do with my game, wishes to remain anonymous). Said the pro: "Practice doesn't make perfect; practice makes permanent." And thereafter I revised my strategy and tried to buy good businesses at fair prices rather than fair businesses at good prices." – Warren Buffett***

Berkshire Hathaway is the company it is today because Mr. Buffett stopped kissing toads like Dempster Mill and the original Berkshire textile business and started aggressively pursuing supermodels like See's Candies instead even if they were more "expensive dates". Ultimately, the advantages of buying "cigar butts" with a couple of puffs left pales in comparison with the cumulative benefits offered by excellent businesses that have the ability to compound returns at high rates for years or decades.


The Collector
Investor Who Piled Up $100 Million in the '60s Piles Up Firms Today

Warren Buffett Considers His New Life More Fun; The Country-Club Caper

From Stamps to Newspapers

Warren Buffett worked in relative obscurity for most of his early career but his success began to attract attention by the 1970s. While Mr. Buffett had not reached celebrity status at that point, readers of the Wall Street Journal should have been familiar with him based on a front page article that appeared on March 31, 1977 entitled *The Collector*.

Our research of Wall Street Journal archives yielded several mentions of Berkshire prior to 1977 but *The Collector* was the first that detailed Warren Buffett's investment philosophy and track record. Berkshire's stock, the predecessor of today's "A" Shares, closed at $95 on the day of the article. Excerpts from the article and a link to the original are available at the following link: http://bit.ly/e2KvLR.

As we shall see, Berkshire Hathaway in 2011 is comprised of a broad array of subsidiaries operating in many lines of business and it is fair to characterize many of them as excellent franchises – even as “business supermodels”. Over the years, Berkshire Hathaway did acquire some businesses that, in retrospect, did not deliver expected results, but the bias for most of the past four decades has been toward acquiring excellent businesses.

Fortunately for today’s shareholders, kissing toads is a practice Warren Buffett abandoned long ago.

The Washington Post

While the distinction between buying “cigar butts” and “business supermodels” is important, one should not forget the fact that, at times, it may be possible to achieve the best of both worlds in an investment. When this occurs, the investment can take on the characteristics of what Berkshire Hathaway Vice Chairman calls the “Lollapalooza Effect”.

The early 1970s were characterized by economic, political, and social unrest that contributed to the bruising 1973-74 bear market which, at the time, was the worst in the post-war period. Just a few years earlier, Warren Buffett had closed his investment partnership in 1969 after feeling “out of step with present conditions”. By 1974, Mr. Buffett was telling Forbes that he felt like “an oversexed guy in a harem.”

Perhaps one reason for his change in sentiment was Berkshire Hathaway’s opportunistic investment in The Washington Post Company in 1973. As Mr. Buffett would later recall in *The Superinvestors of Graham-and-Doddsville*, the market capitalization of The Washington Post was $80 million at a time when the value of the business on a conservative sum-of-the-parts basis was in excess of $400 million.

Mr. Buffett took a seat on the Post’s board of directors in 1974 and became a close friend and confidant of Katharine Graham, the Post’s Chairman and CEO. Under Mr. Buffett’s guidance, the Post repurchased a significant amount of stock which further increased Berkshire’s percentage ownership of the company.

According to Roger Lowenstein’s book *“Buffett: The Making of an American Capitalist”,* Berkshire Hathaway’s $10 million investment in The Washington Post was worth $205 million by the time Mr. Buffett left the Post’s board in 1985. By the end of 2010, the stake was worth over $759 million. Mr. Buffett later rejoined the Post’s board but recently decided to not seek re-election at the Post’s annual meeting in May 2011.

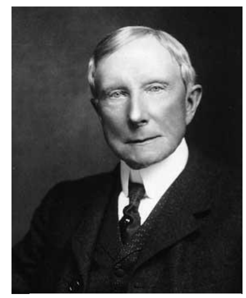
In recent years, the core newspaper business has been in decline, but the Post has diversified into for-profit education, an industry that has been under increasing attack. However, Mr. Buffett’s loyalty to the Post remains intact and he has stated that “We’re going to keep every share of stock we have.”

For an excellent brief summary of Berkshire’s investment in the Washington Post, we recommend Max Olson’s paper, *Warren Buffett & The Washington Post:* http://bit.ly/ewfNK8

Buffett Seizes Opportunities During Financial Crisis

"There are worse situations than drowning in cash and sitting, sitting, sitting. I remember when I wasn't awash in cash — and I don't want to go back." — Berkshire Hathaway Vice Chairman Charlie Munger

If an investor following the literary tradition of Rip Van Winkle had fallen asleep at the start of 2008 and rose from his slumber in early 2011, he could be forgiven for looking at the level of the Standard & Poor's 500 and thinking that not much had changed over the past three years. For more sentient investors, the past three years have been quite a bit less boring. The United States economy has endured the most severe recession since the Great Depression of the 1930s while the major market averages fell by more than half before staging a steep recovery that few anticipated during the depths of the crisis.



John D. Rockefeller Sr

In October 1929, John D. Rockefeller Sr. responded to the stock market crash by buying a million shares of Standard Oil of New Jersey and issuing a press release stating in part: "These are days when many are discouraged. In the ninety years of my life, depressions have come and gone. Prosperity has always returned, and will again. Believing that the fundamental conditions of the country are sound, my son and I have been purchasing sound common stocks for some days."[1] Unfortunately, Rockefeller's timing left something to be desired and his family's net worth declined significantly during the subsequent recession, but at the time his statement inspired confidence in the economy.

In the fall of 2008, Warren Buffett wrote an op-ed article for The New York Times that had many close parallels with John D. Rockefeller's statement nearly eighty years earlier. Mr. Buffett's article, entitled *"Buy American. I Am."* acknowledged the serious turmoil facing the country but indicated that he had confidence in the American economy and was purchasing American stocks for his personal account[2].

> ***"A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now."***
>
> ***-- Warren Buffett, New York Times op-ed, October 16, 2008.***

Mr. Buffett indicated that his personal account, which had been invested entirely in government bonds, would soon be 100 percent in United States equities if prices continued to become more attractive. He clearly stated that there was no way to predict where stocks would be in a month or a year but that prices would recover substantially well before widespread positive sentiment returned. As it turns out, it is a good thing his goal was not to predict the short term direction of the market because he was several months too early in terms of identifying the market bottom which finally arrived in March 2009. However, at the time his statement did have a brief positive impact on market sentiment.

In this section, we briefly examine three of Warren Buffett's major investment moves during the financial crisis both in terms of results delivered for Berkshire and the impact of his statements and actions on market sentiment in general and the perceived stability of the investees in particular. While Mr. Buffett's comments on purchases in the public equity markets proved to be well founded, the combined power of his prestige and Berkshire's hefty cash position were most evident in purchases of securities unavailable to ordinary investors.

Goldman Sachs

Although the definitive history of the financial crisis will probably only appear several years from now, it seems safe to consider the events of mid September 2008 to represent the peak of the crisis and the point at which the entire financial system was at the precipice of disaster. Within a span of several days, Fannie Mae and Freddie Mac were placed into conservatorship, Lehman Brothers was left with no choice but to file for bankruptcy, and Merrill Lynch was forced into the arms of Bank of America[3].

In this highly charged environment, *all* financial institutions operated under a cloud of suspicion. The most common question at the time was not *whether* another major institution would fail, but *which* bank was the next domino in what seemed like an unstoppable chain reaction.

On September 21, 2008, Goldman Sachs announced that it would convert to a Bank Holding Company subject to regulation by the Federal Reserve[4]. Two days later, Berkshire Hathaway announced that it would invest $5 billion in Goldman Sachs[5]. Media reports at the time highlighted the importance of Warren Buffett's vote of confidence in Goldman Sachs as being equally important to the capital infusion[6].

On October 1, 2008, Berkshire purchased $5 billion of perpetual preferred shares in Goldman paying a 10 percent annual dividend and also received warrants to buy $5 billion in common stock at a strike price of $115 per share. Goldman has the right to repurchase the preferred shares at any time for a 10 percent premium although approval to execute the buyback is subject to permission from the Federal Reserve. The warrants expire on October 1, 2013[7]. Warren Buffett insisted that Goldman's top executives agree to limit their personal sales of Goldman common stock until the preferred shares are redeemed or three years had passed from the date of Berkshire's investment[8].

At the time that Berkshire's investment was announced, Goldman also announced an intention to issue $2.5 billion of common stock to the public. On September 29, 2008, Goldman was able to complete a public offering of 46.75 million shares at $123 per share for proceeds of $5.75 billion[9]. On October 28, 2008, Goldman Sachs issued $10 billion of preferred stock to the United States Treasury which paid a 5 percent annual dividend and came with warrants exercisable for ten years at a strike price of $122.90 per share. The overall terms of the government's investment were clearly not as favorable as Berkshire's investment[10].

Berkshire's investment in Goldman Sachs was executed at favorable terms precisely because Warren Buffett's "seal of approval" helped to establish confidence that convinced the financial markets that Goldman would be among the survivors of the financial crisis. This confidence shored up Goldman's stock price in the days following the announcement facilitating the $5.75 billion equity issuance to the public. It is highly doubtful that Goldman Sachs would have been able to raise capital through an issue of common stock at $123 per share without Warren Buffett's vote of confidence. Debate continues regarding whether Goldman Sachs was truly at risk of failing in September 2008, but few would disagree with the observation that Warren Buffett's involvement was critical to dissipating a cloud of suspicion that plagued Goldman during those turbulent weeks.

During the fourth quarter of 2008, financial turbulence continued and the price of Goldman's common stock fell to under $48 intraday on November 21, 2008. While the benefit of hindsight might suggest that Mr. Buffett could have extracted more favorable terms by waiting several more weeks prior to investing, this ignores the stabilizing impact of Berkshire's investment during the darkest days of the crisis in September and October 2008 and presumes that history would have been unaltered absent Berkshire's investment. The reality could have been far worse.

In recent months, many analysts have predicted that Goldman Sachs would soon be permitted to redeem Berkshire's preferred stock investment and may even pursue a buyback of up to 10 percent of its common stock[11]. The combination of the availability of cheaper capital and a likely desire of Goldman executives to eliminate the personal restrictions on share liquidations imposed by Berkshire may lead to repayment in the first half of 2011. Goldman Sachs will have to pay a 10 percent premium of $500 million as part of the process. Berkshire will retain the warrants to purchase $5 billion of Goldman common stock at the $115 strike price and will likely hold these warrants until expiration in October 2013. The warrants are currently comfortably in the money.

General Electric

Based on the public statements made by General Electric's management in September 2008, the company had no pressing need for outside capital. After issuing a press release revising 2008 earnings guidance on September 25, GE Chairman and CEO Jeffrey Immelt indicated in a conference call that raising additional equity was not on the table[12]. Mr. Immelt told the analysts on the call that he felt secure regarding the strength of the company, overall liquidity, and the state of the balance sheet.

Only a few days later, General Electric announced plans to offer $12 billion of common stock to the public as well as Berkshire Hathaway's $3 billion investment in newly issued GE perpetual preferred stock carrying a dividend of 10 percent and callable after three years at a 10 percent premium. Berkshire also received warrants to purchase $3 billion of common stock at a strike price of $22.25 per share, exercisable at any time over a five year term[13]. Mr. Buffett again insisted that company executives including Mr. Immelt refrain from selling more than 10 percent of the common stock they held until either the date when the preferred stock is redeemed or three years had passed from the date of Berkshire's investment. The transaction closed on October 16, 2008[14].

Notably, the title of GE's press release referred to *Warren Buffett* announcing an investment in the company rather than more accurately stating that *Berkshire Hathaway* was making the investment. Clearly, this announcement was specifically intended to increase confidence in GE and to facilitate the planned $12 billion equity sale to the public which closed on October 7, 2008. The following quote from Mr. Buffett illustrates the vote of confidence in GE's management:

> ***"GE is the symbol of American business to the world. I have been a friend and admirer of GE and its leaders for decades. They have strong global brands and businesses with which I am quite familiar. I am confident that GE will continue to be successful in the years to come."***

If Mr. Buffett's vote of confidence in Goldman Sachs served to instill confidence in America's financial system, the investment in General Electric had a similar effect on GE's global industrial businesses and also may have helped to alleviate some of the fears surrounding GE Capital.

General Electric's common stock price fell precipitously over the five months following Berkshire's investment and eventually traded under $7 for a brief period in early March 2009. As of late February 2011, GE's stock remains slightly below the strike price on Berkshire's warrants but the potential remains for the warrants to generate significant profits for Berkshire since expiration will not occur until October 2013.

Swiss Re

On March 23, 2009, Berkshire Hathaway invested CHF 3 billion in a convertible preferred security issued by Swiss Re. The preferred security was in addition to Berkshire's January 2008 investment in 3 percent of Swiss Re common stock as well as a quota-share reinsurance agreement in which Berkshire assumed 20 percent of Swiss Re's property/casualty business over a five year period ending in 2012. At the time of Berkshire's investment in the convertible preferred, Swiss Re was in danger of losing its AA rating due to heavy investment portfolio losses suffered during 2008. Berkshire's capital infusion helped to instill confidence in Swiss Re's future prospects. At the time, Warren Buffett was quoted as being "delighted" with the deal[15].

Although the investment carried an interest rate of 12 percent, Swiss Re had the right to defer interest payments and could opt to pay interest using shares rather than cash. The investment provided Berkshire with conversion rights but the conversion price was above Swiss Re's stock price at the time of the deal and Swiss Re retained the right to redeem the instrument at a premium to prevent future dilution. In early November 2010, Berkshire and Swiss Re agreed to terms for the redemption of the security[16]. On February 17, 2011, Swiss Re confirmed that the final repayment took place in January 2011[17].

This transaction was far from risk free due to the subordinated status of the instrument compared to Swiss Re's other debt obligations. However, the deal has produced excellent results for Berkshire. In exchange for a CHF 3 billion initial outlay, Berkshire received an aggregate total of CHF 4.42 billion in interest payments, redemption premium, and repayment of the original principal.

We estimate that the annualized internal rate of return was approximately 25.8 percent when expressed in Swiss Francs. However, the Swiss Franc has significantly appreciated over the past two years. Assuming that Berkshire converted interest payments and the redemption proceeds to US Dollars on the date the Swiss Francs were received, we estimate the annualized internal rate of return at approximately 37 percent. The exhibit on the following page shows the timing of the cash flows.

Date	Cash Flow (CHF Millions)	Exch. Rate (CHF/USD)	Cash Flow (USD Millions)	Description
3/23/2009	(3,000)	1.12856	(2,658)	Initial Investment
9/23/2009	180	1.02300	176	Interest Payment
3/23/2010	180	1.05932	170	Interest Payment
9/23/2010	180	0.98611	183	Interest Payment
11/25/2010	180	1.00038	180	Redemption - 1st Installment
1/10/2011	3,700	0.96858	3,820	Redemption - 2nd Installment
Net Cash Flow Totals	**1,420**		**1,870**	
Annualized IRR	**25.8%**		**37.0%**	

Exhibit 2: Berkshire's Swiss Re Investment Results [18]

The original term sheet specified that Swiss Re would have to pay a 40 percent premium if redemption took place prior to the second anniversary of the transaction and 20 percent thereafter. However, Berkshire agreed to accept a 20 percent premium although Swiss Re had to pay interest for Q1 2011 in full.

Other Investments

In addition to the three investments we have discussed, Berkshire Hathaway also made significant investments in Dow Chemical and Wrigley during 2008 and 2009. On April 1, 2009, Berkshire invested $3 billion in Dow Chemical perpetual preferred stock paying dividends of 8.5 percent. Berkshire's investment helped to facilitate Dow's acquisition of the Rohm and Haas Company. The preferred stock is convertible into Dow common stock at an effective price of $41.32[19]. On October 6, 2008, Berkshire made an investment in Wrigley comprised of $4.4 billion of 11.45 percent subordinated notes due 2018 and $2.1 billion of Wrigley preferred stock[20]. The investments provided the financial backing to facilitate the acquisition of Wrigley by Mars Inc.

While future CEOs of Berkshire Hathaway are very likely to have the cash required to pursue large deals during periods of financial turmoil, it is clear that the terms of Berkshire's transactions during the 2008-2009 financial crisis were substantially enriched by the intangible benefit of obtaining Warren Buffett's stamp of approval. Therefore, investors who wish to evaluate whether a "Buffett Premium" exists in the current price of Berkshire Hathaway stock should focus on whether the company's current valuation assumes that future deals will be available on similar terms. This is a question we will examine in more detail once our valuation of Berkshire is complete.

Valuation Approach

One of the mistakes many investors make involves attempting to estimate the value of a business with excessive precision. Indeed, the quest for exact mathematical precision in finance has led to models such as the Capital Asset Pricing Model that are elegant but use suspect variables such as Beta (a measure of stock price volatility) as a proxy for risk to arrive at estimates of where a stock should trade[1].

In our view, risk involves the possibility of *permanent loss of capital* rather than stock price volatility. Stock markets are known for extreme volatility and are driven by periods of greed and fear that often has little to do with underlying business fundamentals. Unfortunately, precise academic definitions of risk and valuation are inadequate when it comes to arriving at intrinsic value estimates.

The valuation of any business is theoretically represented by the cash the business will generate over its remaining life discounted to present value to account for the time value of money. Since the future is necessarily uncertain, one cannot hope to arrive at a precise number for the value of a business. Instead, the goal should be to arrive at a reasonable *range of value* for a business. The decision to purchase a business should only be made if it can be obtained at a significant discount relative to intrinsic value. Warren Buffett describes the concept of intrinsic value as follows[2]:

> ***"Intrinsic value is an all-important concept that offers the only logical approach to evaluating the relative attractiveness of investments and businesses. Intrinsic value can be defined simply: It is the discounted value of the cash that can be taken out of a business during its remaining life.***
>
> ***The calculation of intrinsic value, though, is not so simple. As our definition suggests, intrinsic value is an estimate rather than a precise figure, and it is additionally an estimate that must be changed if interest rates move or forecasts of future cash flows are revised. Two people looking at the same set of facts, moreover—and this would apply even to Charlie and me—will almost inevitably come up with at least slightly different intrinsic value figures. That is one reason we never give you our estimates of intrinsic value. What our annual reports do supply, though, are the facts that we ourselves use to calculate this value." – Warren Buffett***

There are numerous approaches that have been used to estimate Berkshire Hathaway's intrinsic value. In our view, the most compelling model involves evaluating Berkshire Hathaway's insurance float as the main driver of value. This method was first developed by Alice Schroeder and Gregory Lapin in their well known report on Berkshire Hathaway published in 1999[3]. We will use this basic framework as the primary valuation technique throughout this report. One limitation of the "float based" model is a high level of sensitivity to the variables used in the analysis. Therefore, a conservative set of assumptions will be used to come up with a range of intrinsic value rather than an exact figure. In addition, we provide a sensitivity analysis to illustrate the impact of key variables on the calculation of intrinsic value.

While we believe that the "float based" model is the most intellectually valid approach, it is not without controversy. Critics point out that float based valuations, even when conservative assumptions are used, can produce intrinsic value estimates that Berkshire's share price has failed to consistently achieve over long periods of time. Therefore, we will also present two more traditional valuation yardsticks for Berkshire Hathaway.

First, we will examine the "two column"' approach that many Berkshire shareholders believe was implicitly endorsed by Warren Buffett in his shareholder letters. In Berkshire Hathaway's 2008 Letter to Shareholders, Mr. Buffett stated that he believes that Berkshire has two main areas of value[4]:

> ***"Berkshire has two major areas of value. The first is our investments: stocks, bonds and cash equivalents. At yearend [2008] those totaled $122 billion (not counting the investments held by our finance and utility operations, which we assign to our second bucket of value). About $58.5 billion of that total is funded by our insurance float.***
>
> ***Berkshire's second component of value is earnings that come from sources other than investments and insurance. These earnings are delivered by our 67 non-insurance companies, itemized on page 96. We exclude our insurance earnings from this calculation because the value of our insurance operation comes from the investable funds it generates, and we have already included this factor in our first bucket."***

Second, we will look at Berkshire Hathaway's reported book value per share and attempt to draw some conclusions regarding intrinsic value based on the historical relationship between book value and market value. Book value per share is a problematic yardstick because it only captures the value of intangible assets (goodwill) at historic purchase prices and gives no credit to economic goodwill at subsidiaries that have built up over many decades. Nevertheless, according to Mr. Buffett the *change in book value* can serve as a rough proxy for *changes in intrinsic value* over time[5]:

> ***"Book value far understates Berkshire's intrinsic value, a point true because many of the businesses we control are worth much more than their carrying value. Inadequate though they are in telling the story, we give you Berkshire's book-value figures because they today serve as a rough, albeit significantly understated, tracking measure for Berkshire's intrinsic value. In other words, the percentage change in book value in any given year is likely to be reasonably close to that year's change in intrinsic value."***

Since an exact figure for intrinsic value cannot be reasonably calculated, our goal is to arrive at a conservative range of values and draw appropriate conclusions regarding the current stock price. In keeping with the theme of the report, we will also consider whether the methodology used to arrive at these estimates assumes a "Buffett Premium" that could be at risk if a management change occurs sooner than investors anticipate.

Insurance Subsidiaries

"Growing float at a good clip at a low cost is very difficult – it's almost impossible. But we intend to do it anyway." [1]

-- Berkshire Hathaway Vice Chairman Charlie Munger

It is impossible to understand Berkshire Hathaway's unique business model without a solid grasp of the insurance operations that represent the core of the company's strength. Warren Buffett's decision to purchase National Indemnity from Jack Ringwalt for $8.6 million in 1967 represented one of the first deployments of Berkshire Hathaway's capital outside the textile business. While National Indemnity's float was a modest $17 million[2] at the time, this float provided funds for Berkshire to purchase marketable securities and other investments that compounded at astonishingly high rates of the next four decades[3].

> ***"Since Berkshire purchased National Indemnity ("NICO") in 1967, property-casualty insurance has been our core business and the propellant of our growth. Insurance has provided a fountain of funds with which we've acquired the securities and businesses that now give us an ever-widening variety of earnings streams." – Warren Buffett, 2004 Letter to shareholders [4]***

Warren Buffett's 2004 letter to shareholders contains a five page section on the nature of the insurance industry that should be required reading for anyone with interest in this field[5]. Mr. Buffett included the following data on National Indemnity Company to illustrate the importance of underwriting discipline:

Year	Written Premiums ($ millions)	Employees at Year End	Expense Ratio	Underwriting Profit as % of Premiums *
1980	79.6	372	32.3%	8.2%
1981	59.9	353	36.1%	-0.8%
1982	52.5	323	36.7%	-15.3%
1983	58.2	308	35.6%	-18.7%
1984	62.2	342	35.5%	-17.0%
1985	160.7	380	28.0%	1.9%
1986	366.2	403	25.9%	30.7%
1987	232.3	368	29.5%	27.3%
1988	139.9	347	31.7%	24.8%
1989	98.4	320	35.9%	14.8%
1990	87.8	289	37.4%	7.0%
1991	88.3	284	35.7%	13.0%
1992	82.7	277	37.9%	5.2%
1993	86.8	279	36.1%	11.3%
1994	85.9	263	34.6%	4.6%
1995	78.0	258	36.6%	9.2%
1996	74.0	243	36.5%	6.8%
1997	65.3	240	40.4%	6.2%
1998	56.8	231	40.4%	9.4%
1999	54.5	222	41.2%	4.5%
2000	68.1	230	38.4%	2.9%
2001	161.3	254	28.8%	-11.6%
2002	343.5	313	24.0%	16.8%
2003	594.5	337	22.2%	18.1%
2004	605.6	340	22.5%	5.1%

Data from Warren Buffett's 2004 annual letter to shareholders.
*** Underwriting profit was calculated as of year-end 2004.**

Exhibit 3: National Indemnity Company Selected Data: 1980 to 2004

Mr. Buffett asks the reader to consider whether any public company would be able to put in place a business model that calls for the kind of dramatic declines in revenue that National Indemnity experienced from 1986 to 1999, a period of soft insurance pricing when management was unable to secure business at appropriate premium levels.

The likely answer is that few, if any, public companies would tolerate this due to the incentive systems that normally prevail. Most executives would be inclined to cut staffing levels as premium volume decreases in order to lower the expense ratio. However, the problem is that if employees believe that management will cut jobs in response to premium volume declines, incentives are in place for underwriters to accept inadequate premiums that will surely result in underwriting losses at some point in the future. Berkshire Hathaway has a long-standing policy of not cutting staff levels in response to falling premium volumes which removes at least one factor which could lead to underwriting losses.

We can see that National Indemnity managed to post underwriting profits for every year between 1985 and 2000 despite shrinking premium volume. As we shall see, avoiding underwriting losses is the key to success in the insurance business and Berkshire Hathaway's strong track record over the years accounts for a significant portion of the company's overall intrinsic value.

The Benefits and Perils of Float

Every insurance business generates float, although the nature of the float and the cost varies greatly throughout the industry. Float exists because insurers require policyholders to make payment at the start of a coverage period while payments for insured losses occur over time. The duration of the float varies based on the type of insurance policy in question and whether the business is "long-tail" in nature[6]. Insurance companies are able to invest the funds that are held as float and shareholders of the business benefit from the investment returns on the float.

It must be emphasized that float is *not* an asset on the balance sheet. To the contrary, float is a liability on the balance sheet that represents the estimated funds required to eventually satisfy policyholder claims[7]. Furthermore, float does not come without risk because the cost of the float often proves to be higher than the rate of return an insurance company can generate by investing the float over time. If an insurer has a cost of float higher than its investment return, losses will ensue.

> ***"Float is wonderful – if it doesn't come at a high price. Its cost is determined by underwriting results, meaning how the expenses and losses we will ultimately pay compare with the premiums we have received. When an insurer earns an underwriting profit – as has been the case at Berkshire in about half of the 39 years we have been in the insurance business – float is better than free. In such years, we are actually paid for holding other people's money. For most insurers, however, life has been far more difficult: In aggregate, the property-casualty industry almost invariably operates at an underwriting loss. When that loss is large, float becomes expensive, sometimes devastatingly so." – Warren Buffett, 2005 Letter to shareholders*** [8]

Berkshire Hathaway has built a remarkable long term record largely due to management's ability to accumulate a very large amount of float and to do so at zero or negative cost. At the end of 2010, Berkshire held $65.8 billion of float. Better yet, the cost of Berkshire's float has been negative over the past eight years.

How has Berkshire managed to operate at a consistent underwriting profit for so much of its history when, in the aggregate, the industry operates at an underwriting loss? The answer boils down to a culture of underwriting discipline in place at all Berkshire insurance subsidiaries. As we have seen with the National Indemnity example, insurance underwriters are instructed to reject inadequately priced risk even if this will lead to a reduction in premium volume[9].

In addition to Berkshire's commitment to avoid layoffs due to declining premium volume, compensation policies are set to reward underwriting profitability rather than volume growth. Berkshire wants to accumulate *cheap float*, preferably at a zero or negative cost over long periods of time[10]. In the absence of opportunities to obtain cheap float, management would rather see premium volumes and float decline rather than to pursue business aggressively at unprofitable rates.

Historical Average Cost of Float	1999 to 2010	2005 to 2010	1999 to 2004
GEICO	-9.4%	-13.2%	-5.7%
General Re	2.6%	-1.6%	6.8%
Berkshire Hathaway Reinsurance	-1.5%	-2.6%	-0.4%
Other Primary	-5.3%	-5.5%	-5.2%
All Insurance Operations	-0.6%	-3.9%	2.7%

Exhibit 4: Historical Average Cost of Float for Berkshire Insurance Reporting Segments[11]

The exhibit shown above demonstrates that with the exception of General Re, all Berkshire Hathaway insurance subsidiaries have delivered negative cost float, on average, over the twelve year period ending in 2010. If one looks at the six year period ending in 2010, all insurance subsidiaries report a negative cost of float. A negative cost of float figure indicates that Berkshire Hathaway not only had use of the float for investment purposes but also earned underwriting profits. As we will see, the presence of high quality float is one of the key drivers of Berkshire Hathaway's intrinsic value.

Historical Loss Estimation Accuracy

While the data presented above provides some reassurance regarding Berkshire's ability to generate low or negative cost float over a long period of time, the figures do not fully illustrate the hazards inherent in estimating losses on a yearly basis.

While most insurance policies cover losses over a one year period, losses can sometimes emerge at a much later time depending on the nature of the insurance in question. For example, auto insurance claims at GEICO are likely to appear much more quickly than claims against complicated reinsurance policies associated with asbestos exposure or a mega-catastrophe. The goal of loss estimation is to be neither too conservative nor too aggressive in terms of reserving for incurred but not reported (IBNR) claims. Nevertheless, even when management is attempting to reserve accurately, significant mistakes are inevitable for "long tail" policies. The following exhibit illustrates Berkshire's overall track record when it comes to accuracy of loss reserve estimates.

Loss Estimation Accuracy: 2000 - 2010											
Figures in Millions											
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Unpaid losses per Consolidated Balance Sheet	32,868	40,562	43,771	45,393	45,219	48,034	47,612	56,002	56,620	59,416	60,075
Reserve discounts	1,675	2,022	2,405	2,435	2,611	2,798	2,793	2,732	2,616	2,473	2,269
Unpaid losses before discounts	34,543	42,584	46,176	47,828	47,830	50,832	50,405	58,734	59,236	61,889	62,344
Ceded reserves	(2,997)	(2,957)	(2,623)	(2,597)	(2,405)	(2,812)	(2,869)	(3,139)	(3,210)	(2,922)	(2,735)
Net unpaid losses	31,546	39,627	43,553	45,231	45,425	48,020	47,536	55,595	56,026	58,967	59,609
Reserve discounts	(1,675)	(2,022)	(2,405)	(2,435)	(2,611)	(2,798)	(2,793)	(2,732)	(2,616)	(2,473)	(2,269)
Deferred charges	(2,593)	(3,232)	(3,379)	(3,087)	(2,727)	(2,388)	(1,964)	(3,987)	(3,923)	(3,957)	(3,810)
Net unpaid losses, net of discounts/deferred charges	27,278	34,373	37,769	39,709	40,087	42,834	42,779	48,876	49,487	52,537	53,530
Liability re-estimated:											
1 year later	28,569	36,289	39,206	40,618	39,002	42,723	41,811	47,288	48,836	49,955	
2 years later	30,667	38,069	40,663	39,723	39,456	42,468	40,456	46,916	47,293		
3 years later	32,156	40,023	40,517	40,916	39,608	41,645	40,350	45,902			
4 years later	33,532	40,061	41,810	41,418	38,971	41,676	39,198				
5 years later	34,096	41,448	42,501	40,891	39,317	40,884					
6 years later	35,566	42,229	42,007	41,458	38,804						
7 years later	36,410	41,744	42,643	41,061							
8 years later	36,124	42,455	42,275								
9 years later	36,658	42,194									
10 years later	36,394										
Cumulative deficiency (redundancy)	9,116	7,821	4,506	1,352	(1,283)	(1,950)	(3,581)	(2,974)	(2,194)	(2,582)	
Cumulative foreign exchange effect	(1,812)	(1,487)	(974)	(107)	319	(257)	227	721	84	312	
Net deficiency (redundancy)	7,304	6,334	3,532	1,245	(964)	(2,207)	(3,354)	(2,253)	(2,110)	(2,270)	
Source: Berkshire Hathaway 2010 10-K Report											

Exhibit 5: Berkshire Hathaway Loss Estimation Accuracy 2000 to 2010

We can see that the estimate for net unpaid losses made at the end of each year can change substantially as actual claims are received and the ultimate liability is re-estimated. For example, if we examine the column for 2000, we can see that the net unpaid loss estimate was originally $27,278 million. This was management's best estimate for all IBNR losses as of December 31, 2000. However, this estimate turned out to be too low and was subsequently re-estimated to a higher figure. Ten years after the initial estimate, the liability was re-estimated at $36,394.

Redundancies can occur as well, as we can see for years from 2004 to 2009. For example, net unpaid losses as of December 31, 2005 were originally estimated at $42,834 million but this ended up being too pessimistic. Five years later (at year-end 2010), the liability as of year-end 2005 was re-estimated to be $40,884 million.

Despite deficiencies in the estimates in the early part of the last decade, Berkshire Hathaway has a solid long term track record of underwriting discipline which has consistently delivered low or negative cost float.

Float Based Valuation Principles

While float is carried as a liability on the balance sheet and represents very real claims that must eventually be paid out to policy holders, cost free or negative cost float can create significant value for an insurance company's shareholders. As long as the insurer does not liquidate the business or shrink over a sustained period of time, low cost float takes on equity-like characteristics because it can be used to generate returns for the benefit of shareholders.

Alice Schroeder is widely credited for being the first Wall Street analyst to value an insurance business using a float based model[12]. The basic concept is that one may view the cash flows generated from float as a stream of income that can persist indefinitely. The difference between the return the insurer can achieve by investing the float and the cost of float represents the spread. As long as the spread is positive, the insurer benefits from positive cash flows as a result of holding the float. If these cash flows can be estimated for a number of years into the future, one can discount the cash flows to present value terms to arrive at the value the float represents to shareholders.

> ***"If you could see our float for the next 20 years and you could make an estimate as to the amount and the cost of it, and you took the difference between its cost and the returns available on governments, you could discount it back to a net present value." – Warren Buffett[13]***

Of course, it is easier said than done to come up with reasonable estimates of float over a long period of time and to determine the cost of float. Furthermore, small changes in the assumptions for the cost and level of float as well as the investment return can have a dramatic impact on the present value calculation. Nevertheless, the float based model is intellectually sound and represents a viable approach if conservative assumptions are used.

We will present data on the cost of float for each of Berkshire Hathaway's insurance segments along with information regarding how the float has grown over time. Based on historical patterns and forecasts of future developments, we will estimate cost and growth of float in the future. In addition, we will estimate the rate of return Berkshire is likely to achieve on the float. This exercise will result in a present value calculation for the cash flows that Berkshire can expect to generate from policyholder float going forward. We will then add Berkshire's insurance segment statutory capital (less certain adjustments) to arrive at an estimate for the intrinsic value of Berkshire's insurance subsidiaries.

GEICO: *The Auto Insurance Powerhouse*

Warren Buffett and GEICO have a history spanning nearly six decades. In 1951, when Mr. Buffett was a 20 year old student at Columbia University, he took the train to Washington D.C. on a Saturday morning to find someone at GEICO headquarters who would be willing to answer questions regarding the business[14]. He found Lorimer Davidson, a financial Vice President at the time, and the two men spoke for four hours. With Benjamin Graham serving as Chairman of GEICO, the company quickly became "The Security I Like Best"[15] for Mr. Buffett and he put two-thirds of his $8,000 savings to work[16].

Fast forward twenty five years to early 1976 long after Mr. Buffett sold his original holdings in the company. After a series of missteps, GEICO was bleeding red ink and brought in a new CEO, Jack Byrne, who was rapidly making changes designed to engineer a turnaround. While GEICO retained the fundamental advantages that had led to its prior success, the company relaxed underwriting standards in the early 1970s while maintaining very low prices. As a result, by 1976 the company was teetering on the edge of bankruptcy[17].

Even while GEICO's ultimate fate was in no way assured, Warren Buffett began purchasing shares for Berkshire Hathaway in 1976 and eventually became the controlling shareholder. In early 1996, Berkshire Hathaway paid $2.3 billion for the half of the company that it did not already own.

GEICO is now the third largest private passenger auto insurer in the United States with 8.8 percent market share at the end of 2010[18]. GEICO leads Progressive in terms of market share and trails only State Farm and Allstate[19]. While auto insurance is considered a commodity business, GEICO has managed to differentiate itself through clever advertising symbolized by the ever-present GEICO gecko. This has helped to attract 10 million policyholders covering 16 million vehicles[20]. As we shall see from the presentation below, GEICO has been a dream business for Berkshire Hathaway over the past decade as it has leveraged a low cost model to generate significant cumulative underwriting profits while growing the amount of float available for Berkshire to invest at a steady rate.

Key Statistics: 1999 to 2010

The exhibit below presents a number of key statistics for GEICO for the past twelve years. All figures are expressed in millions. The combined ratio represents the total of underwriting losses and expenses divided by earned premiums. The cost of float represents underwriting losses divided by year end float. In years when underwriting profits are earned, the cost of float is *negative*.

Figures in Millions		2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
GEICO	Year End Float	10272	9613	8454	7768	7171	6692	5960	5287	4678	4251	3943	3444
	Premiums Earned	14283	13576	12479	11806	11055	10101	8915	7784	6670	6060	5610	4757
	Underwriting Gain/Loss	1117	649	916	1113	1314	1221	970	452	416	221	-224	24
	Combined Ratio	92.2%	95.2%	92.7%	90.6%	88.1%	87.9%	89.1%	94.2%	93.8%	96.4%	104.0%	99.5%
	Cost of Float	**-10.9%**	**-6.8%**	**-10.8%**	**-14.3%**	**-18.3%**	**-18.2%**	**-16.3%**	**-8.5%**	**-8.9%**	**-5.2%**	**5.7%**	**-0.7%**
	% of Total BRK Float	**15.6%**	**15.5%**	**14.5%**	**13.2%**	**14.1%**	**13.6%**	**12.9%**	**12.0%**	**11.3%**	**12.0%**	**14.1%**	**13.6%**

Exhibit 6: Key Statistics for GEICO: 1999 to 2010

We can see that float has compounded at a 10.4 percent annualized rate from 1999 to 2010, with the pace of growth decelerating when one compares the second half of the last decade to the first half. Premiums earned have compounded at the rate of 10.5 percent over the same timeframe Other than one year of underwriting losses in 2000, GEICO has produced underwriting profits in every year. The combined ratio has averaged in the low 90s during this period. The cost of float has been negative due to the strong underwriting profitability of the insurance operations. To sum up the data, GEICO has proven to be a marvelous business that generates a growing amount of negative cost float. Berkshire Hathaway has access to GEICO's float for investment in businesses and securities while also realizing underwriting profitability. This is the best of both worlds.

Prior to the General Re acquisition in 1999, GEICO represented over 40 percent of Berkshire Hathaway's total float. The consolidation of General Re along with growth in the other insurance subsidiaries has reduced the overall impact of GEICO's float. In recent years, GEICO's float has accounted for approximately 13 to 14 percent of Berkshire Hathaway's total insurance float and grew to 15.6 percent in 2010. Although more limited in terms of impact on Berkshire's overall insurance results, GEICO's delivers very high quality float year after year and management has been able to do this even while the company has steadily increased market share.

The Security I Like Best

In 1951, Warren Buffett wrote an article describing his bullish investment thesis for GEICO. The article provides fascinating insight into Mr. Buffett's early investment philosophy.

Link to original article: http://bit.ly/fkKNmv

Long Term Projections

While past history shows that GEICO has been capable of delivering growing amounts of negative cost float for Berkshire to invest, can these trends be sustained in the future? One of the penalties of success is that growth inevitably slows as a company gains market share. The rate of growth over the past decade has resulted in GEICO reaching the third highest market share in the United States auto insurance market which is up dramatically from seventh place in 1998. The company has more than doubled its market share from 3.5 percent in 1998 to 8.8 percent in 2010[21].

While GEICO's growth of float has not shown any signs of stopping in recent years, we believe that it is prudent to assume that float growth must decelerate in the future, particularly if the company maintains underwriting discipline. Indeed, growth of float in exchange for lower underwriting profitability (or even underwriting losses) would be counterproductive. GEICO's corporate culture will not permit trading market share and float growth for lower levels of underwriting profitability and risking a repeat of the company's near death experience in the 1970s. One other growth limiting factor to consider is that GEICO now operates in all fifty states after the company's entry into the Massachusetts market in early 2009. GEICO previously expanded into New Jersey in 2004[22].

In the float based valuation model, we will assume that GEICO's growth in float over the next decade will slow to 6 percent while the cost of float will run at roughly -6 percent.

Both assumptions are conservative given GEICO's strong track record. A deceleration in float growth and a moderation in underwriting profitability are prudent adjustments to make given GEICO's current market share compared to its starting point ten years ago. It is unlikely that the cost of float would deteriorate much beyond a -6 percent level given that there were only three years over the past twelve when results were worse. GEICO has clearly demonstrated that consistent delivery of negative cost float can be safely expected going forward.

Lou Simpson Retires From GEICO

Most media reports attribute all of Berkshire Hathaway's investment moves to Warren Buffett. However, Lou Simpson has long been responsible for managing GEICO's stock portfolio. Mr. Simpson retired from GEICO at the end of 2010.

According to Warren Buffett's 2004 letter to shareholders, Mr. Simpson delivered average annual gains of 20.3 percent from 1980 to 2004 compared to average annual gains of 13.5 percent for the S&P 500. Over the 25 year time frame, the portfolio experienced only three annual losses and underperformed the S&P 500 only six times. As Mr. Buffett noted in the letter, Lou Simpson is "a cinch to be inducted into the investment Hall of Fame."

General Re: *It's Finally "Fixed"*

When Warren Buffett decided to acquire General Re in 1998, it is doubtful that he anticipated the dismal financial results that the insurer would post over the next several years. While Mr. Buffett knew about General Re's derivatives book, the amount of time and effort required to wind it down was far greater than expected. General Re also caused numerous headaches due to involvement in a scandal related to American International Group early in the last decade[23].

In the quote below from early 2003, Mr. Buffett reflected on the state of General Re during the years immediately following the transaction[24]:

> ***"Gen Re's culture and practices had substantially changed and unbeknownst to management – and to me – the company was grossly mispricing its current business. In addition, Gen Re had accumulated an aggregation of risks that would have been fatal had, say, terrorists detonated several large scale nuclear bombs in an attack on the U.S. A disaster of that scope was highly improbable, of course, but it is up to insurers to limit their risks in a manner that leaves their finances rock-solid if the "impossible" happens. Indeed, had Gen Re remained independent, the World Trade Center attack alone would have threatened the company's existence."***

At the time of the General Re merger, the transaction was the largest in Berkshire Hathaway's history and dramatically increased the amount of float available for investment. However, it turned out that the float came at a very high cost due to the gross mispricing of business and aggregation of risks that could have destroyed the company after September 11, 2001 if it had not been part of Berkshire.

While the history of General Re during Berkshire Hathaway's twelve years of ownership has had its share of turbulence, the future of General Re is looking quite a bit brighter today. As we will see in our analysis below, it is finally safe to say that General Re has been "fixed".

Key Statistics: 1999 to 2010

In the four years immediately following the acquisition, General Re posted over $7.5 billion in cumulative underwriting losses while running an average combined ratio of 123% and a cost of float averaging in the low double digits as we can see in the exhibit below. Starting in 2003, results began to dramatically improve with the cost of float remaining either negative or at very low levels from 2003 to 2010:

Figures in Millions		**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
General Re	Year End Float	20049	21014	21074	23009	22827	22920	23120	23654	22207	19310	15525	15166
	Premiums Earned	5693	5829	6014	6076	6075	6435	7245	8245	8500	8353	8696	6905
	Underwriting Gain/Loss	452	477	342	555	526	-334	3	145	-1393	-3671	-1254	-1184
	Combined Ratio (%)	92.1%	91.8%	94.3%	90.9%	91.3%	105.2%	100.0%	98.2%	116.4%	143.9%	114.4%	117.1%
	Cost of Float	**-2.3%**	**-2.3%**	**-1.6%**	**-2.4%**	**-2.3%**	**1.5%**	**0.0%**	**-0.6%**	**6.3%**	**19.0%**	**8.1%**	**7.8%**
	% of Total BRK Float	**30.5%**	**33.9%**	**36.0%**	**39.2%**	**44.9%**	**46.5%**	**50.2%**	**53.5%**	**53.9%**	**54.4%**	**55.7%**	**59.9%**

Exhibit 7: Key Statistics for General Re: 1999 to 2010

While certain events could not have been foreseen in advance, such as the September 11, 2001 terrorist attacks, clearly there were structural problems at General Re which were undetected at the time of purchase. Under Mr. Buffett's leadership and new management at General Re, this situation should not repeat.

"We did something wrong and we paid the price." – Warren Buffett

On January 20, 2010, General Re reached a $92 million settlement with the federal government which will allow the firm to avoid prosecution for its role in an accounting fraud involving AIG. This concluded a painful chapter in General Re's history that had serious consequences for Berkshire Hathaway because a number of General Re executives were implicated in the case.

The controversy involved a reinsurance transaction between General Re and AIG that allegedly helped AIG to inflate loss reserves by $500 million in 2000 and 2001. Although General Re had no control over how AIG accounted for the transaction, several executives were implicated in the transaction. Warren Buffett was never charged with wrongdoing. In 2010 upon settlement of the matter, Mr. Buffett took responsibility by stating that "We did something wrong and we paid the price. It shouldn't have been done, and there's nothing inappropriate about the fine we paid." Additional information and links: http://bit.ly/gcDeH5

During the years immediately following the acquisition, General Re accounted for a majority of Berkshire Hathaway's total float. This figure has been steadily declining over the past decade with General Re's float only accounting for 30.5 percent of total Berkshire Hathaway float in 2010.

After the first four disastrous years, General Re has posted consistent underwriting profits with the exception of a small loss in 2005. While underwriting profitability has improved, the level of float has stagnated as General Re's annual premium volume declined. In fact, General Re had lower earned premium volume in 2010 than in 1999 immediately after the acquisition. However, premium declines in soft insurance markets should not surprise us if we recall National Indemnity's track record presented earlier in this section. At Berkshire, underwriting discipline is a requirement at all insurance subsidiaries.

It is readily apparent that General Re management, led by Chairman and CEO Tad Montross, has made the decision to reject inadequately priced risk even if that leads to lower premium volume and smaller growth in overall levels of float. As Warren Buffett has repeatedly stated in his letters to shareholders, it is far better for an insurance company to accept lower premium volume rather than to keep prices artificially low and risk crippling underwriting losses. This is particularly important in General Re's "long-tail" insurance where a great deal of estimation error can occur when underwriters attempt to forecast future claims experience.

Tad Montross

Today, General Re provides Berkshire Hathaway with over $20 billion of negative cost float that has been used to invest in securities and businesses. While the cost of float at General Re is not nearly as attractive as at GEICO, we can confidently say that the business has finally been "fixed".

Long Term Projections

It is safe to predict that Warren Buffett and General Re management are now committed to rejecting inadequately priced risk as we can see by virtue of the company's willingness to see the level of float stagnate over several years. We can also see that management has succeeded in delivering negative cost float the for past five years.

In the float based valuation model, we will assume that General Re's growth in float over the next decade will stabilize at 1.5 percent while the cost of float will run at roughly 2 percent.

These are conservative projections because we are implicitly assuming that General Re's growth of float will not even keep up with likely growth in Gross Domestic Product over the next decade. While in any particular year, General Re may sacrifice volume, it is unlikely that the company will fail to at least retain its market share over an extended insurance cycle consisting of both "hard" and "soft" markets. Indeed, General Re is well placed to *increase* market share in the periods immediately after super-catastrophes because it will have capital due to conservative management practices while many competitors will be reeling from heavy losses. Opportunity will come to the patient and well prepared players.

Assuming a positive 2 percent cost of float appears to be conservative given management's ability to deliver negative cost float over the past five years. Nevertheless, we do not feel comfortable projecting negative cost float for General Re over the next decade simply because the company has, so far, failed to deliver negative cost float over a full decade under Berkshire's ownership. If we continue to see negative cost float over the next few years, it may be safer to assume that the performance can be maintained over very long periods. Even at a positive 2 percent cost of float, General Re will be delivering funds to Berkshire at a rate materially lower than its likely return on investments.

Berkshire Hathaway Reinsurance: *"There isn't anyone like Ajit"*

Berkshire Hathaway Reinsurance Group's lead insurance entity is National Indemnity Company which was Warren Buffett's first entry into the insurance business. For the past twenty-five years, National Indemnity's reinsurance business has been run by Ajit Jain who specializes in underwriting very large and unusual risks. Warren Buffett and Ajit Jain speak on the phone nearly every day[25]. Other than Charlie Munger, it is probably fair to say that Ajit Jain is Warren Buffett's closest business associate at Berkshire.

> ***"Our third major insurance operation is Ajit Jain's reinsurance division, headquartered in Stamford and staffed by only 31 employees. This may be one of the most remarkable businesses in the world, hard to characterize but easy to admire. From year to year, Ajit's business is never the same. It features very large transactions, incredible speed of execution and a willingness to quote on policies that leave others scratching their heads. When there is a huge and unusual risk to be insured, Ajit is almost certain to be called.***
>
> ***Ajit came to Berkshire in 1986. Very quickly, I realized that we had acquired an extraordinary talent. So I did the logical thing: I wrote his parents in New Delhi and asked if they had another one like him at home. Of course, I knew the answer before writing. There isn't anyone like Ajit."***

While some forms of insurance have commodity-like characteristics, this is not the case for Ajit Jain's business. National Indemnity has often taken on risks that other insurers would be unwilling or unable to assume.

Keeping Abreast of Industry Trends

National Underwriter is one of the leading insurance industry publications and provides interesting information for investors including an annual report listing data for the top 100 individual insurance groups. Detailed reports of regulatory filings are available along with industry-wide combined ratios and commentary on the policy pricing environment.

For more information regarding last year's "Top 100" report, please follow this link: http://bit.ly/gI8tMF

THE NU TOP 100 P&C PREMIUM RANKINGS

The backing of Berkshire Hathaway is a major factor that differentiates National Indemnity from other insurers and Warren Buffett's willingness to accept a high degree of volatility in annual results makes it possible for Mr. Jain to optimize his underwriting for multi-year periods. The Berkshire Hathaway Reinsurance reporting segment is now responsible for over 46 percent of the float at Berkshire Hathaway and is the largest segment in terms of the level of float.

Key Statistics: 1999 to 2010

Berkshire Hathaway Reinsurance has experienced rapid growth over the twelve year period shown in the exhibit below. The jump in float from 2006 to 2007, along with the dramatically higher premium volume in 2007, is attributed to a one-time retroactive reinsurance deal with Equitas which resulted in a single premium of $7.1 billion. The increase in 2010 can be mostly attributed to the CNA retroactive reinsurance transaction[26]. However, even adjusting for the impact of the retroactive reinsurance transactions, it is clear that Berkshire Hathaway Reinsurance has been growing at a steady pace in recent years.

Figures in Millions		2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
B-H Re	Year End Float	30370	26223	24221	23692	16860	16233	15278	13948	13396	11262	7805	6285
	Premiums Earned	9076	6706	5082	11902	4976	3963	3714	4430	3300	2991	4712	2387
	Underwriting Gain/Loss	176	250	1222	1427	1658	-1069	417	1047	547	-647	-162	-251
	Combined Ratio	98.1%	96.3%	76.0%	88.0%	66.7%	127.0%	88.8%	76.4%	83.4%	121.6%	103.4%	110.5%
	Cost of Float	-0.6%	-1.0%	-5.0%	-6.0%	-9.8%	6.6%	-2.7%	-7.5%	-4.1%	5.7%	2.1%	4.0%
	% of Total BRK Float	46.1%	42.4%	41.4%	40.4%	33.1%	32.9%	33.1%	31.5%	32.5%	31.7%	28.0%	24.8%

Exhibit 8: Key Statistics for Berkshire Hathaway Reinsurance: 1999 to 2010

Underwriting losses have only been recorded in four of the past twelve years. The largest losses were due to the September 11, 2001 terrorist attacks and the 2005 hurricane season. In other years, the group has demonstrated a consistent ability to deliver float at a negative cost. In some years, such as 2006 and 2008, results have been extremely strong. Float has grown at a rapid clip over the past decade and now stands at over $30.3 billion compared to $6.3 billion at the end of 1999.

As we could see with General Re, Berkshire's policy of maintaining high levels of underwriting discipline applies at Berkshire Hathaway Reinsurance as well. There were several years over the past decade when earned premium volume dropped precipitously when management could not charge adequate rates to justify the risks taken. As a percentage of Berkshire's overall float, Berkshire Hathaway Reinsurance has grown from just under 25% of float in 1999 to over 46% today.

Long Term Projections

We project that management will continue the disciplined pattern of rejecting inadequately priced risk and acting in an opportunistic manner when it comes to obtaining additional float at low or negative cost (such as the Equitas and CNA transactions). While the average cost of float has been negative over the past decade and has averaged -4.5% over the past five years, this has also been a period of relatively light catastrophe losses.

In the float based valuation model, we assume that Berkshire Hathaway Reinsurance Group's float will grow over the next decade at a 2 percent rate while the cost of float will run at break-even levels.

These projections are subject to criticism by those who observe that Berkshire Hathaway Reinsurance Group has generated negative cost float on a consistent basis and has grown at rates far in excess of 2 percent. In defense of the more modest projections, we would note that the historical rates of float growth are based on a much smaller starting level of float. In addition, excluding the impact of the Equitas deal in 2007, float has grown at modest levels since 2004.

Our projection of zero cost float acknowledges the historical superiority of Berkshire Hathaway Reinsurance Group's results compared to General Re but recognizes that years of exceptionally poor results are inevitable given the group's business model. On average, results should be highly satisfactory under Ajit Jain and Warren Buffett's leadership but we would be perfectly satisfied with zero cost float rather than demanding to be paid to hold the float. Indeed, zero cost float growing at a two percent rate would provide a powerful source of value for Berkshire given the starting level of float in excess of $30 billion.

Berkshire Hathaway Primary Group

Berkshire Hathaway's Primary Insurance Group consists of a wide variety of independently managed businesses that primarily write commercial liability policies. Included in this group are Medical Protective Corporation, National Indemnity's primary group, U.S. Investment Corporation, Homestate, Central States Indemnity Company, Applied Underwriters, and Boat U.S[27]. The businesses are lower profile in nature but deliver meaningful value for Berkshire in the aggregate.

> ***"Our smaller insurers are just as outstanding in their own way as the "big three," regularly delivering valuable float to us at a negative cost. We aggregate their results … under "Other Primary." For space reasons, we don't discuss these insurers individually. But be assured that Charlie and I appreciate the contribution of each". – Warren Buffett[28]***

MEDICAL PROTECTIVE
Strength. Defense. Solutions. Since 1899.
a Berkshire Hathaway Company

Berkshire Hathaway acquired Medical Protective on July 1, 2005 from General Electric for $825 million. Medical Protective has been in the business of providing professional liability insurance for medical professionals since 1899. Medical Protective accounted for approximately one-third of earned premiums in the Berkshire Hathaway Primary Group from 2006 to 2008.

Medical malpractice has been a mine field for many insurers but Warren Buffett believes underwriting discipline will yield good results: "It will have the attitudinal advantage that all Berkshire insurers share, wherein underwriting discipline trumps all other goals." (2005 Annual letter to shareholders: http://bit.ly/eFceS0)

Key Statistics: 1999 to 2010

Berkshire Hathaway's Primary Group has experienced the most rapid growth in float and premium volume of any of the insurance groups over the past twelve years, although starting from a small baseline level in 1999. The group has delivered 26 percent annualized growth in float from 1999 to 2010. This growth has decelerated significantly over the past four years as we can see from the exhibit shown below. The big jump in float and premium volume in 2005 is mostly accounted for by the acquisition of Medical Protective[29].

Figures in Millions		**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
B-H Primary Group	Year End Float	5141	5061	4739	4229	4029	3442	1736	1331	943	685	598	403
	Premiums Earned	1697	1773	1950	1999	1858	1498	1211	1034	712	501	325	257
	Underwriting Gain/Loss	268	84	210	279	340	235	161	74	32	30	25	17
	Combined Ratio	84.2%	95.3%	89.2%	86.0%	81.7%	84.3%	86.7%	92.8%	95.5%	94.0%	92.3%	93.4%
	Cost of Float	**-5.2%**	**-1.7%**	**-4.4%**	**-6.6%**	**-8.4%**	**-6.8%**	**-9.3%**	**-5.6%**	**-3.4%**	**-4.4%**	**-4.2%**	**-4.2%**
	% of Total BRK Float	**7.8%**	**8.2%**	**8.1%**	**7.2%**	**7.9%**	**7.0%**	**3.8%**	**3.0%**	**2.3%**	**1.9%**	**2.1%**	**1.6%**

Exhibit 9: Key Statistics for Berkshire Hathaway Other Primary Group: 1999 to 2010

In terms of the cost of float, performance of this group has been exceptional. It is the only group that has delivered underwriting profits in every year over the past twelve years. It is always unwise to extrapolate a short term trend into the future, but it is perfectly reasonable to draw conclusions based on a track record spanning a timeframe in excess of one decade.

Long Term Projections

While it is unproductive to speculate regarding Berkshire's acquisition strategy, we can note that a significant amount of the growth of float in the Primary Group was the result of acquisitions such as Medical Protective. We believe that it is more prudent to evaluate the Primary Group in terms of organic growth than can be expected in the future based on existing businesses rather than to build in speculative assumptions regarding future acquisitions.

In the float based valuation model, we assume that Berkshire Hathaway Primary Group's float will grow over the next decade at a 8.3 percent rate while the cost of float will run at -5.3 percent.

An assumption of 8.3 percent growth is equivalent to average annual float growth for the primary group since the Medical Protective acquisition in 2005 during which time float grew from $3.4 billion to $5.1 billion. This growth assumption seems justified given the group's track record over time. The negative 5.3 percent cost of float projection is the lowest that appears reasonable given the fact that the cost of float figure has averaged negative 5.3 percent over the entire twelve year period.

Consolidated Insurance Group Data and Projections

The exhibit below consolidates the key statistics presented for each of the four insurance segments. The data provide a useful summary of Berkshire's overall level of float, premiums earned, underwriting results, and cost of float over the past twelve years.

Figures in Millions		2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
B-H Totals	Year End Float	65832	61911	58488	58698	50887	49287	46094	44220	41224	35508	27871	25298
	Premiums Earned	30749	27884	25525	31783	23964	21997	21085	21493	19182	17905	19343	14306
	Underwriting Gain/Loss	2013	1460	2690	3374	3838	53	1551	1718	-398	-4067	-1615	-1394
	Combined Ratio	**93.5%**	**94.8%**	**89.5%**	**89.4%**	**84.0%**	**99.8%**	**92.6%**	**92.0%**	**102.1%**	**122.7%**	**108.3%**	**109.7%**
	Cost of Float	**-3.1%**	**-2.4%**	**-4.6%**	**-5.7%**	**-7.5%**	**-0.1%**	**-3.4%**	**-3.9%**	**1.0%**	**11.5%**	**5.8%**	**5.5%**

Exhibit 10: Key Consolidated Statistics for All Berkshire Hathaway Insurance Operations

We can see that the insurance subsidiaries in aggregate have generated negative cost float for the past eight years. This is, in fact, the expectation of Berkshire Hathaway management. A well managed insurance business should generate float at zero to negative cost, even when one accounts for the occasional disastrous year (such as 2001 or 2005).

> ***"Of course, we ourselves will periodically have a terrible year in insurance. But, overall, I expect us to average an underwriting profit. If so, we will be using free funds of large size for the indefinite future." – Warren Buffett[30]***

The following exhibit summarizes the long term projections for ***cost of float*** that we have made for each of the four insurance reporting segments. We also list 2010 year end float (in millions) and the percentage of total float represented by each insurance group. We can then arrive at a weighted average long term estimated cost of float for Berkshire's overall insurance business.

Long Term Cost of Float Estimates	Estimated Cost of Float	2010 Year End Float	% of Total Float
GEICO	-6.0%	10272	15.6%
General Re	2.0%	20049	30.5%
Berkshire Hathaway Reinsurance	0.0%	30370	46.1%
Other Primary	-5.3%	5141	7.8%
All Insurance Operations (Weighted Avg)	-0.7%	65832	100.0%

Exhibit 11: Long Term Cost of Float Estimates

The exhibit below provides a summary of the long term projections for ***growth of float*** that we have made for each of the four insurance reporting segments. We also list 2010 year end float (in millions) and the percentage of total float represented by each insurance operation. We can then arrive at a weighted average long term rate of float growth for Berkshire's overall insurance business.

Forecasted Growth of Float	Estimated Growth Rate	2010 Year End Float	% of Total Float
GEICO	6.0%	10272	15.6%
General Re	1.5%	20049	30.5%
Berkshire Hathaway Reinsurance	2.0%	30370	46.1%
Other Primary	8.3%	5141	7.8%
All Insurance Operations (Weighted Avg)	3.0%	65832	100.0%

Exhibit 12: Long Term Growth of Float Estimates

In summary, we are anticipating that the consolidated insurance group will grow float at an average rate of 3.0 percent over the next decade and that the cost of float will average -0.7 percent.

In other words, Berkshire's insurance operations as a group should provide modest underwriting profitability over the next ten years while growing at a pace slightly lower than nominal Gross Domestic Product expansion.

While we estimated the cost and growth of float rates independently for each insurance reporting segment, the consolidated figures provide an important "reality check" and do not appear to be unreasonable. Berkshire Hathaway clearly has some of the best insurance operations in the world in terms of delivering low cost float for investment purposes. The average cost of float over the past twelve years was -0.6 percent and that includes several terrible years immediately following the General Re acquisition. Even with terrible years sure to come in the future, our assumption for slightly negative cost float over long periods of time seems reasonable.

Although underwriting discipline will restrain float growth from time to time, it is perfectly reasonable to assume that Berkshire's insurance businesses will be well positioned to grow at a rate similar to overall economic growth over extended periods of time, or at a slightly slower pace during soft markets when management restrains premium volumes. This is because the conservatism of management will allow the insurance subsidiaries to periodically take market share after disasters reduce the capacity of the industry as a whole. After a disaster, insurance rates often harden leading to opportunities to increase market share at attractive terms. ***Therefore, we will assume a 3.0 percent growth of float in perpetuity.***

Insurance Subsidiaries Valuation

As we discussed in the *Float Based Valuation Principles* section, the intrinsic value of Berkshire Hathaway's insurance business will be calculated by adding the net present value of the forecasted cash flows emanating from the use of policyholder float to adjusted statutory capital levels held in the insurance business:

$$\textit{Insurance Subsidiary Valuation} = \textit{Present Value of Float} + \textit{Statutory Capital}$$

Present Value of Float

We already have arrived at two of the variables required to estimate the net present value of the cash flows generated from Berkshire Hathaway's insurance float based on the analysis we have completed on each of the four insurance segments:

We have arrived at an estimated long term cost of float of -0.7 percent and will assume that float grows at 3.0 percent, on average, in perpetuity.

In order to arrive at a present value figure, we will also need to determine the investment return Berkshire is likely to achieve by investing the float. In general, we wish to avoid making aggressive predictions for investment returns *regardless of the fact that Warren Buffett is the chief capital allocator.*

Due to Mr. Buffett's age, we simply cannot predict how many years he will be available to allocate capital. It is better to take any excess returns Mr. Buffett can earn as a "bonus" over the next several years rather than to bake overly optimistic assumptions into a long term valuation model .

We are assuming that Berkshire will achieve a 6 percent investment return on insurance float.

Our intention is to assume that Berkshire will not achieve returns far in excess of what we believe the thirty year Treasury Bond should offer over the long run. While the thirty year Treasury Bond is currently yielding less than five percent, there are many reasons to believe that yields are artificially depressed due to actions taken to ameliorate the economic recession that began in 2008 as well as more recent steps such as the Federal Reserve's policy of "quantitative easing" intended to speed up the recovery[31].

The following formula is required to calculate the present value of the cash flows we anticipate will be generated from investing the float. We will treat the present value calculation as a "growing perpetuity":

$$\boldsymbol{Present\ Value = \frac{Year\ One\ Cash\ Flow}{Capitalization\ Factor}}$$

Where:

$$\boldsymbol{Year\ One\ Cash\ Flow = 2010\ Year\ End\ Float * (Investment\ Return - Cost\ of\ Float - Tax\ Burden)}$$

And:

$$\boldsymbol{Capitalization\ Factor = Discount\ Rate - Growth\ Rate}$$

We have not yet addressed the question of the tax burden. In order to generate float, Berkshire operates through an insurance subsidiary and this results in double taxation of shareholders' capital. According to Alice Schroeder's 1999 analysis, Mr. Buffett has commented that the cost of these corporate taxes to a Berkshire shareholder amounts to approximately 100 basis points, or 1 percent.[32]

We have also not discussed the rate that is used to discount the cash flows back to present value. We will use our six percent assumption for the long term rate on Treasury Bonds as the discount rate which may serve as a proxy for the risk free rate and is also used as our assumption of the investment return available to Berkshire for investing the float.

We are now able to incorporate the variables into the equation and come up with an estimate of the net present value of cash flows resulting from investment of float:

$$\textbf{\textit{Present Value}} = \frac{\mathbf{65832 * [0.06 - (-0.007) - 0.01)]}}{\mathbf{0.06 - 0.03}}$$

$$\textbf{\textit{Present Value}} = \mathbf{125{,}081}\ \textbf{\textit{million}}$$

From Berkshire Hathaway's 2010 annual report, we know that statutory capital for the Insurance business was approximately $94 billion[33]. Statutory capital increased by $30 billion in 2010 primarily due to capital contributions associated with the Burlington Northern Santa Fe (BNSF) acquisition. BNSF is a wholly owned subsidiary of National Indemnity.

We intend to account for the intrinsic value of BNSF separately from the insurance subsidiaries. Therefore, to avoid double counting, we must adjust the insurance statutory capital level to exclude the amount attributable to BNSF. The purchase price allocation for BNSF, presented in Note 2 of Berkshire's 2010 annual report, indicates that net assets acquired for BNSF were $34,495 million. We will deduct this figure from statutory capital in our valuation of the insurance business. Some might ask why the "adjusted statutory capital" figure we are using is now below the $64 billion statutory capital level recorded at December 31, 2009. The reason is that the intrinsic value of Berkshire's minority position in BNSF was considered as part of the insurance business valuation in 2009. In 2010, the original minority position along with the rest of BNSF purchased in February 2010 will be valued separately as a wholly owned subsidiary of Berkshire.

We can estimate the intrinsic value of Berkshire Hathaway's insurance subsidiaries as follows:

$$\textbf{\textit{Insurance Subsidiary Valuation}} = \textbf{\textit{PV Float}} + \textbf{\textit{Statutory Capital}} - \textbf{\textit{BNSF Adjustment}}$$

$$\textbf{\textit{Insurance Subsidiary Valuation}} = \mathbf{125{,}081 + 94{,}000 - 34{,}495} = \mathbf{\$184{,}586\ million}$$

We should note that Alice Schroeder's 1999 analysis subtracted $13 billion of estimated goodwill from General Re from her valuation estimate in an attempt to eliminate goodwill from the statutory capital figure. However, this is no longer necessary because under statutory accounting rules, the goodwill embedded in statutory capital is to be fully amortized over ten years[34]. Since the General Re acquisition took place in early 1999, goodwill has been fully amortized from statutory capital (although not from GAAP which is why General Re's goodwill still appears on Berkshire's consolidated financial statements.)

Sensitivity Analysis

The reader should be aware that the present value calculation described here is subject to a great deal of variability based on the assumptions that are used in the equation. We have attempted to use conservative assumptions, but it is still prudent to examine the sensitivity of the analysis to changes in key variables.

Consider the following changes in the insurance subsidiary valuation based on the following hypothetical scenarios. In each case, we adjust the single variable mentioned while holding all other variables in our baseline model constant:

Scenario	Valuation of Insurance Subsidiaries ($ millions)
Baseline Case	**184,586**
1% Increase in Float Growth Rate to 4.0%	247,126
1% Decrease in Float Growth Rate to 2.0%	153,316
1% Increase in Cost of Float to 0.3%	162,642
1% Decrease in Cost of Float to -1.7%	206,530
1% Increase in Investment Returns to 7%	206,530
1% Decrease in Investment Returns to 5%	162,642

Exhibit 13: Insurance Valuation Sensitivity Analysis

We provide this sensitivity information to caution the reader regarding the need to use conservative assumptions. For example, if one uses a growth rate for float that approaches the discount rate, the present value figure will approach an infinite value. Common sense must govern the assumptions we use and the results derived from estimates using this model. We believe that the assumptions used in the baseline case presented in this report are well supported by past history and reasonable assumptions regarding the future.

Readers who are interested in performing additional sensitivity analysis can get a feel for the nature of changing various variables by modifying the estimated values in the “Insurance Segment Valuation” Excel spreadsheet that accompanies this report or by simply replacing our assumptions in the equations presented above and performing the calculations manually.

Utilities and Energy

One of the most compelling aspects of Berkshire Hathaway's business model is that the company is constantly searching for new streams of income that can be obtained through investments of the free cash flow generated by the insurance subsidiaries and other operating companies. Simply because a particular operating unit generates cash flow does not mean that the cash should automatically be reinvested where it was generated.

Berkshire's investment in MidAmerican Energy Holdings Company is an excellent example of management's ability to redeploy cash flow into new business ventures. In this section, we will examine Berkshire's investment in MidAmerican and provide key details for each of the key utility and energy operating units. We will not attempt to provide an exhaustive discussion of the nuances of each business within MidAmerican and instead focus on the salient points likely to be of interest to Berkshire Hathaway shareholders.

Background Information

In 2010, Utilities and Energy generated $1,131 million of net income which represents a 5.6 percent increase over 2009 net income. Prior to March 2000, the Utilities and Energy reporting segment did not even exist, meaning that the earnings stream from utilities and energy was built entirely over the past decade through reinvestment of cash flows from other sources at Berkshire. The following exhibit shows the investments that Berkshire has made in MidAmerican over the past decade as disclosed in the company's annual 10-K filings:

Event Date	Description	Amount ($ Millions)	Economic Interest	Voting Interest
March 14, 2000	900,942 shares of Common stock and 34,563,395 shares of a non-dividend paying convertible preferred stock.	1,240	76.0%	9.7%
March 14, 2000	11% non-transferable trust preferred security.	455	76.0%	9.7%
March 2002	6,700,000 shares of convertible preferred stock	402	83.4%	9.7%
March 2002	11% non-transferable trust preferred security.	1,273	83.4%	9.7%
August 2003	Partial redemption of 11% non-transferrable trust preferred security.	(150)	83.4%	9.7%
February 9, 2006	Upon repeal of PUHCA, Berkshire converted preferred stock to common stock and, upon conversion, owned 83.4% of voting common shares.	N/A	83.4%	83.4%
March 21, 2006	Acquisition of additional common shares to finance MidAmerican's purchase of PacifiCorp.	3,400	87.8%	87.8%
March 2009	Berkshire issued 74,574 shares of Class B Common Stock to acquire certain non-controlling shareholder interests in MidAmerican. Berkshire Class B average closing price in March was approximately $2680 assigning an approximately $200 million market valuation to the stock issued.	200	89.5%	89.5%
During 2010	Berkshire reported $125 million in stock based compensation expense for purchasing the remaining stock options that had been granted upon Berkshire's acquisition of MidAmerican in 2000.	125	89.8	89.8%

Exhibit 14: Investments in MidAmerican Energy Holdings since March 2000

The Utility and Energy segment businesses include the operations of MidAmerican Energy which serves 725,000 electric customers primarily in Iowa; CE Electric UK which is comprised of Yorkshire Electricity and Northern Electric serving 3.8 million customers in the United Kingdom; PacifiCorp which is comprised of Pacific Power and Rocky Mountain Power serving 1.7 million customers in six western states; and Kern River and Northern Natural pipelines which carry approximately 8 percent of the natural gas consumed in the United States. When viewed from the perspective of nearly a decade after Berkshire began acquiring an interest in MidAmerican, the wisdom of the decision to enter the energy business cannot be denied, as Warren Buffett pointed out in a recent letter to shareholders:

> ***"We agreed to purchase 35,464,337 shares of MidAmerican at $35.05 per share in 1999, a year in which its per-share earnings were $2.59. Why the odd figure of $35.05? I originally decided the business was worth $35.00 per share to Berkshire. Now, I'm a "one-price" guy (remember See's?) and for several days the investment bankers representing MidAmerican had no luck in getting me to increase Berkshire's offer. But, finally, they caught me in a moment of weakness, and I caved, telling them I would go to $35.05. With that, I explained, they could tell their client they had wrung the last nickel out of me. At the time, it hurt.***
>
> ***Later on, in 2002, Berkshire purchased 6,700,000 shares at $60 to help finance the acquisition of one of our pipelines. Lastly, in 2006, when MidAmerican bought PacifiCorp, we purchased 23,268,793 shares at $145 per share.***
>
> ***In 2007, MidAmerican earned $15.78 per share. However, 77¢ of that was non-recurring – a reduction in deferred tax at our British utility, resulting from a lowering of the U.K. corporate tax rate. So call normalized earnings $15.01 per share. And yes, I'm glad I wilted and offered the extra nickel." – Warren Buffett[1]***

David Sokol is the Chairman of MidAmerican and Greg Abel is the Chief Executive Officer. Mr. Sokol held the CEO position from 1991 to 2008 and holds a minority ownership interest in MidAmerican. Mr. Sokol is now Chairman and CEO of NetJets, another Berkshire subsidiary, and has been considered a potential future Berkshire Hathaway CEO.

David Sokol

"Our partners in ownership of MidAmerican are Walter Scott, and its two terrific managers, Dave Sokol and Greg Abel. It's unimportant how many votes each party has; we make major moves only when we are unanimous in thinking them wise. Eight years of working with Dave, Greg and Walter have underscored my original belief: Berkshire couldn't have better partners." – Warren Buffett[2]

PacifiCorp

PacifiCorp is a regulated electric utility headquartered in Oregon serving 1.7 million retail electric utility customers in Utah, Oregon, Wyoming, Washington, Idaho, and California. The vast majority of electricity is sold to retail customers in Utah, Oregon, and Wyoming. A diverse group of industries are served which management believes helps to mitigate exposure to economic fluctuations. The company has a diversified portfolio of power generation facilities comprised of coal, natural gas, hydroelectric, and wind sources as we can see from the exhibit below. PacifiCorp had a total of 10,623 MW of net owned generating capacity at the end of 2010.

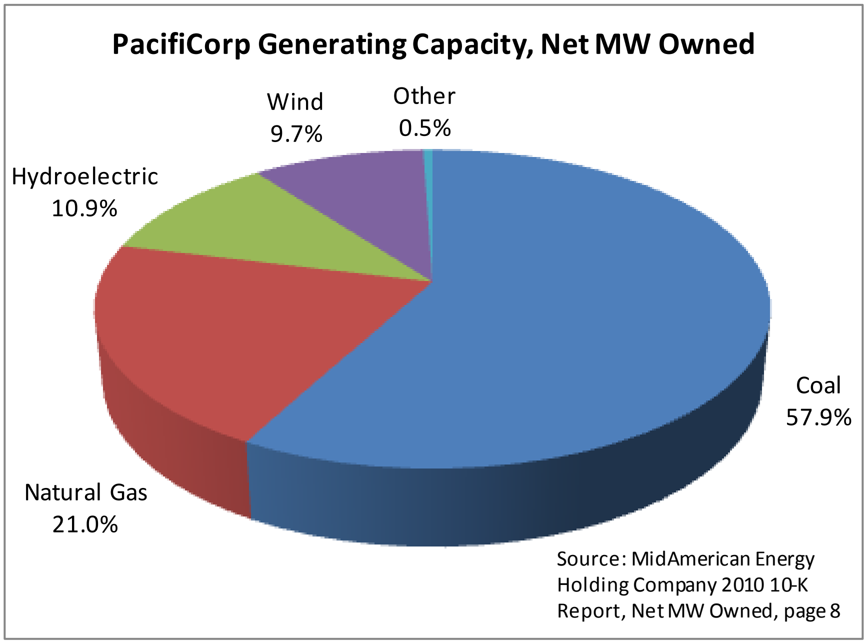


Exhibit 15: PacifiCorp Generating Capacity by Fuel Type

In recent years, PacifiCorp has generated the majority of its power from coal and bases its fuel mix on commodity prices, transportation costs, and various operational factors. PacifiCorp owns coal mines in Colorado, Utah, and Wyoming that have supplied approximately 30 percent of the company's total coal requirements in recent years. The remainder is purchased under short and long term contracts with suppliers.[3]

PacifiCorp typically has exclusive rights to service electric customers within its territory and is regulated by state utility commissions that establish rates based on a "cost of service" basis. These regulated rates are designed to

SEC Filings for Utility and Railroad Segments

Berkshire Hathaway provides condensed information regarding the Utility and Railroad segments within annual and quarterly reports filed with the SEC. However, MidAmerican Energy Holdings Company and Burlington Northern Santa Fe both file much more detailed quarterly and annual reports as well. In this report, we present data for MidAmerican and BNSF primarily based on Berkshire's reporting but we have often found it useful to review the more detailed SEC filings as well. MidAmerican Filings: http://bit.ly/gvIMfM BNSF Filings: http://bit.ly/fnqsnx permit PacifiCorp to cover the costs of generation and transmission of power as well as earn a "reasonable" rate of return on capital deployed in the business.

MidAmerican Energy Holdings Company acquired PacifiCorp on March 21, 2006 for a cash purchase price of $5.12 billion plus assumption of outstanding PacifiCorp debt. The acquisition was partially funded by Berkshire's additional equity investment of $3.4 billion. Pre-tax earnings were $356 million for the partial year of ownership in 2006 and has steadily increased to $783 million in 2010. Revenues were $4,518 million in 2010.

MidAmerican Energy Company

MidAmerican Energy is headquartered in Iowa and serves approximately 725,000 regulated retail customers in Iowa, South Dakota, Illinois, and Nebraska. The company's main activities include the generation, transmission, and distribution of electricity and the distribution, sale, and transport of natural gas. The majority of operating revenues are derived from the regulated gas and electric businesses with non-regulated activities accounting for approximately 30 percent of revenues in recent years. Approximately 90 percent of retail customers are located in Iowa.

MidAmerican has a diversified collection of power generating facilities primarily located in Iowa. Of the 6,501 net MW of generating capacity at the end of 2010, slightly over half was coal fired with natural gas and wind each accounting for approximately 20 percent of total capacity. MidAmerican has the largest wind-powered generation capability in the United States and has approval to invest in additional capacity in the future. MidAmerican's investments in wind energy are authorized to earn a 12.2 percent return on equity[4].

The exhibit shown below provides a breakdown of electric generating capacity by energy source:

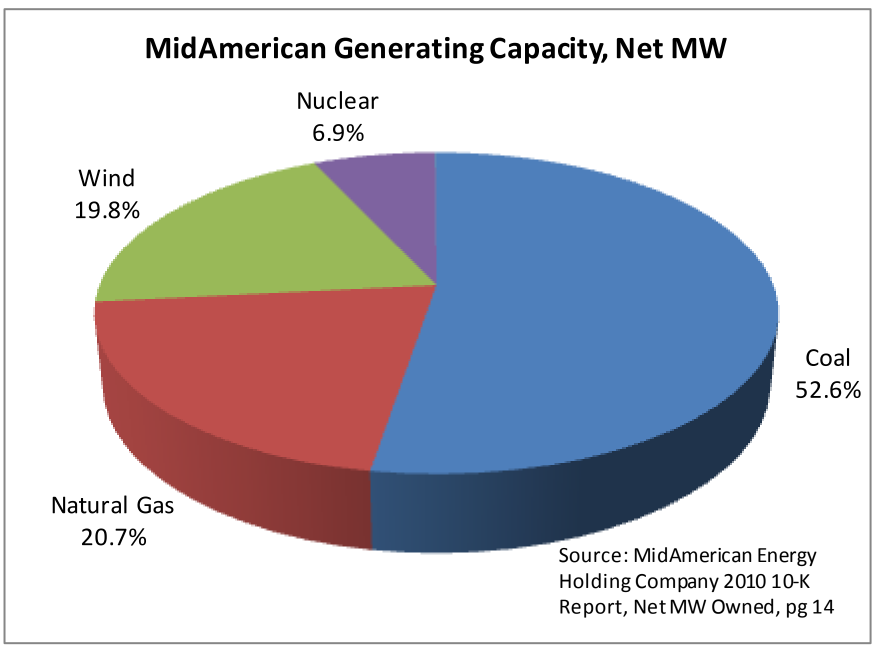


Exhibit 16: MidAmerican Energy Generating Capacity by Fuel Type

One interesting observation from MidAmerican's 10-K filing is the fact that the coal-fired generation facilities are fueled by low-sulphur coal from the Powder River Basin in northeast Wyoming. Unlike PacifiCorp, MidAmerican does not own coal mines but has long term contracts in place with suppliers. MidAmerican has a long-haul coal transportation agreement with Union Pacific Railroad which brings up the intriguing possibility of potentially leveraging Berkshire's ownership of Burlington Northern Santa Fe in the future:

> ***MidAmerican Energy has a long-haul coal transportation agreement with Union Pacific Railroad Company ("Union Pacific") that expires in 2012. Under this agreement, Union Pacific delivers coal directly to MidAmerican Energy's George Neal and Walter Scott, Jr. Energy Centers and to an interchange point with Canadian Pacific Railway for short-haul delivery to the Louisa and Riverside Energy Centers. MidAmerican Energy has the ability to use BNSF Railway Company, an affiliate company, for delivery of coal to the Walter Scott, Jr., Louisa and Riverside Energy Centers should the need arise.[5] (Source: MidAmerican Energy Holding Company 2010 10-K)***

The idea of "synergies" developing between BNSF and other Berkshire subsidiaries is ultimately a speculative exercise. However, it is interesting to note that in MidAmerican's 2009 10-K, the version of the quote shown above did not refer to expiration of the Union Pacific agreement in 2012, and it characterized its arrangement with BNSF to involve only a "small" amount of coal.

MidAmerican also has regulated operations associated with procuring, transporting, and distributing natural gas for customers within its service territory. Iowa has accounted for slightly over three-quarters of natural gas sales to retail customers in recent years. Between 45 to 55 percent of natural gas revenue is recorded during the winter months from December through March. MidAmerican's exposure to the price of natural gas is limited by the fact that the company is permitted to recover its cost of natural gas, thereby shifting the risk associated with price fluctuations to customers. MidAmerican had a distribution network of over 22,000 miles of gas mains and service pipelines at the end of 2010.

MidAmerican Energy Company recorded pre-tax operating earnings of $279 million for 2010 on revenues of $3,824 million.

Natural Gas Pipelines

MidAmerican Energy Holdings acquired two important natural gas pipeline systems in 2002 which now carry approximately 8 percent of the natural gas consumed in the United States[6]. MidAmerican paid $419.7 million for Kern River in March 2002 and $882.7 million for Northern Natural Gas in August 2002[7].

As we have seen in many other situations, Warren Buffett was able to orchestrate these acquisitions on favorable terms by being a buyer that could be counted on to come up with cash in tough times. In his 2002 letter to shareholders, Mr. Buffett recounted the long history of Northern Natural Gas from its origins in Omaha in the 1930s to its acquisition in July 1985 by Houston Natural Gas led by none other than Ken Lay who would later change the name of the company to Enron. In late 2001, Enron encountered difficulties and borrowed money from Dynergy using Northern Natural Gas as collateral. When ownership of the pipeline moved to Dynergy, the company's management decided to opt for a quick cash sale and naturally called Berkshire Hathaway. The story of the transaction is quite interesting:

> ***"From its beginnings in the 1930s, Northern Natural was one of Omaha's premier businesses, run by CEOs who regularly distinguished themselves as community leaders. Then, in July, 1985, the company – which in 1980 had been renamed InterNorth – merged with Houston Natural Gas, a business less than half its size. The companies announced that the enlarged operation would be headquartered in Omaha, with InterNorth's CEO continuing in that job.***
>
> ***Within a year, those promises were broken. By then, the former CEO of Houston Natural had taken over the top job at InterNorth, the company had been renamed, and the headquarters had been moved to Houston. These switches were orchestrated by the new CEO – Ken Lay – and the name he chose was Enron.***
>
> ***Fast forward 15 years to late 2001. Enron ran into the troubles we've heard so much about and borrowed money from Dynegy, putting up the Northern Natural pipeline operation as collateral. The two companies quickly had a falling out, and the pipeline's ownership moved to Dynegy. That company, in turn, soon encountered severe financial problems of its own. MEHC received a call on Friday, July 26, from Dynegy, which was looking for a quick and certain cash sale of the pipeline. Dynegy phoned the right party: On July 29, we signed a contract, and shortly thereafter Northern Natural returned home." – Warren Buffett's 2002 Letter to Shareholders*** [8]

Northern Natural Gas currently runs a pipeline system of 15,000 miles of natural gas pipelines consisting of 6,400 miles of mainline transmission pipelines and 8,600 miles of branch and lateral pipelines. According to the company, the pipeline network is the largest single pipeline in the United States as measured by pipeline miles and the twelfth-largest when measured by throughput. Northern Natural Gas does not actually own the vast majority of the natural gas transported through its pipeline system and instead collects revenues for transporting gas between producers and consumers of the product. As expected, the bulk of demand and revenue occurs during the colder months of November through March.

Kern River® GAS TRANSMISSION COMPANY A MIDAMERICAN ENERGY HOLDINGS COMPANY

When MidAmerican acquired Kern River in 2002, the company owned a 926 mile pipeline system extending from Wyoming to end markets in California, Nevada and Utah. Further expansion has created today's 1700 mile network which includes 1400 miles of wholly owned mainline section and 300 miles of common facilities which are jointly owned by Mojave Pipeline Company with Kern River holding a 77 percent majority interest.

Kern River is currently the only interstate pipeline that delivers natural gas directly from gas supply basins to end-users in California. This provides a competitive advantage because customers need not pay a "rate stack" fee that is imposed when natural gas moves from an interstate pipeline to an intrastate pipeline within California. Management believes that the company's relatively new pipeline system also has an advantage over competitors because it is able to comply with new safety regulations with limited incremental capital expenditures.

Warren Buffett has been pleased with the pipeline acquisitions and made the following comments in his 2008 letter to shareholders:

> ***"Our two pipelines, Kern River and Northern Natural, were both acquired in 2002. A firm called Mastio regularly ranks pipelines for customer satisfaction. Among the 44 rated, Kern River came in 9th when we purchased it and Northern Natural ranked 39th. There was work to do. In Mastio's 2009 report, Kern River ranked 1st and Northern Natural 3rd. Charlie and I couldn't be more proud of this performance. It came about because hundreds of people at each operation committed themselves to a new culture and then delivered on their commitment."*** [9]

As we will see in Exhibit 18 on Page 45, the natural gas pipelines have delivered steady profits for Berkshire over the past several years, although profits have been lower over the past two years. In 2010, the natural gas pipeline business generated $378 million of pre-tax earnings on revenues of $994 million. This was down from $457 million of pre-tax earnings and revenues of $1,073 million in 2009 due to lower transmission volumes resulting from less favorable economic conditions and lower natural gas price spreads.

When considering the earnings contributions of the natural gas pipelines, it is important to understand that MidAmerican invested heavily in capital expenditures over the years so one cannot look at the operating income figures in relation to the initial investment amounts in 2002 in isolation. Kern River pursued a major expansion project that was put into service in 2003 and nearly doubled system capacity. Kern River has invested $1.28 billion from the 2002 acquisition to the end of 2009 with the vast majority taking place in 2002 and 2003. Northern Natural Gas has invested $1.15 billion over the same timeframe with expenditures occurring on a more regular basis[10].

U.K. Utilities

Northern Electric and Yorkshire Electricity serve a combined total of 3.8 million end-users in an area of northeast England covering 10,000 square miles. Electricity is delivered over 18,000 miles of overhead lines, 40,000 miles of underground cables, and 700 major substations. The two companies, which combined ranks as the third largest U.K. utility, are managed jointly through CE Electric UK.

The companies build, maintain, and operate electricity distribution networks to serve end-users. In most cases, the electricity can only be delivered to the end-users through these distribution systems which provides relatively stable volume from year to year. Suppliers of electricity are charged fees for use of the distribution system. Rates are subject to regulation based on the government licenses for each company. The U.K. utilities earned $333 million in operating income on $804 million of revenues in 2010.

HomeServices of America

Although somewhat incongruous with the rest of MidAmerican's operations, the company owns the second largest residential real estate brokerage in the United States. In addition to providing residential real estate services, HomeServices also provides mortgage originations, title and closing services, and other services typical in the home sale process. HomeServices operates through 300 broker offices in 20 states and has over 15,000 sales associates. Most people have never heard of HomeServices because the company operates through local brand names as shown below:

Exhibit 17: HomeServices of America Brand Names

HomeServices is clearly in a competitive business that has seen unprecedented turmoil over the past four years as the housing bubble imploded and transaction volumes plummeted. During the peak bubble years, HomeServices routinely posted operating income in excess of $100 million per year but posted a $45 million operating loss in 2008 followed by a $43 operating profit in 2009, and a $42 million operating profit in 2010.

Earnings Summary

The earnings summary for MidAmerican Energy Holdings appears in the exhibit on the next page. Until 2005, the business was not fully consolidated in Berkshire's financial statements. Following the repeal of the Public Utility Holding Company Act (PUHCA)[11] on February 8, 2006, Berkshire converted its preferred stock to common stock and exceeded the ownership level required to consolidate MidAmerican. The data for the exhibit was obtained from Berkshire's management discussions and allows for comparability before and after consolidation.

Net earnings applicable to Berkshire includes both Berkshire's share of net earnings from MidAmerican after subtracting minority interests as well as the interest (net of income taxes) that Berkshire receives from debt MidAmerican owes to Berkshire. As we would expect, net earnings jumped considerably after the purchase of PacifiCorp in early 2006 which was funded, in part, by an additional $3.4 billion cash investment from Berkshire. There has been steady growth in the pipeline business over the years as well due to capacity increases.

Results in 2008 were unusually good due to a one time gain in Constellation Energy. MidAmerican realized a $917 million gain on the investment plus a $175 million breakup fee when an attempted takeover of Constellation was aborted[12]. Adjusting for the after-tax impact of this one time gain, normalized net earnings from MidAmerican over the past three years appears to be averaging roughly $1.1 billion per year. MidAmerican utilizes a significant amount of debt financing, but it should be noted that Berkshire Hathaway does not guarantee this debt. Berkshire continues to hold a small amount of MidAmerican's debt while debt owed to others totaled $19,646 million at the end of 2010.

All figures in millions	2010	2009	2008	2007	2006	2005	2004	2003
PacifiCorp	783	788	703	692	356			
MidAmerican Energy Company	279	285	425	412	348	288	268	269
Natural Gas Pipelines	378	457	595	473	376	309	288	261
U.K. Utilities	333	248	339	337	338	308	326	289
Home Services	42	43	(45)	42	74	148	130	113
Income (Loss) from discontinued zinc project						8	(579)	(46)
Other (net)	47	25	186	130	245	107	172	190
Operating earnings before corporate interest and taxes	1,862	1,846	2,203	2,086	1,737	1,168	605	1,076
Constellation Energy			1,092					
Interest, other than to Berkshire	(323)	(318)	(332)	(312)	(261)	(200)	(212)	(225)
Interest on Berkshire Junior Debt	(30)	(58)	(111)	(108)	(134)	(157)	(170)	(184)
Income Tax & Noncontrolling interests	(271)	(313)	(1,002)	(477)	(426)	(248)	(53)	(251)
Net Earnings	**1,238**	**1,157**	**1,850**	**1,189**	**916**	**563**	**170**	**416**
Net Earnings Applicable to Berkshire	**1,131**	**1,071**	**1,704**	**1,114**	**885**	**523**	**237**	**429**
Debt owed to others	19,646	19,579	19,145	19,002	16,946	10,296	10,528	10,296
Debt owed to Berkshire	165	353	1,087	821	1,055	1,289	1,478	1,578

Exhibit 18: MidAmerican Energy Holdings Summary: 2003 to 2010

In 2009, MidAmerican's results were impacted by lower regulated natural gas and electricity sales. This decline was due to lower consumption due to the economic downturn as well as mild temperatures in 2009. In addition, reported earnings were impacted by higher levels of depreciation due to additions of new wind-power generation facilities which was offset partially by lower costs of purchased natural gas and electricity. A weaker British Pound was mostly responsible for lower U.K. Utilities revenues when translated into U.S. Dollars.

In 2010, net earnings for the utility group as a whole increased 5.6 percent from 2009. PacifiCorp and MidAmerican Energy produced roughly flat operating income compared to 2009. Operating earnings from the natural gas pipelines declined by 17.3 percent from 2009 primarily due to lower transportation volumes resulting from less favorable economic conditions and lower natural gas price spreads. The U.K. utilities posted a 34.3 percent increase in operating profits primarily due to the sale of CE Gas, a subsidiary based in Australia.

As we briefly noted earlier, HomeServices has posted poor results in recent years. However, we believe that Home Services can potentially generate $100 million or more in operating profits once real estate industry conditions normalize. This would represent additional upside value not explicitly recognized by using the past three years to approximate normalized earnings. There have already been improvements at HomeServices with a return to profitability in 2009 and 2010, albeit at levels far lower than during the housing boom.

In his 2009 letter to shareholders, Warren Buffett predicted that HomeServices would be "much larger" in a decade[13]. Mr. Buffett believes that a housing recovery will "probably begin within a year or so" based on comments in his 2010 letter to shareholders[14].

Utility and Energy Valuation

From a valuation perspective, MidAmerican's electric utility and natural gas pipeline business are similar to other utilities operating in the United States with publicly traded stocks. However, there are no comparable companies that exactly match MidAmerican's mix of utilities in the United Kingdom and United States along with its ownership of HomeServices.

We will take a simple approach in our valuation of Berkshire's Utility and Energy segment by applying a market multiple to the earnings attributed to Berkshire's ownership interest. Value Line Investment Survey publishes data for the electric utility industry in the United States. The February 25, 2011 issue contains composite statistics for all of Value Line's electric utility sub-industry classifications (West, Central, and East) [15]. Value Line estimates that the average price/earnings ratio for the industry was 14.8 in 2006, 17.0 in 2007, 15.4 in 2008, and 12.5 in 2009. It appears that a P/E multiple of 14 to 16 is well supported. We will calculate the Utility and Energy Segment valuation as follows:

$$\boldsymbol{Valuation = Normalized\ Net\ Earnings\ Applicable\ to\ Berkshire\ x\ 15\ P/E\ Multiple}$$

$$\boldsymbol{Valuation = \$1.1\ Billion\ x\ 15 = \$16.5\ Billion}$$

BYD AUTO
Build Your Dreams

As of December 31, 2010, MidAmerican Energy Holdings Company owned 225 million shares of BYD with a market value of nearly $1.2 billion. The cost basis for the 10 percent investment in BYD made during 2008 is $232 million. David Sokol, MidAmerican's Chairman, is on BYD's Board of Directors.

BYD is a Chinese car manufacturer with roots in rechargeable battery technology. Led by founder Wang Chuan-Fu, BYD has developed an electric vehicle capable of traveling over 200 miles on a single charge, far in excess of products such as the Chevrolet Volt or Nissan Leaf. However, BYD has experienced difficulty bringing their products to western markets due to manufacturing capacity constraints and a lack of brand awareness outside China.

Charlie Munger has characterized Wang Chuan-Fu as "a combination of Thomas Edison and Jack Welch – something like Edison in solving technical problems, and something like Welch in getting done what he needs to do." Mr. Buffett has described Berkshire's investment as "a bet on the man". These are strong words of praise particularly given the fact that BYD's technology may be subject to tough competition in this emerging field.

Recently, a small company named Planar Energy announced plans to complete a pilot production line to build solid-state batteries that are printed in a roll much like newsprint. Such battery technology could deliver similar performance to BYD's technology. For more information on Planar Energy, see The Rational Walk's recent article at: http://bit.ly/efCYet. Also see The Rational Walk's series of articles on BYD: http://bit.ly/hsn8Yg.

Note: Berkshire's investment in BYD is considered part of the equity portfolio, not part of the valuation of the Utility and Energy business described in this section. As such, it is implicitly considered in the Insurance valuation.

Burlington Northern Santa Fe

"Railroads – now that's an example of changing our minds. Warren and I have hated railroads our entire life. They're capital-intensive, heavily unionized, with some make-work rules, heavily regulated, and long competed with a comparative disadvantage vs. the trucking industry, which has a very efficient method of propulsion (diesel engines) and uses free public roads. Railroads have long been a terrible business and have been lousy for investors. We did finally change our minds and invested. We threw out our paradigms, but did it too late. We should have done it two years ago, but we were too stupid to do it at the most ideal time."[1]

-- Berkshire Hathaway Vice Chairman Charlie Munger

Charlie Munger has often urged attendees of Wesco Financial's annual meetings to keep an open mind when it comes to amending or even discarding long held "best-loved ideas". In the case of railroads, both Warren Buffett and Charlie Munger long considered railroads to represent the type of business that is best avoided, but the equation dramatically changed due to deregulation, efficiency advantages, and sharply escalating fuel costs which have had a major impact on the trucking industry.

Industry Background

For most of the twentieth century, strict government regulations were imposed on the railroad industry due to a belief that monopolistic practices that prevailed during the late 1800s justified robust government restrictions on rail routes, business practices, and profitability[2]. By the 1970s, it became apparent that many American railroads were at the brink of collapse with more than 21 percent of the nation's rail mileage accounted for by bankrupt railroads[3].

The Staggers Act of 1980 introduced a number of important reforms that allowed companies to have more control over their networks. Among other provisions, the Staggers Act permitted railroads to base rates on market demand, liberalized regulations that previously limited allowed returns on capital, and more explicitly recognized the fact that interstate trucking represents a viable alternative to rail and can serve to act as a check on railroads seeking to raise prices. The Staggers Act did not entirely deregulate the industry, but did create a far more market based environment and railroads have generally prospered as a result. The Association of American Railroads (AAR) estimates that the new regulatory climate since 1980 has helped to attract investment of over $460 billion into the overall freight rail system. At the same time, average rail rates per ton-mile have decreased by 55 percent from 1981 to 2009, facilitated by a 172 percent increase in industry productivity over the same timeframe.[4]

ASSOCIATION OF AMERICAN RAILROADS

The Association of American Railroads is the standard setting organization for North American railroads. AAR's Rail Time Indicators report is published by AAR on a monthly basis and is highly recommended for those who wish to follow the industry.

In 2009, Warren Buffett referred to rail car loadings as the one statistic he would want to receive on the economy if "stranded on a desert island". This is likely because rail car loadings are highly correlated with important macroeconomic indicators.

Rail Time Indicators Report: http://bit.ly/cg5BBg

In an era of persistently high fuel costs, freight rail has become a very economical alternative to long haul trucking given that a train can move one ton of freight 457 miles which far surpasses the fuel efficiency of trucks[5]. The increasing use of intermodal containers has made it possible to utilize freight rail and achieve cost savings over long hauls while retaining flexibility with transfers to trucks for shorter hauls to and from final destinations.

The following exhibit displays selected industry data for Class I Railroads. The complete set of AAR statistics for 2010 were not yet available when this report was published:

SELECTED CLASS I RAILROAD: KEY INDUSTRY STATISTICS			
Industry-Wide Resource Availability:	**2009**	**2008**	**2007**
Miles of Road Operated less Trackage Rights	94,048	94,209	94,440
Miles of Track Operated less Trackage Rights	160,781	160,734	161,114
Miles of High-Density "A" Track Maintained	62,067	69,749	70,323
Locomotives in Service	24,047	24,003	24,143
Freight Cars in Service	416,180	450,297	460,172
Industry-Wide Financial Results			
Figures in Billions	**2009**	**2008**	**2007**
Freight Revenue	46.1	59.4	52.9
Operating Revenue	47.8	61.2	54.6
Operating Expense	37.2	47.3	42.7
Net Income	6.4	8.1	6.8
Operating Ratio *	77.80%	77.30%	78.30%
Return on Average Equity	9.79%	13.26%	11.49%
*** Operating Ratio equals operating expenses as percentage of operating revenue.**			
Source: AAR Railroad Statistics Report Dated October 29, 2010: http://bit.ly/hIm0JA			

Exhibit 19: Selected Class I Railroad Statistics

We can quickly see that the recession had a major impact on the industry as a whole as revenues plummeted in 2009. In fact, the number of railcar loadings in 2009 fell to the lowest level in at least 21 years based on AAR data. In spite of the precipitous decline in activity which led to the 22.4 percent decline in revenue shown in the exhibit, railroads continued to be profitable and the operating ratio increased only marginally from 2008 levels. The decline in fuel costs driven by the collapse of crude oil prices was clearly a factor in controlling operating costs. The industry recovered partially in 2010, although carloads were still at historically depressed levels and intermodal container loads were just above 2004 levels, as the exhibit on the following page shows.

While total carloads on U.S. railroads in 2010 increased by 7.3 percent and total intermodal volume increased by 14.2 percent compared to 2009 levels, both measures are still below the levels achieved in 2008. In fact, the last time prior to 2009 when U.S. carloadings were as low as they were in 2010 was in 1993 and intermodal volume was at its lowest level since 2004. While all of the individual commodity categories in the AAR report increased in 2010 compared to 2009, all categories were also still lower than 2008 levels.[6]

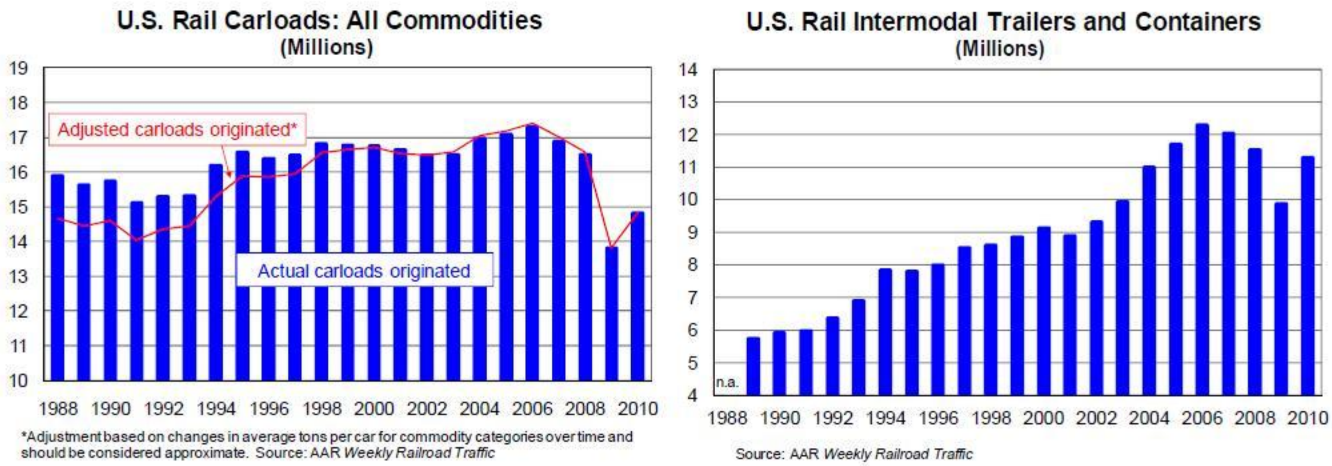


Exhibit 20: AAR Report of Railcar and Intermodal Loadings 1988 to 2010

Initial reports in 2011 point to a continued recovery for the industry as a whole which should correlate closely with increased activity in the physical economy. Although it is impossible to chart alternate paths of history with great confidence, it is difficult to imagine that the industry would have survived the shocks of 2008-2009 without the more favorable conditions created by the 1980 Staggers Act[7]. It is very likely that the deregulated industry was a driving factor behind the evolution of Warren Buffett and Charlie Munger's thinking with respect to railroad investments.

Building a Position in Burlington

Berkshire Hathaway first disclosed a significant stake in Burlington Northern Santa Fe with a SEC filing reporting positions held as of December 31, 2006. The regulatory filing in May 2007 reported that Berkshire had begun accumulating shares during the third quarter of 2006[8]. By the end of 2007, Berkshire reported a 17.5 percent stake in Burlington Northern worth over $5 billion. By the end of 2008, Berkshire's stake in the company had risen to over 20 percent. By the end of September 2009, Berkshire's position had increased to 76.8 million shares worth $6.1 billion. This represented a 22.6 percent economic interest in Burlington[9].

BNSF
Burlington Northern Santa Fe Railway
We Can Move Your World.™

The exhibit on the following page lists Berkshire's holdings of Burlington stock from September 2006 through the end of 2009 when Berkshire's $100 per share offer for Burlington resulted in a sharp increase in market value.

Berkshire began purchasing shares in the third quarter of 2006 and accelerated buying over the next two quarters. However, Berkshire was able to obtain permission from the SEC to defer revealing the investment until May 15, 2007 when the bulk of the initial purchases were already made. Berkshire nearly doubled its stake in Burlington between April 2007 and March 2008 and then halted new purchases as Burlington shares appreciated significantly in mid 2008. Buying began again in the final quarter of 2008 and the first quarter of

2009 as the price of Burlington stock fell significantly during the financial crisis. By March 31, 2009, Berkshire had completed building its sizeable 22.6 percent minority position.

Building a Minority Position in Burlington: 2006 to 2009			
Position Reporting Date	**Shares**	**Market Value**	**Share Price**
9/30/2006	997,200	73,234,000	73.44
12/31/2006	16,074,000	1,186,422,000	73.81
3/31/2007	34,647,376	2,786,689,000	80.43
6/30/2007	39,027,430	3,322,796,000	85.14
9/30/2007	52,981,000	4,300,468,000	81.17
12/31/2007	60,828,818	5,062,783,000	83.23
3/31/2008	63,785,418	5,882,291,000	92.22
6/30/2008	63,785,418	6,371,525,000	99.89
9/30/2008	63,785,418	5,895,686,000	92.43
12/31/2008	70,089,829	5,306,440,000	75.71
3/31/2009	76,777,029	4,618,138,000	60.15
6/30/2009	76,777,029	5,646,183,000	73.54
9/30/2009	76,777,029	6,129,110,000	79.83
12/31/2009	76,777,029	7,571,751,000	98.62
Note: The 9/30/2006 and 12/31/2006 positions were announced in amended 13F-HR filings on May 15, 2007			
Source: Berkshire 13F-HR quarterly filings.			

Exhibit 21: Building a Position in Burlington: 2006 to 2009

The Offer: $100 per Share

On November 3, 2009, Berkshire Hathaway announced a definitive agreement for the company to acquire the remaining 77.4 percent of Burlington Northern for $100 per share in cash and stock putting a value of $44 billion on the overall transaction including assumption of $10 billion of outstanding Burlington debt[10].

In a statement made at the time of the announcement, Warren Buffett made it clear that the Burlington acquisition represented a massive bet on the American economy:

> ***"Our country's future prosperity depends on its having an efficient and well-maintained rail system," said Warren E. Buffett, Berkshire Hathaway chairman and chief executive officer. "Conversely, America must grow and prosper for railroads to do well. Berkshire's $34 billion investment in BNSF is a huge bet on that company, CEO Matt Rose and his team, and the railroad industry. "Most important of all, however, it's an all-in wager on the economic future of the United States," said Mr. Buffett. "I love these bets."***

Berkshire's offer to acquire Burlington Northern was hardly without controversy among Berkshire shareholders. One serious issue involved Berkshire's decision to use stock to fund part of the transaction. Many shareholders strongly believed that Berkshire stock was trading well below intrinsic value at the time of the transaction[11]. Berkshire issued approximately 95,000 Class A equivalent shares to fund the transaction at an effective price per share of approximately $111,450. The exhibit on the following page shows the composition of the payment made for the Burlington acquisition on February 12, 2010.

BNI Elections	Shares of BNI	Cash Value Paid ($)	Stock Value Paid ($)	Total Consideration
No Election	41,760,408	4,176,040,800		4,176,040,800
Elected Cash	108,054,170	10,805,417,000		10,805,417,000
Elected Stock	114,692,846	888,869,557	10,580,415,044	11,469,284,600
Totals	264,507,424	15,870,327,357	10,580,415,044	26,450,742,400

Exhibit 22: Composition of Payment for Burlington Purchase[12]

Mr. Buffett noted that he was not pleased about using shares and directly stated that he felt that Berkshire's shares were undervalued at the time of the transaction. While the issuance of shares was unfortunate from a valuation perspective, the total impact of the acquisition could be favorable if Burlington Northern represents an attractive destination for Berkshire's diverse streams of free cash flow. Here is an excerpt from the 2009 Letter to Shareholders where the Burlington acquisition was discussed at length with a focus on the justification to pay for part of the purchase with Berkshire stock. This quote is one of the rare occasions when Mr. Buffett has directly commented on Berkshire's stock market valuation relative to intrinsic value:

> ***In our BNSF acquisition, the selling shareholders quite properly evaluated our offer at $100 per share. The cost to us, however, was somewhat higher since 40% of the $100 was delivered in our shares, which Charlie and I believed to be worth more than their market value. Fortunately, we had long owned a substantial amount of BNSF stock that we purchased in the market for cash. All told, therefore, only about 30% of our cost overall was paid with Berkshire shares.***
>
> ***In the end, Charlie and I decided that the disadvantage of paying 30% of the price through stock was offset by the opportunity the acquisition gave us to deploy $22 billion of cash in a business we understood and liked for the long term. It has the additional virtue of being run by Matt Rose, whom we trust and admire. We also like the prospect of investing additional billions over the years at reasonable rates of return. But the final decision was a close one. If we had needed to use more stock to make the acquisition, it would in fact have made no sense. We would have then been giving up more than we were getting.***[13]

The Controversy: Crazy Deal or Heck of an Investment?

Bruce Greenwald, Professor of Finance at Columbia University, is one of the most respected authorities on value investing. Given Prof. Greenwald's reputation, many Berkshire shareholders were taken aback at his depiction of the Burlington Northern acquisition as a "crazy deal"[14]. At the same time, other value investors such as Bruce Berkowitz, founder of Fairholme Funds, have defended the transaction as a means of profitably deploying Berkshire's policyholder float[15]. Clearly sentiment at the time of the acquisition was mixed among value investors. Which point of view was supported by the evidence?

The answer is likely to be based on the degree to which Berkshire Hathaway uses Burlington Northern as a profitable destination for free cash flow generated by Berkshire's diverse group of operating companies or for funds generated through policyholder float. Mr. Berkowitz's premise is that Berkshire will have opportunities to deploy incremental funds into Burlington Northern in the coming years at attractive rates of return.

To determine whether this scenario is likely going forward, it helps to examine Burlington Northern's recent operating history and pattern of capital investments. The exhibit below contains information regarding Burlington Northern's operating history over the past six years:

FREE CASH FLOW AND CAPITAL EXPENDITURES - SELECTED DATA							
Figures in Millions	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2005-10**
Net Income	2,459	1,721	2,115	1,829	1,889	1,534	11,547
Cash Flow From Operations (a)	4,414	3,413	3,977	3,492	3,189	2,706	21,191
Cash Capital Expenditures, excl Equipment:	Details not provided in BNSF 2010 10-K						
Maintenance of way (rails, ties, surfacing)		1,605	1,561	1,359	1,226	1,053	6,804
Mechanical		107	168	141	152	136	704
Information Services		83	83	75	65	64	
Other		110	133	105	121	108	577
Total Maintenance Cap-Ex		1,905	1,945	1,680	1,564	1,361	8,455
Terminal and line expansion		86	222	568	450	389	1,715
Total Cash Capital Expenditures (b)	1,966	1,991	2,167	2,248	2,014	1,750	12,136
Depreciation	1,724	1,537	1,397	1,293	1,176	1,111	8,238
Free Cash Flow (a) - (b)	2,448	1,422	1,810	1,244	1,175	956	9,055
Deployment of Free Cash Flow							
Dividends	1,476	546	471	380	310	267	3,450
Share Repurchases (Net of Options Exercised)	(21)	(43)	1,056	1,123	614	555	3,284
Total Cash Flow to Shareholders	1,455	503	1,527	1,503	924	822	6,734
Equipment Configuration	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	
Locomotives	Details not provided in BNSF 2010 10-K	6,759	6,510	6,400	6,330	5,790	
Total Freight Cars		79,329	82,555	85,338	85,121	81,881	
Average age of locomotive fleet		16	15	15	15	15	
Average age of freight car fleet		19	18	18	14	15	
Railway Investments		**2009**	**2008**	**2007**	**2006**	**2005**	
Track miles of rail laid		956	972	994	854	711	
Cross ties inserted (thousands)		3,310	3,167	3,126	2,957	3,171	
Track resurfaced (miles)		15,456	13,005	11,687	12,588	12,790	
Sources and Notes:							
Data for 2010 are combined for predecessor and successor entities. The merger's effective date was February 12, 2010. Figures are for the full year.							
Data as originally reported from 2007-2010 10-Ks. Data for 2005 and 2006 "as adjusted" in 2007 10-K							
Data on capital expenditure breakdown can be found under Item 7: "Liquidity and Capital Resources" section of 10-K							
Data for 2009 from Burlington Northern Santa Fe Annual 2009 Investors' Report							

Exhibit 23: Burlington Northern Santa Fe Operating Statistics, 2005 to 2010[16]

We can see that Burlington Northern has devoted a significant portion of operating cash flow toward capital expenditures over the past six years. However, of the amount spent on capex from 2005 to 2009, over 80 percent was identified by the company as "maintenance" capex. Although the figure for depreciation is below the maintenance capex amount, this difference can be accounted for by the fact that depreciation is based on the historical cost of the assets while maintenance capex is purchased at today's prices.

The company has not pursued significant expansion capex over the past six years. Instead, the majority of free cash flow has been returned to shareholders either via dividends or share repurchases. The apparent lack of significant expansion capex can be verified by small growth in the overall size of the company's fleet of locomotives and freight cars, along with a steady average age for rolling stock. Additionally, the majority of railway investments have gone toward existing tracks rather than expansion activities.

Assuming that Bruce Berkowitz and others are correct regarding the opportunities for Berkshire to deploy low to no cost funds from float into the railroad business, one must then come to the conclusion that Berkshire is planning on a rapid expansion of Burlington Northern in the coming years. However, even with expansion, it is likely that Burlington's internally generated cash flow will be sufficient to fund expansion capex going forward.

If Burlington Northern continues on its current course of capital expenditures, the company will still be generating significant free cash flow each year. Virtually all of the free cash flow was returned to shareholders prior to the acquisition and Berkshire received $1.25 billion in dividends from Burlington Northern between February 12, 2010 and December 31, 2010. In February 2011, another $1 billion dividend was paid to Berkshire[17].

Warren Buffett and Matthew Rose

Going forward, free cash flow could instead be reinvested in Burlington Northern for expansion purposes rather than paid to Berkshire in the form of dividends. This could accommodate approximately $1.5 billion annually in expansion capital expenditures simply based on Burlington's cash flow *without requiring any additional cash inflows from Berkshire.* If Berkshire hopes to direct *new funds* to Burlington from other operating companies or from policyholder float, this would imply a very significant expansion program at Burlington in the coming years.

If the railroad does not expand rapidly, it will continue to generate enough cash flow to maintain operations, fund modest expansion, and return some funds to Berkshire Hathaway in the form of dividends. This may not seem like a bad result. However, if this is all Berkshire has planned for Burlington Northern, the deal is subject to Prof. Greenwald's criticism. The main way in which this transaction will generate value for Berkshire Hathaway shareholders is if profitable expansion is possible and can not only consume Burlington Northern's internally generated cash but also a significant amount of cash flow from Berkshire's other operating companies.

In May 2010, Burlington Northern Chairman and CEO Matthew Rose appeared on *Nightly Business Report* and made the following comments:

> ***There is no doubt that Warren has been very clear he wants to us reinvest in the railroad. And if you think about, if you are a public company, in terms of generating free cash flow, you really have three different alternatives. Buy back your stock. Dividend out to your shareholders or reinvest in your company either your own company or through a strategic acquisition. We no longer can buy back our own stock because we don't have any so we're down to dividending up to Berkshire as the parent or reinvesting in our company. And I think Warren's made it clear that he wants to see us reinvest back in the railroad.***[18]

More recently, Mr. Rose indicated that Burlington Northern's 2011 capital expenditure budget is expected to be approximately $2.6 billion, a significant increase compared to 2010 spending[19]. Among the projects, Mr. Rose indicated that the railroad would accelerate the purchase of freight locomotives which cost approximately $2 million each. Burlington Northern also plans to spend $200 million to build a new intermodal facility in Kansas. Although this level of capital expenditure is a major increase, it still appears that Burlington Northern should be able to fully fund the program with internally generated cash flow and may even be able to continue paying dividends to Berkshire. At this point, the jury is still out on the Greenwald vs. Berkowitz debate.

A Closer Look at the Railroad

Burlington Northern is a complicated enterprise and could itself justify a detailed report. While we will not attempt to delve into all aspects of the business in this report, we will present some key operating statistics as well as a breakdown of Burlington's sources of revenues to give the reader a feel for the nature of the business and the company's overall position within the railroad industry.

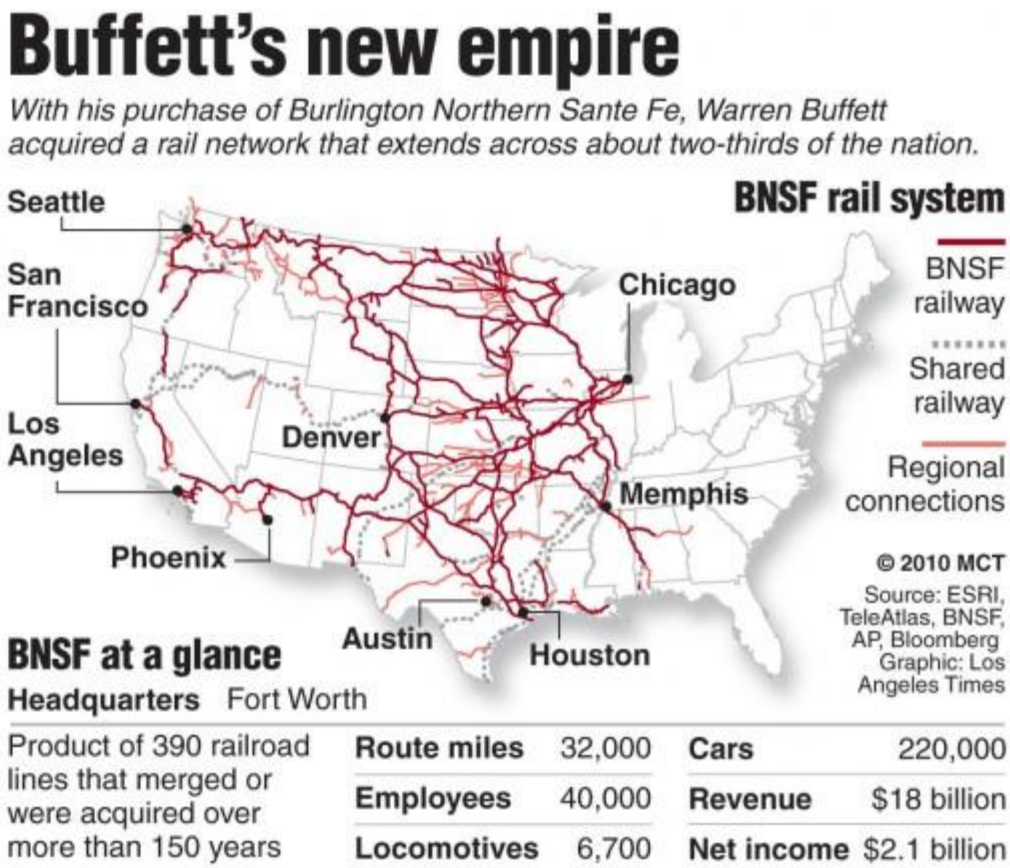


Exhibit 24: BNSF's Rail Network and Selected Statistics

Burlington Northern Santa Fe is the second largest freight railroad in the United States, trailing only Union Pacific in terms of freight volume. The company has a long history and is the product of multiple railroad mergers that took place during the 20th century. In 1995, the merger of Burlington Northern Inc. and Santa Fe

Pacific Corp. formed the current railroad system which covers the western two-thirds of the United States. In total, Burlington Northern Santa Fe is the product of 390 predecessor railroads[20].

The exhibit on the previous page, which appeared in the Los Angeles Times last year, displays the BNSF route map along with some key statistics. The railroad's route system has some significant overlap with Union Pacific, although BNSF has a greater presence in the far northern central and mountain states[21].

Burlington Northern reports revenues for four business groups: Consumer Products, Coal, Industrial Products, and Agricultural Products. Consumer products represents approximately 31 percent of revenues and includes international and domestic intermodal businesses as well as automotive shipments. Coal contributes approximately 27 percent of revenues. Burlington Northern is one of the largest transporters of low-sulfur coal in the United States and more than 90 percent of the railroad's coal tonnage originates from the Powder River Basin area of Wyoming and Montana. Industrial products, which accounts for 21 percent of revenues, consists of construction materials, building products, petroleum products, chemicals and plastics, and food and beverages. Agricultural products accounts for 21 percent of revenues and includes an array of food crops as well as ethanol and fertilizer products. The following exhibit provides selected data on Burlington Northern's revenues for the past four years:

BNSF Revenue and Cars/Units by Business Group								
Revenues in Millions, Car/Units in Thousands	Revenues				Cars / Units			
	2010	2009	2008	2007	2010	2009	2008	2007
Consumer Products	5,031	4,316	6,064	5,664	4,287	3,911	4,818	5,149
Coal	4,348	3,564	3,970	3,279	2,415	2,390	2,516	2,472
Industrial Products	3,460	2,874	4,028	3,684	1,397	1,172	1,598	1,664
Agricultural Products	3,493	2,834	3,441	2,722	1,058	945	1,062	1,033
Totals	**16,332**	**13,588**	**17,503**	**15,349**	**9,157**	**8,418**	**9,994**	**10,318**

Exhibit 25: BNSF Revenue and Cars/Units by Business Group

We can see the dramatic drop in both revenues and cars/units that took place in 2009 along with the recovery that began in 2010. In light of the 22.4 percent decline in revenue in 2009, which was approximately in line with the decline in overall revenues for all Class I railroads, the operating statistics on the next page appear quite impressive. Note that while a strong recovery took place in 2010, revenue statistics are still below 2008 levels.

Net income declined by 18.6 percent in 2009 which was a lower percentage decline compared to the fall in revenues. This was driven by an improving operating ratio which fell from 78.3 percent to 76.7 percent.[22] As we can see from the exhibits, freight revenues bounced back strongly by over 20 percent in 2010 with gains in all of the business groups. Net income advanced by nearly 43 percent in 2010 thanks to improvements in the operating ratio which led to profits exceeding 2008 levels. While these exhibits do not form a full analysis of Burlington Northern, we would argue that Charlie Munger was justified in his assessment of improving economics within the overall industry. It appears that Burlington Northern and other railroads have improved operating efficiencies to the point where the survival of the industry was not in question even in the midst of the most severe recession since the Great Depression of the 1930s.

BNSF KEY OPERATING STATISTICS				
	2010	**2009**	**2008**	**2007**
Owned Route Miles	23,000	23,000	23,000	23,000
Miles of Track Operated less Trackage Rights	40,000	40,000	40,000	40,000
Locomotives in Service	6,700	6,759	6,510	6,400
Freight Cars in Service	76,800	79,329	82,555	85,338
Figures in Millions	**2010**	**2009**	**2008**	**2007**
Freight Revenue	16,332	13,588	17,503	15,349
Operating Revenue	16,850	14,016	18,018	15,802
Operating Expense	12,346	10,754	14,106	12,316
Net Income	2,459	1,721	2,115	1,829
Operating Ratio	73.3%	76.7%	78.3%	77.9%
Source: 2010, 2009, and 2008 10-K				
2010 Data combine predecessor and successor entities				

Exhibit 26: BNSF Key Operating Statistics 2006 to 2010

Burlington Northern Valuation

Given the fact that the Burlington Northern acquisition took place only one year ago and considering the signals Warren Buffett sent regarding his thoughts on valuation, we can draw some straight forward conclusions regarding the contribution of the railroad to Berkshire's overall intrinsic value.

Warren Buffett, in the quotation provided earlier, clearly stated that a richer price involving a larger allocation of Berkshire Hathaway stock would have resulted in Berkshire shareholders giving up more intrinsic value than they were getting. However, the statement was actually more subtle than it might appear because Mr. Buffett was commenting on the *relative valuation* of Berkshire stock versus the price paid for Burlington Northern rather than Burlington Northern's valuation in absolute terms.

In other words, had Berkshire stock been trading at a much higher level, presumably a higher price could have been paid to Burlington Northern shareholders via Berkshire stock without resulting in Berkshire shareholders giving up more intrinsic value than they received through the acquisition. It is therefore possible, although not certain, that Mr. Buffett believed that Burlington Northern was worth more than the price Berkshire paid in the acquisition; indeed, he must have considered the acquisition to be a net positive for Berkshire shareholders or the deal would not have taken place.

The exhibit on the next page provides an analysis of the allocation of the purchase price of Burlington Northern toward the balance sheet accounts as they stood on February 12, 2010 when the acquisition was finalized. The merger was accounted for using the acquisition method of accounting which allocates the purchase price toward tangible and intangible assets based on fair value estimates made at the time. The remainder of the purchase price was allocated to goodwill. Berkshire's equity in Burlington Northern at the time of the acquisition was approximately $34.5 billion which includes Berkshire's previously held minority position and the consideration in cash and stock paid to Burlington shareholders to acquire the rest of the company.

Purchase Price Allocation for Burlington Northern ($ millions)				
Merger Consideration Paid:				
Cash paid as merger consideration				15,874
Value of Berkshire common stock issues as merger consideration				10,577
Total merger consideration to acquire the remaining shares of Burlington Northern				26,451
Value of Burlington Northern already owned by Berkshire valued at merger price of $100/share				7,678
Value of Berkshire equity awards to replace pre-existing Burlington equity awards				366
Total purchase price to be allocated				**34,495**
Purchase Price Allocation:				
Assets:			**Liabilities:**	
Cash and Equivalents	971		Accounts Payable and other liabilities	2,261
Accounts Receivable, Net	808		Long-term debt due within one year	649
Materials and Supplies	630		Long-term debt	10,493
Current portion of deferred income taxes	210		Deferred Income Taxes	13,413
Other Current Assets	144		Intangible Liabilities, net	2,056
Property, plant and equipment	43,987		Casualty and environmental liabilities	928
Goodwill	14,803		Pension and retiree health benefits	865
Intangible Assets, net	2,025		Other Liabilities	513
Other	2,095		**Net Assets Acquired (Equity)**	**34,495**
Total Assets	**65,673**		**Total Liabilities & Net Assets Acquired**	**65,673**
Source: Burlington Northern Santa Fe Q3 2010 10-K Report				

Exhibit 27: Purchase Price Allocation for Burlington Northern

For the cash component of the transaction, Berkshire used existing cash on hand along with $8 billion in proceeds from newly issued debt at the parent company level. Berkshire also assumed all of Burlington Northern's outstanding debt which is reflected on the balance sheet shown above.

In order to arrive at an intrinsic value estimate for Burlington Northern, we have assumed that the merger took place at the approximate intrinsic value of Burlington Northern. Although Berkshire's purchase price of $100 per share was approximately 31.5 percent higher than Burlington Northern's stock price on the day before the acquisition was announced, we believe that Burlington Northern's valuation was depressed at the time due to the ongoing recession in the United States and the industry headwinds facing all railroads at the time, as discussed earlier in this section. Indeed, all major railroad stock prices have rallied sharply over the past year as the economic recovery took hold in the United States. While market value is not necessarily reflective of intrinsic value, if one looks at the appreciation of Union Pacific stock over the past year, it is difficult to conclude that a stand-alone Burlington Northern Santa Fe would trade at a valuation lower than $100 per share today.

To determine an approximate value for Burlington Northern, we will use book value per share which stood at $35,507 million as of December 31, 2010. This figure reflects net assets acquired on February 12, 2010 as well as retained earnings for the remainder of 2010.

$$\boldsymbol{BNSF\ Valuation = \$35.5\ Billion}$$

As noted previously, it is very likely that Burlington Northern's overall market value would be significantly higher than Berkshire's carrying value based on the stock price appreciation of Union Pacific and other railroads in the United States. As a result, we view the use of book value as of December 31, 2010 to be a conservative approximation for intrinsic value which does not depend on a rapid return to peak levels of railroad activity.

Why Did Buffett Choose Burlington Northern Santa Fe?

BNSF Burlington Northern Santa Fe Railway We Can Move Your World.™ UNION PACIFIC NORFOLK SOUTHERN NS RAILWAY CO.

When Warren Buffett's interest in the railroad industry was first disclosed in early 2007, Burlington Northern Santa Fe was not the only railroad investment in Berkshire's portfolio. Larger positions in Union Pacific and Norfolk Southern were revealed in the same 13F report. However, Berkshire sold the bulk of the Norfolk Southern and Union Pacific positions in the second and third quarters of 2007 while the Burlington Northern position was steadily increasing.*

Norfolk Southern covers the eastern one-third of the country and has little overlap with Burlington Northern. Union Pacific, on the other hand, is Burlington Northern's primary competitor with coverage in the western two-thirds of the country. While a comparative analysis of the three railroads is beyond the scope of this report, it appears that Mr. Buffett clearly preferred the western presence of the BNSF system and perhaps was attracted to the company's coal transportation operations in the Powder River Basin region.

Berkshire's MidAmerican Energy subsidiary operates coal plants as well as a pipeline network that may require new rights of way in the future. While Berkshire typically does not pursue synergies between operating companies, the prospect of favorable economics between the railroad and utility operations having geographical overlap seems difficult to ignore.

MidAmerican's 2009 and 2010 10-K reports refer to arrangements the company has with Union Pacific which expire in 2012. In both reports, MidAmerican refers to having the ability to contract with BNSF for a portion of coal deliveries to two of MidAmerican's electricity generating facilities. In the 2010 10-K, MidAmerican no longer characterized the potential for BNSF deliveries as "small" as it did in 2009. An intriguing possibility exists for MidAmerican to expand its relationship with BNSF after the Union Pacific contracts expire in 2012.

* History of the Norfolk Southern and Union Pacific investments: http://bit.ly/hNkzP2 and http://bit.ly/fjpbBC via Dataroma.

Finance and Financial Products

Berkshire Hathaway's Finance and Financial Products segment consists of companies engaged in the sale and financing of manufactured homes, transportation and furniture equipment leasing, and operations engaged in various proprietary investment strategies. Warren Buffett has personally managed many of the proprietary strategies over the years leading some observers to consider the "proprietary strategies" portion of this reporting segment to be "Buffett's Hedge Fund". On a less pleasant note, the unwinding of the General Re derivatives book also took place within this segment[1]. Berkshire also had an investment in Value Capital, an investment fund run outside Berkshire, which was wound down in 2006.

The following exhibit provides a summary of the Financial Products Segment for the past five years:

All figures in millions	**2010**		**2009**		**2008**		**2007**		**2006**	
	Revenue	**Earnings**	**Revenue**	**Earnings**	**Revenue**	**Earnings**	**Revenue**	**Earnings**	**Revenue**	**Earnings**
Manufactured Housing and Finance	3256	176	3257	187	3560	206	3665	526	3570	513
Furniture & Transportation Equipment Leasing	660	53	661	14	773	87	810	111	880	182
Other Earnings	348	460	669	580	614	494	644	369	674	462
Total Revenues	4264		4587		4947		5119		5124	
Pre-Tax Earnings		689		781		787		1006		1157
Income Taxes and Minority Interests		248		287		308		374		425
Net Earnings		441		494		479		632		732

Exhibit 28: Financial Products Segment Selected Data: 2006 to 2010

Clayton Homes: *The Survivor*

Clayton Homes is the largest company in the manufactured housing industry with deliveries of 23,343 units to customers in 2010, which was approximately 47% of the industry's total sales of 50,046 units for the year[2]. Last year, total industry sales dropped nearly 17 percent from the already depressed level of 60,000 units in 2009. To put the current depressed market into proper context, we point out that the manufactured housing industry has been in a freefall for years since hitting a peak of 372,843 units in 1998 when Clayton had a market share of only 8 percent.

Unlike the majority of competitors in the industry, Clayton refrained from pursuing unethical practices such as selling homes to buyers who clearly could not afford the product. Many manufactured housing companies were willing to finance homes for buyers who had no hope of affording the property in the long run because they could securitize mortgages and unload the debt to investors. In sharp contrast with the default rates afflicting most of the industry, Clayton's default rate was only 3.6 percent in 2008. Net losses as a percentage of average loans was only 1.72 percent in 2010, a level that most bankers would envy when compared to loan losses on residential real estate in recent years. Clayton accomplished this record by going back to the basics in terms of lending standards. The company has also demonstrated a willingness to help customers who temporarily run into trouble[3].

One major headwind facing Clayton Homes is the differential between mortgage rates available to buyers of traditional site-built homes compared to buyers of factory-built homes. Government backed loans are particularly difficult for potential Clayton customers to secure. The disadvantage facing buyers of manufactured housing in terms of higher interest rates can often offset the price advantage of a factory-built home[4].

While Clayton's results over the past three years have reflected the unprecedented decline in the housing sector, it is notable that the company has remained profitable and has been able to avoid the disastrous pitfalls facing many competitors. Clayton has been introducing innovative new products such as the Clayton i-house pictured on the previous page. The i-house is designed to appeal to buyers who are concerned about environmental impacts and could expand the reach of manufactured housing into demographics that previously would not have considered a home that is not site built. However, based on reports in early 2010, it appears that the i-house has yet to achieve meaningful sales volume[5].

Clayton Homes has formidable advantages over its competitors, not the least of which is backing from Berkshire Hathaway when it comes to funding its loan portfolio. Since acquiring Clayton in 2003, Berkshire has issued debt to fund Clayton's loan portfolio and charges Clayton one percent over Berkshire's borrowing cost[6]. The interest that Clayton pays to Berkshire is *in addition* to the figures reported as net income and appears instead in the "Other" category. In effect, Clayton is leveraging Berkshire's high credit rating to achieve a lower cost of funds than competitors.

When the eventual housing recovery comes, we believe that Clayton will be well positioned to gain additional market share and to surpass the peak earnings posted in 2007. It is not unreasonable to estimate that normalized earnings could exceed $400 million over the economic cycle based on Clayton's history. The main risk would involve changing consumer tastes or perceptions that impede a recovery.

CORT and XTRA

CORT is a the national leader in "rent to rent" furniture that is used in both offices and residential locations such as temporary occupants of apartments. Many individuals confuse CORT with businesses engaged in the "rent to own" market serving low income people who usually have poor credit. Wesco Financial, an 80.1 percent owned subsidiary of Berkshire, purchased CORT in 2000. In 2010, Berkshire announced plans to acquire the remaining 19.9 percent of Wesco that it does not already own. At the date of this report, Wesco's Board of Directors has recommended that shareholders approve the transaction which is expected to close in the near future[7].

XTRA Corporation was purchased in September 2001 and is a leading operating lessor of transportation equipment such as over-the-road trailers and intermodal equipment. Together, CORT and XTRA make up the Furniture and Transportation Leasing line item listed in the exhibit on the prior page.

As we can see from the exhibit, both leasing businesses have suffered over the past few years during the economic downturn. Earnings peaked in 2006 and steadily declined during subsequent years before staging a partial recovery in 2010. While this is not surprising given the nature of the business, the fundamental economics of both furniture and transportation leasing should remain intact once economic conditions improve. It is difficult to come up with a figure for normalized earnings, but it would be hard to argue for a number under $125 million.

Other Activities

Earnings in the "Other Activities" category come from diverse sources including investment and trading income, a life and annuity operation (which moved to Berkshire Hathaway Reinsurance in 2010), and other activities including interest paid to Berkshire by Clayton Homes. Starting in 2010, Berkshire began charging NetJets a guaranty fee which amounted to $38 million. In 2005 and 2006, there were charges for the derivatives book run-off at General Re and the termination of the Value Capital investment. Earnings in this category are difficult to predict in advance but it is not unreasonable to assume normalized earnings of approximately $400 million pre-tax.

Finance and Financial Products Valuation

Based on the discussion above and our estimates of normalized pre-tax earnings power of $400 million for Clayton Homes, $125 million for CORT and XTRA, and $400 million for Other Activities, we arrive at pre-tax normalized earnings of $925 million which should result in approximately $550 million of net income after minority interest and taxes. The inherent cyclicality of manufactured housing, furniture and equipment leasing, and the variability of the proprietary trading business argues for a conservative below market multiple of 10 times net normalized earnings:

Valuation = Normalized Earnings x 10 P/E Multiple

Valuation = $550 Million x 10 = $5.5 Billion

"Historical Accident" Draws to a Close

Charlie Munger has often described Wesco's unusual ownership structure as a "historical accident". The accident is now drawing to a close with Berkshire Hathaway set to acquire the 19.9 percent of Wesco that it does not already own. Berkshire has proposed a complex formula intended to pay adjusted book value for the Wesco shares. Wesco shareholders can elect to receive either Berkshire Class B shares or cash. Mr. Munger has made statements in the past regarding Wesco's valuation relative to Berkshire that may be of interest to readers. The Rational Walk published an article on Mr. Munger's comments on this topic from the 2010 Wesco Financial annual meeting: http://bit.ly/gqnzBg

Manufacturing, Service, and Retailing

As Warren Buffett has said, Berkshire's activities in the manufacturing, service, and retailing group "covers the waterfront". Indeed, this group includes businesses selling candy, carpet, paint, bricks, recreational vehicles, underwear, precision machinery, equipment for the livestock industry, and much more. A number of Berkshire's subsidiaries have numerous subsidiaries of their own. To take an extreme example, Marmon is a large conglomerate consisting of 130 manufacturing and service businesses operating in eleven diverse business sectors. Many of Berkshire's subsidiaries regularly make their own "tuck in" acquisitions such as McLane's purchase of Kahn Ventures in March 2010[1].

In recent years, the granularity of Berkshire's reporting segments has been significantly reduced due to the number of acquisitions that have taken place. For example, in the 1999 annual report, See's Candies had its own reporting segment. Today, See's is consolidated into the "Retailing" segment which also contains Berkshire's furniture and jewelry businesses. The trend has continued in 2010 with Shaw Industries being absorbed into the "Other Manufacturing" group. Loss of granularity has made it more difficult to measure the progress of individual businesses over time as they are consolidated into larger reporting groups.

Background Information

Space constraints make it impractical to prepare a detailed evaluation of each of the individual businesses within each segment. Furthermore, such an evaluation would be unlikely to shed much additional light on the aggregate valuation of the overall manufacturing, service, and retailing group. We will examine each of the five reporting segments within the Manufacturing, Service, and Retailing group: Marmon, McLane, Other Manufacturing, Other Service, and Retailing. Within Other Manufacturing, we will highlight Shaw Industries and within Other Service, we will examine NetJets in more detail. For each reporting segment, we will estimate normalized pre-tax profit and then attempt to come up with a valuation for the entire group.

The following exhibit presents a high level overview of the contributions to revenues and earnings from each of the reporting segments within the manufacturing, service, and retailing group over the past five years:

All figures in millions	2010		2009		2008		2007		2006	
Reporting Segment	**Revenue**	**Pre Tax Profit**	**Revenue**	**Pre Tax Profit**	**Revenue**	**Pre Tax Profit**	**Revenue**	**Pre Tax Profit**	**Revenue**	**Pre Tax Profit**
Marmon	5,967	813	5,067	686	5,529	733				
McLane Company	32,687	369	31,207	344	29,852	276	28,079	232	25,693	229
Shaw Industries	In Other Manufacturing		4,011	144	5,052	205	5,373	436	5,834	594
Other Manufacturing	17,664	1,911	11,926	814	14,127	1,675	14,459	2,037	11,988	1,756
Other Service	7,355	984	6,585	(91)	8,435	971	7,792	968	5,811	658
Retailing	2,937	197	2,869	161	3,104	163	3,397	274	3,334	289
Total Revenues	**66,610**		**61,665**		**66,099**		**59,100**		**52,660**	
Pre-Tax Earnings		4,274		2,058		4,023		3,947		3,526
Income Taxes and Minority Interests		1,812		945		1,740		1,594		1,395
Net Earnings		**2,462**		**1,113**		**2,283**		**2,353**		**2,131**

Exhibit 29: Operating Summary for Manufacturing, Service, and Retailing 2006 to 2010

We can begin to form some initial impressions regarding the impact of the recent recession on the businesses in this group. The manufacturing and retailing businesses have all been impacted by slow economic conditions in recent years but managed to show a strong recovery in 2010 as economic conditions began to improve. Appendix 3 contains a quarterly presentation of revenue and pre-tax earnings for Berkshire subsidiaries from 2008 to 2010 in order to more closely examine the company's performance during the recession and subsequent recovery. A discussion of each segment will shed more light on the five year history and allow us to form some impressions regarding prospects for these businesses in an economic recovery. However, before we begin, it is instructive to step back a full decade to view the manufacturing, service, and retailing group in the proper perspective.

Taking a Long Term View

It is often difficult to gain a proper perspective regarding the progress of a company such as Berkshire Hathaway when one is looking at results from year to year. Satisfactory progress may occur in most years but there will certainly be some setbacks along the way. From time to time, dramatic acquisitions have been made. To provide a more complete perspective on Berkshire's transformation over the past decade, let's step back to the turn of the century and examine the results of the businesses in this group that Berkshire owned in 1999.

All Figures in Millions		1999		
1999 Reporting Segment	**Current Segment Category**	**Revenue**	**Pre-Tax Earnings**	**BRK Share of Net Earnings**
Buffalo News	Other Service	157	55	34
Flight Services	Other Service	1856	225	132
Home Furnishings	Retailing	917	79	46
International Dairy Queen	Other Service	460	56	35
Jewelry	Retailing	486	51	31
Scott Fetzer Companies	Other Manufacturing	1021	147	92
See's Candies	Retailing	306	74	46
Shoe Group	Other Manufacturing	498	17	11
Totals		**5701**	**704**	**427**

Exhibit 30: 1999 Results for Businesses in today's Manufacturing, Service, and Retailing Segment

The exhibit shown above presents the revenue and pre-tax earnings of Berkshire Hathaway's non-insurance businesses in 1999. Each of the line items represents a reporting segment in 1999. We have also listed the present-day reporting segment in which each business now resides. In 1999, revenues of the non-insurance subsidiaries represented approximately 25.3 percent of the total for all of Berkshire's reporting segments[2].

In 2010, the revenue of the Manufacturing, Service, and Retailing group represented 48.9 percent of Berkshire's total consolidated revenues. Revenues have grown from $5.7 billion in 1999 to $66.6 billion in 2010 while pre-tax earnings have increased from $704 million in 1999 to $4.3 billion in 2010. Pre-tax earnings in 2007 and 2008 were close to $4 billion while 2009 earnings were a depressed $2.1 billion. Much of the drop in aggregate operating margin is due to the acquisition of McLane given its high sales volume and razor thin profit margins.

Where did this rapid growth come from? Clearly, the majority of the growth has been due to the numerous acquisitions of new wholly owned subsidiaries. Berkshire Hathaway in 2010 was barely recognizable from the perspective of someone who last examined the company a decade ago. As we have noted before, Warren Buffett routinely harvests free cash flow from the insurance and operating businesses and uses the funds to acquire new businesses with better prospects for high returns on invested capital.

We anticipate that this pattern will continue in the future and can be confident that Berkshire's collection of operating companies in 2020 will look much different than in 2010, although we find it unproductive to speculate on the specific moves that could be made.

Marmon

Berkshire purchased 60 percent of Marmon Holdings for $4.5 billion in March 2008 which, at the time, was the largest cash purchase in Berkshire's history[3]. Since the initial transaction, Berkshire has purchased additional shares of Marmon and now holds a 63.6 percent interest. Under the terms of the agreement, Berkshire will purchase the remaining shares of Marmon between 2011 and 2014 for consideration based on the future earnings of Marmon. Berkshire will soon pay $1.5 billion to increase its ownership to 80 percent[4].

Marmon is a conglomerate built over the course of 50 years by the Pritzker family and currently made up of over 130 manufacturing and service businesses that operate under independent management[5]. It is notable that Marmon has a business model that is similar to Berkshire itself in terms of allowing individual subsidiaries to operate without micromanagement from headquarters. Marmon's management team includes the former CEO of Illinois Tool Works which is a highly successful conglomerate employing a similar management structure. Here is Warren Buffett's characterization of the Marmon transaction and management team:

> ***"We arrived at a price using only Marmon's financial statements, employing no advisors and engaging in no nit-picking. I knew that the business would be exactly as the Pritzkers represented, and they knew that we would close on the dot, however chaotic financial markets might be. During the past year, many large deals have been renegotiated or killed entirely. With the Pritzkers, as with Berkshire, a deal is a deal. Marmon's CEO, Frank Ptak, works closely with a long-time associate, John Nichols. John was formerly the highly successful CEO of Illinois Tool Works (ITW), where he teamed with Frank to run a mix of industrial businesses. Take a look at their ITW record; you'll be impressed". – Warren Buffett[6]***

Marmon's collection of businesses have not been spared from the impact of the recession. While Marmon's management was able to achieve a record high 13.5 percent pre-tax profit margin in 2009, sales were down 27 percent for the year compared to 2008 full year results[7]. Margins improved further to 13.6 percent in 2010 on 17.8 percent revenue growth. Please note that the figures in Exhibit 29 for 2008 show Marmon's results from the date of Berkshire's acquisition of the company rather than full year 2008 results.

While it may appear that Marmon's value has remained flat or declined since Berkshire's initial purchase, the fact that the company achieved record high pre-tax profit margins in 2009 and 2010 demonstrates that the core economics of the business remain intact and will recover along with the economy. We will assume normalized earnings power of $850 million for Marmon before income taxes and minority interests.

The exhibit below displays Marmon's member companies operating within eleven industry sectors as described by Marmon's management. Marmon's website provides links to each member company for those who would like more information.

Sector	Description	Member Companies
Building Wire	Marmon Building Wire is a leading manufacturer of copper electrical building wire. Cerro Wire supplies wire for interior electrical wiring in homes, apartments and manufactured housing as well as for commercial and industrial buildings. Products are sold through wholesale electrical distributors and retail home improvement centers.	Cerro Wire LLC
Construction Services	Through Sterling Crane, Marmon Construction Services is a leading North American provider of crane services. Sterling and affiliates own and operate more than 650 hydraulic and conventional boom mobile cranes in Canada and the United States, primarily supporting the energy, mining and petrochemical markets.	Sterling Crane
Distribution Services	A major supplier of specialty pipe and tubing, Marmon Distribution Services operates more than 50 sales and service centers in North America, the United Kingdom and Europe. Marmon/Keystone and affiliated companies serve a broad range of industries.	Bushwick Metals LLC, Future Metals LLC, M/K Express Company LLC, Marmon/Keystone Canada Inc., Marmon/Keystone LLC
Engineered Wire & Cable	This sector manufactures electrical and electronic wire and cable for energy related markets and other industries. Applications include industrial power and instrumentation; aerial and underground utility distribution; and environments where exposure to harsh elements is anticipated. Markets also include automotive, aerospace, telecommunications, computers, transit and appliances.	Aetna Insulated Wire LLC, Cable USA LLC, Comtran Cable LLC, Dekoron Unitherm LLC, Dekoron Wire and Cable LLC, Harbour Industries LLC, Marmon Utility LLC (Hendrix), Marmon Utility LLC (Kerite), Owl Wire and Cable LLC, RSCC Aerospace & Defense, RSCC Wire & Cable LLC, TE Wire & Cable LLC
Flow Products	Marmon Flow Products serves the plumbing, heating, air conditioning, refrigeration, construction, automotive and industrial markets with a variety of products including copper tube, extruded aluminum shapes and drawn aluminum tubing, and brass fittings and valves.	Anderson Copper and Brass Company LLC, Cerro Flow Products LLC, Penn Aluminum International LLC
Food Service Equipment	Businesses in this sector supply quick-serve and fast-casual restaurants and convenience stores with products including toasters, timers and food-processing devices; gas and electric infrared conveyor ovens; and refrigeration equipment and beverage dispensers; as well as supply shopping carts in both wire and plastic to retail stores worldwide.	Catequip S.A. and Cat'Serv S.a.r.l., Prince Castle LLC, Silver King, Unarco Industries LLC

Sector	Description	Member Companies
Highway Technologies	This sector supports the heavy-duty highway transportation industry with trailers, fifth wheel coupling devices, OEM truck modifications, spray suppression products, wheel end products and suspension systems. Businesses also supply axles and transfer cases for all-wheel drive conversions, as well as clutches for the light vehicle and heavy-duty aftermarkets.	Fleetline Products, Fontaine International, Inc., Fontaine Modification Company, Fontaine Spray Suppression Company, Fontaine Trailer Company, Marmon-Herrington Company, NU-LINE Products Inc., Perfection, Triangle Suspension Systems, Inc., TSE Brakes, Inc., Webb Wheel Products, Inc.
Industrial Products	This sector consists of three groups: fasteners for the metal building, furniture, cabinetry, construction and industrial markets as well as patented processes to treat fasteners for aerospace, automotive and construction markets; safety products including gloves, portable lighting equipment, and overhead electrification equipment for mass transit systems; and custom-machined brass, aluminum and copper forgings for the construction, valve and other industries.	Atlas Bolt & Screw Company LLC, Cerro E.M.S., Cerro Fabricated Products LLC, Deerwood Fasteners International, IMPulse NC LLC, Koehler-Bright Star LLC, Nylok LLC (Delaware), Pan American Screw LLC, Robertson Inc., Specialty Bolt & Stud Inc., Wells Lamont Europe Industry, Wells Lamont Industry Group LLC
Retail Store Fixtures	With manufacturing operations in North America, the United Kingdom, Europe and Asia, Marmon Retail Store Fixtures provides major retailers worldwide with store fixtures and accessories used to display merchandise for consumers. Sector businesses also provide fixture installation and logistical services, as well as work and garden gloves for the retail market.	Eden, L. A. Darling Company LLC, Leader Metal Industry Co., Ltd., Sloane, Store Opening Solutions LLC, Streater LLC, Thorco Industries LLC, Wells Lamont Retail Group
Transportation Services & Engineered Products	This sector is anchored by Union Tank Car, which with Canadian affiliate Procor, is North America's leading lessor, manufacturer and maintainer of railroad tank cars. Sector products and services also include intermodal tank containers; in-plant rail services; bi-modal railcar movers; wheel, axle and gear sets for light rail transit; gear products for locomotives; and steel tank heads, as well as services, equipment and technology for processing and distributing sulfur.	Ameritrack Rail, Enersul Inc., Enersul Operations, Enersul Technologies, EXSIF Worldwide, Inc., Intermodal Transfer LLC, McKenzie Valve & Machining LLC, Penn Machine Company LLC, Procor Limited, Railserve, Inc., Trackmobile LLC, Uni-Form Components Co., Union Tank Car Company, WCTU Railway LLC
Water Treatment	This sector provides water treatment equipment globally. Residential products include water softening and purification systems as well as refrigeration filters and drinking water systems. Businesses also supply water treatment systems for power generation, oil and gas, chemical and other industrial markets, as well as commercial applications. Products also include gear drives for irrigation systems and cooling towers, as well as air-cooled heat exchangers.	Amarillo Gear Company LLC, Amarillo Wind Machine LLC, Ecodyne Heat Exchangers LLC, Ecodyne Limited, Ecodyne Water Treatment LLC, EcoWater Canada Ltd., EcoWater Systems Europe NV, EcoWater Systems LLC, Graver Technologies LLC, Graver Water Systems LLC, KX Technologies LLC (KXT), KX Technologies, Pte. Ltd.

Exhibit 31: Marmon – The Conglomerate Within a Conglomerate

McLane Company

McLane is engaged in the wholesale distribution of grocery and non-food items to retailers, convenience stores, and restaurants. The business was purchased from Wal-Mart Stores in 2003 for approximately $1.5 billion. McLane has accounted for close to fifty percent of revenues in the manufacturing, service, and retail group over the past five years. McLane typically operates on very low margins (in many years pre-tax margins have been under one percent) so the contribution from the business is much less important as a percentage of overall group earnings.

In recent years, McLane's contribution to the manufacturing, service, and retail group's pre-tax earnings has averaged approximately 8 percent. In 2009, McLane held up well while most other businesses ran into severe headwinds and this increased McLane's contribution to the group's pre-tax earnings to 16.7 percent. Additionally, an inventory adjustment related to an increase in federal tobacco excise taxes boosted 2009 performance. In 2010, McLane's pre-tax earnings accounted for 8.6 percent of the group's total.

Taking a longer term view, McLane's business has held up well during the recession and recovery with increases in revenues and profits in each of the past six years. McLane is a good example of a solid, albeit boring, business with good long term economics driven by scale. Wal-Mart Stores still accounts for approximately 30 percent of McLane's revenues. With McLane now within the Berkshire family of businesses, expansion possibilities have come up that were previously hindered by potential customers who competed with Wal-Mart and were reluctant to do business with a Wal-Mart subsidiary[8].

On April 23, 2010, McLane acquired Kahn Ventures which is the parent company of Empire Distributors. Empire Distributors is a wholesale distributor of distilled spirits, wine, and beer operating mainly in the southeastern United States. Max E. Kahn founded the company in 1940 with two trucks, eight brands, and 149 customer accounts. Terms of the transaction were not disclosed.

McLane's pre-tax profits of $369 million for 2010 appear to be sustainable based on the company's track record. It seems reasonable to expect pre-tax margins to come in at slightly over 1 percent which has been the pattern over the past two years. We will assume normalized pre-tax earnings power for McLane of $370 million.

Other Manufacturing

The Other Manufacturing group is comprised of a number of distinct businesses including manufacturers of building products such as Shaw Industries, Acme Building Products, Benjamin Moore paints, Johns Mansville, and MiTek. Berkshire's apparel business is led by Fruit of the Loom which also includes Russell athletic brands and Vanity Fair brands. Other manufacturers also includes Iscar, Forest River, and CTB International. Shaw Industries was added to this group starting in 2010 so all figures presented in this section for prior years now include Shaw's results although we present Shaw's data separately in Exhibit 29 for years prior to 2010.

The businesses in this group rebounded strongly in 2010 with sales of $17,664 million, a 10.8 percent increase from the prior year. The group posted pre-tax earnings of $1,911 million, nearly double the $958 in pre-tax earnings posted in 2009. During the recession, profits were impacted both by lower sales and a reduction in manufacturing efficiencies as facility utilization declined along with production. All of the businesses in this group took cost reduction measures in 2010 and positive results were apparent in 2010 figures.

The Other Manufacturing group had average pre-tax earnings of $1,914 million over the past five years. Peak pre-tax earnings of $2,473 million were recorded in 2007. While we cannot predict the exact timing of a return to the level of earnings seen in 2007, an assumption of $2 billion in normalized pre-tax earnings strikes us as reasonable for this group given the earnings momentum seen in 2010 and the fact that the more economically sensitive businesses should see a return to prosperity as the housing market normalizes. While it is not practical to provide a profile of each business in the group, we will briefly discuss Shaw Industries and Iscar Metalworking.

Shaw Industries

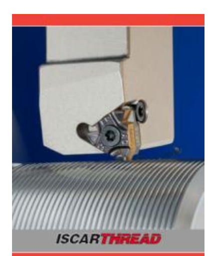
Shaw Industries is the world's largest manufacturer of tufted broadloom carpeting and also carries a full line of other types of flooring. Due to high correlation between spending on flooring items and the state of the real estate market, Shaw's results have suffered in recent years. Both new home construction and sales of existing homes declined dramatically in 2009 which led to the company's third consecutive year of declining revenues and earnings. The nature of Shaw's business is inextricably tied to the housing sector but, as the leading manufacturer within the industry, Shaw should have the ability to fully participate in the eventual recovery. Due to Shaw's consolidation into the "Other Manufacturing" group in 2010, we do not have 2010 results for the company. We briefly discuss 2009 results since this represents the last available data.

Berkshire purchased 87.3 percent of Shaw in January 2001 for $2.1 billion in cash. The remaining interest in Shaw was purchased in January 2002 for Berkshire stock with a market value of approximately $324 million. At the time of purchase, Shaw was Berkshire's largest non-insurance business[9].

Shaw's revenues in 2009 were $4,011 million which represents a decline of 21 percent from 2008. Carpet volumes declined 18 percent due to overall weakness in the housing sector. Pre-tax profits declined 30 percent from 2008 to $144 million. While Shaw was able to benefit from lower raw material costs in 2009, the company incurred higher manufacturing costs due to declining sales volume which decreased manufacturing efficiencies. The company incurred plant closure costs of $101 million in 2009 compared to closure costs of $59 million in 2008. It is likely that Shaw experienced a recovery in 2010, although continued slow new housing starts likely weighed on results.

While it is difficult to predict the exact timing of a recovery in the housing sector, looking at Shaw's results over the past five years provides clues regarding the company's earnings power on a normalized basis. Shaw's pre-tax earnings peaked at $594 million in 2006 after posting pre-tax earnings of $466 million and $485 million in 2004 and 2005 respectively. Average pre-tax earnings for the past five years is calculated at $373 million. The 2005 to 2009 period includes both an unprecedented real estate boom and bust.

Iscar Metalworking



Berkshire purchased 80 percent of Iscar for $4 billion in 2006 with the remaining 20 percent ownership retained by the founding Wertheimer family. Iscar has demonstrated resilience during the economic downturn. Profits were up 159 percent in 2010 due to improving sales throughout the world and particularly in Asia. Warren Buffett believes that Iscar's profits may surpass pre-recession levels in 2011. Here is how Mr. Buffett described Iscar's business in a recent annual letter to shareholders:

> ***"Iscar continues its wondrous ways. Its products are small carbide cutting tools that make large and very expensive machine tools more productive. The raw material for carbide is tungsten,***

mined in China. For many decades, Iscar moved tungsten to Israel, where brains turned it into something far more valuable. Late in 2007, Iscar opened a large plant in Dalian, China. In effect, we've now moved the brains to the tungsten. Major opportunities for growth await Iscar. Its management team, led by Eitan Wertheimer, Jacob Harpaz, and Danny Goldman, is certain to make the most of them". – Warren Buffett [10]

Mr. Buffett is so confident in Iscar's leadership that he is expanding the reach of the company through "tuck in" acquisitions such as Iscar's purchase of Japanese tool maker Tungaloy in 2008 for a reported $1 billion[11].

Iscar is one of many examples of a family owned and operated business that decided to sell to Berkshire Hathaway due to a desire to ensure that the company will be able to continue operating in the manner that led to its initial success while also benefitting from the backing of Berkshire's unique strengths. When Iscar Chairman Eitan Wertheimer decided to sell his business, he wrote a brief letter to Warren Buffett introducing the company. According to Mr. Buffett, the quality of the company and the character of management "jumped off the page"[12]. We discuss management succession issues at Berkshire in a later section. One key concern is whether family run businesses will be as willing to sell to Berkshire after Warren Buffett steps down as CEO.

Other Service: *Spotlight on NetJets*

Other Service is a diverse group of businesses includes NetJets, Flight Safety, Business Wire, The Pampered Chef, International Dairy Queen, and The Buffalo News. Of these businesses, NetJets has the most important impact on the aggregate results of the group. There is limited disclosure regarding the results of each individual business unit within this group but recent data highlight the fact that NetJets has been the main driver of poor results during the recession. We will briefly recount these difficulties and then examine the subsequent turnaround engineered by David Sokol.

NetJets has been one of the major problem areas for Berkshire Hathaway in recent years. While the company is the clear leader in fractional ownership of jets and has an excellent reputation for customer service and safety, financial results have left much to be desired in the years since Berkshire's acquisition of the company for $725 million in 1998. From the date of the acquisition through the end of 2009, NetJets posted cumulative pre-tax losses of $157 million while debt soared from $102 million to a peak of $1.9 billion in April 2009. According to Warren Buffett, NetJets would have been "out of business" without Berkshire's backing[13]. NetJets also had a management change in 2009 when the company's founder and longtime CEO Richard Santulli was replaced by David Sokol who also serves as Chairman of MidAmerican.

"Dave Sokol, the enormously talented builder and operator of MidAmerican Energy, became CEO of NetJets in August. His leadership has been transforming: Debt has already been reduced to $1.4 billion, and, after suffering a staggering loss of $711 million in 2009, the company is now solidly profitable.

> ***Most important, none of the changes wrought by Dave have in any way undercut the top-of-the-line standards for safety and service that Rich Santulli, NetJets' previous CEO and the father of the fractional ownership industry, insisted upon. Dave and I have the strongest possible personal interest in maintaining these standards because we and our families use NetJets for almost all of our flying, as do many of our directors and managers. None of us are assigned special planes nor crews. We receive exactly the same treatment as any other owner, meaning we pay the same prices as everyone else does when we are using our personal contracts. In short, we eat our own cooking. In the aviation business, no other testimonial means more." – Warren Buffett[14]***

While it is reassuring to read that Warren Buffett has confidence in the future of NetJets, it must be noted that prior commentary on this business was generally very positive over the previous twelve years. The fact that David Sokol has been brought in to fix the business is a positive sign given his track record at MidAmerican and also has led many to believe that Mr. Sokol may be a top candidate for the CEO position at Berkshire once Mr. Buffett steps down[15].

Turnaround Begins: *Promising First Steps*

In early 2010, David Sokol indicated that he expected a profitable year for NetJets and stated that the dramatic cost cutting measures taken in the second half of 2009 were mostly complete "barring major shifts in the global economy"[16]. Mr. Sokol also indicated that he was being approached by a number of smaller competitors who were interested in selling their businesses to NetJets and that one potential deal was in the pipeline. Although it is unclear whether he was referring to Marquis Jet at the time, NetJets did end up acquiring Marquis in early November 2010[17].

After four quarters of losses, NetJets posted a small profit in the first quarter of 2010 and continued to post profits for the remainder of the year. Pre-tax profit was $207 million for 2010. One factor that led to the profits in 2010 was the absence of large non-cash writedowns which severely depressed 2009 results. In fact, on a cash basis, NetJets would have posted only a small loss of $35 million in 2009 absent the non-cash writedowns.

The exhibit below presents our estimate of key NetJets operating metrics for the past twelve quarters:

Figures in Millions	Revenues	Pre-Tax Profit/Loss	Non-Cash Writedowns	Pre-Tax Profit Excluding Writedowns
Q1 2008	1,159	45	-	45
Q2 2008	1,279		-	
Q3 2008	1,149	168	-	222
Q4 2008	991		54	
Q1 2009	685	(96)	63	(33)
Q2 2009	729	(253)	192	(61)
Q3 2009	678	(183)	181	(2)
Q4 2009	1,021	(179)	240	61
Q1 2010	808	57	13	70
Q2 2010	846	57	-	57
Q3 2010	793	44	-	44
Q4 2010	884	49	-	49
TOTALS	11,022	(291)	743	452

Exhibit 32: NetJets Key Operating Metrics: Q1 2008 to Q4 2010 [18]

We had to estimate some of the operating metrics in the exhibit because Berkshire's reporting has not always presented results for NetJets for each reporting period. In the endnotes, we have provided more information regarding how we arrived at the figures in the exhibit. Please note that pre-tax profits for Q2 2008 to Q4 2008 were not provided in Berkshire's filings individually so we have presented the data for Q1 2008 and for the remaining three quarters of 2008 in the exhibit.

The exhibits below show the precipitous drop in revenues for NetJets through the recession and recovery along with the non-cash writedowns that were taken during this period:

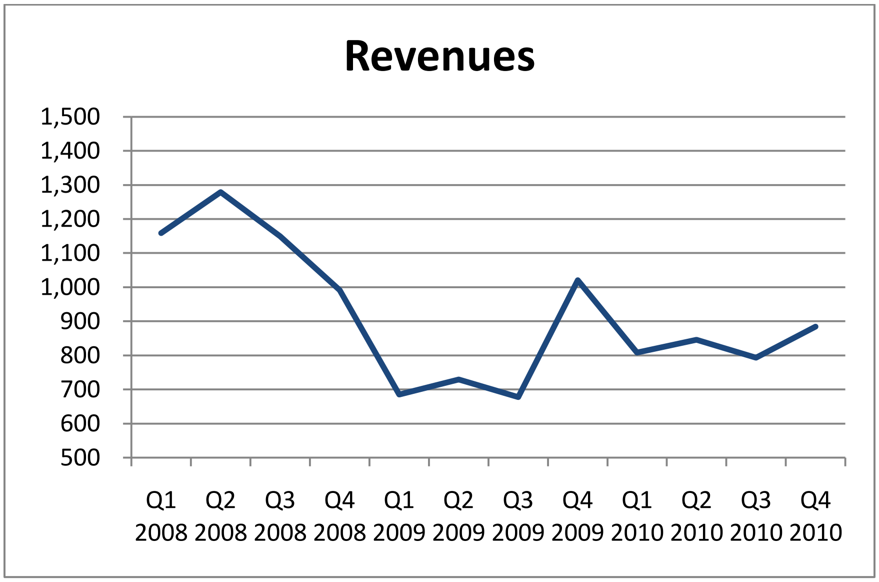


Exhibit 33: NetJets Revenues Q1 2008 to Q4 2010

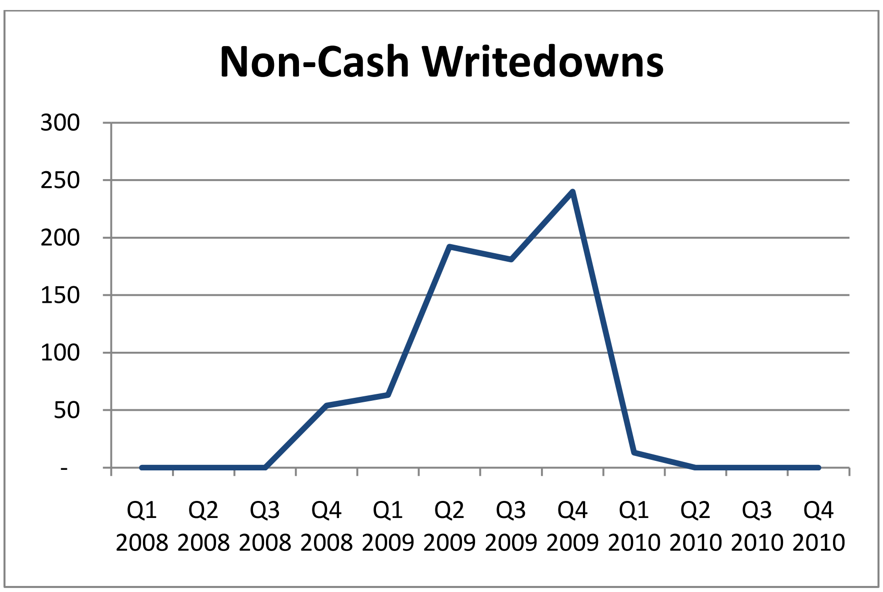


Exhibit 34: NetJets Non-Cash Writedowns Q1 2008 to Q4 2010

Non-Cash Writedowns: *Big Bath or Justified?*

One potential criticism regarding the apparent turnaround at NetJets in 2010 is the fact that the reported figures have not been burdened by the non-cash writedowns that impacted results so heavily in 2009. The writedowns began while former NetJets CEO Richard Santulli was still in charge of the company but continued under David Sokol's oversight starting in Q3 2009 and finally peaked at $240 million in the final quarter of 2009. Non-cash writedowns were a minor $13 million in 2010.

Were the writedowns in late 2009 taken to create a "big bath" effect in which subsequent periods would have easier "comparisons"?

We can say that writedowns of *some amount* were almost certainly justified. The need for writedowns is plausible based on the rapid decline in the fractional aviation market as reported in numerous industry sources as well as evidenced by NetJets revenue decline that began at the end of 2008 and accelerated alarmingly before a recovery began toward the end of 2009. We also know that the resale value of private aircraft plummeted during the recession bolstering the case for writedowns.

The question is one of timing and magnitude. Should management have taken writedowns earlier in 2008, or might have they been delayed? Did they all have to be taken in the periods shown in the exhibits above? Were the size of the writedowns appropriate based on the underlying economics?

What we do know is that NetJets suffered a severe slump in revenues in 2009 – the business quite literally fell off a cliff. In addition to economic woes, the industry had to grapple with constant political attacks against the use of private aviation by corporate executives.

We can see that the writedowns did not begin in earnest until the second quarter although revenues had fallen dramatically in the first quarter. We cannot read management's mind, but it seems plausible that they decided at the end of the first quarter of 2009 to monitor the situation to see if the revenue drop was permanent or temporary prior to taking more significant writedowns. We can see that writedowns did in fact accelerate in the second, third, and fourth quarters of 2009 as revenues stabilized at a low level and then recovered by year-end.

The timing and magnitude of writedowns such as those taken by NetJets is subject to numerous judgment calls by management and is not something outsiders have the ability to monitor. Even if NetJets were a standalone public company, it is doubtful that disclosures would reveal the specific methodology used to arrive at the impairment amount. Within Berkshire, NetJets is required to release even less information. The bottom line: We cannot be sure as outside observers whether the impairments were appropriately timed. However, from the data available, it does not appear *obvious* that any "big bath" maneuver took place after Mr. Sokol took over in August 2009.

The jury is very much still out on NetJets. A recovery is obviously underway but the overall financial results since Berkshire's acquisition remain very poor. Investors will need to monitor NetJets over the course of a full economic cycle to determine whether staggering losses again emerge in the next downturn. We are very comfortable giving Mr. Sokol the benefit of the doubt on the writedowns based on results that have been delivered up to this point and, even more so, based on the weight of Mr. Buffett's frequent explicit endorsements of Mr. Sokol's achievements.

Sokol's Management Style Under Attack

One other major controversy at NetJets has been related to David Sokol's management style which has been attacked by a number of mostly anonymous NetJets employees and former employees. Mr. Sokol has publicly complained about "deceit" at NetJets and has threatened to take corrective actions if the behavior of disgruntled employees causes damage to the NetJets brand. While we will not attempt to cover the entire controversy here, citations are provided in the endnotes for those interested in more information[19].

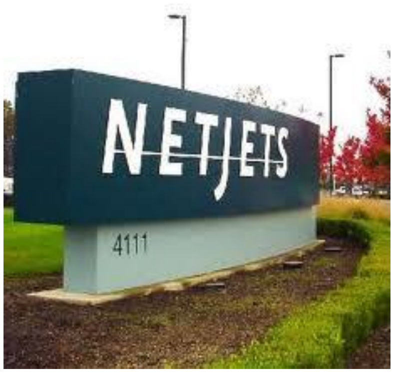
In any restructuring effort that involves reductions in the number of employees at a company, the process is almost certain to inflame tensions and create some level of controversy. What has been surprising is the extent to which these comments called into question Mr. Sokol's management style and accuse him of sacrificing safety to reduce costs[20]. These accusations seem to directly contradict Warren Buffett's statements regarding the turnaround at NetJets and also called into question whether customer satisfaction is in fact at "record levels" as Berkshire reported in its second quarter 2010 earnings press release[21].

As an outside observer presented with anonymous accusations of a serious nature, it is not possible to draw any definitive conclusions regarding the situation. It may not even make much sense to dwell on the issue in this report. However, we bring up the issue mainly because of the importance of the NetJets turnaround as well as David Sokol's importance at Berkshire Hathaway. We are heavily inclined to give Mr. Buffett and Mr. Sokol the benefit of the doubt particularly given the anonymous nature of the complaints and lack of credibility regarding safety lapses. Mr. Buffett and Mr. Sokol own personal NetJets shares and use the same pilots and fleet as other customers so the idea that any compromises on safety have been put in place to reduce costs seems highly unlikely to say the least.

Analysts must be skeptical regarding any company's management and Berkshire Hathaway does not automatically receive a "pass" when it comes to the need for skepticism. Analysts should critically question all data and commentary provided by the company. In this section, we have attempted to focus on NetJets in an effort to dig beneath the surface to the extent possible given public information at our disposal. We believe that all objective indications point to a turnaround at NetJets and the controversies regarding the non-cash writedowns and Mr. Sokol's management style lack credibility.

Steady State Environment: 4 to 5 Percent Net Margins

A key question is the extent to which NetJets is capable of posting acceptable profits in the future when faced with periods of economic turmoil. In a recent interview with Aviation Week, David Sokol indicated that shareholders could expect NetJets to deliver 4 to 5 percent net profit margins in a "steady state, long term" environment[22]. While hardly thrilling, margins at that level sustained over a full economic cycle would be a welcome development for Berkshire shareholders accustomed to erratic results and cumulative losses over long periods of time.



"Berkshire Will Never Walk Away From a Business"

Some readers may question why Berkshire did not simply cut its losses and either sell NetJets or wind down operations during the depths of the recession. In an interview with Aviation Week, David Sokol echoed many of Warren Buffett's statements regarding Berkshire retaining ownership in subsidiaries "forever". This approach can sometimes fail to optimize short term financial results. However, the importance of this policy in the market for acquisitions cannot be overstated. Entrepreneurs who care about the future of their companies will gravitate toward "permanent buyers" but only if actions show that the "never sell" policy is upheld even when times get tough. Link to Rational Walk article on the Aviation Week interview: http://bit.ly/eLYLmS

Other Service – Summary

The Other Service group posted a pre-tax profit of $984 million in 2010 compared to a pre-tax loss of $91 million in 2009. The major factor causing the swing back to profitability was the improvement at NetJets. TTI was the other star performer of 2010 with revenues increasing by approximately 45 percent driven by strong demand.

While 2009 results were very poor, the quick rebound in 2010 is a good sign. 2009 may have been an aberration if NetJets can continue to post profits through a full economic cycle. In the five year period from 2006 to 2010, the Other Service group posted average pre-tax profits of nearly $700 million. Excluding 2009, average pre-tax profits are closer to $900 million. If we consider 2009 to be an aberration, it seems justified to view normalized earnings for the "Other Service" group to be in the neighborhood of $900 million to $1 billion. We will use $950 million in our valuation.

Retailing

The Retailing segment consists of Berkshire's home furnishing and jewelry businesses as well as See's Candies. The home furnishing businesses include Nebraska Furniture Mart, R.C. Willey, Star Furniture, and Jordan's[23]. The jewelry businesses include Borsheim's, Helzberg, and Ben Bridge. In 2010, retailing revenues increased 2.4 percent to $2,937 million while pre-tax profits increased 22.4 percent to $197 million. Given the decline in overall economic activity during 2009, it is notable that the group posted roughly flat pre-tax profits in 2009 of $161 million on a revenue decline of only 8 percent. In 2009, See's Candies, Star Furniture, and Nebraska Furniture Mart posted increased pre-tax earnings while the Jewelry businesses posted a pre-tax loss. Please see the introductory essay of this report, *From Cigar Butts to Business Supermodels*, for a more in depth discussion of See's Candies.

The Retailing group posted peak pre-tax profits of $289 million in 2006 and had average pre-tax profits of $217 million over the past five years. The presence of an economic moat in many of these businesses is readily apparent based on relatively robust results during the recession. Based on our assessment of the economic characteristics of these businesses, we fully expect an eventual return to peak levels of profitability. However, due to the unknown timing and pace of the economic recovery, we will assume normalized earnings of $250 million in our valuation which is somewhat higher than the five year average but still below the 2006 peak.

Manufacturing, Service, and Retailing Valuation

The following table presents a summary of our estimate of "normalized" pre-tax earnings for the manufacturing, service, and retailing group:

Reporting Segment	Pre-Tax Normalized Earnings (millions)
Marmon	850
McLane Company	370
Other Manufacturing	2,000
Other Service	950
Retailing	250
Total	**4,420**

Exhibit 35: Manufacturing, Service, and Retail Valuation Summary

After accounting for minority interests and taxes, the contribution of the manufacturing, service, and retailing group to normalized net earnings should be approximately $2,550 million. Net earnings came in at $2,462 million for the group in 2010 when the economy was still not firing on all cylinders. Net income averaged over $2,250 million from 2006 to 2008 *even though Marmon's contribution did not exist prior to the March 2008 acquisition.* It is very possible that our estimate for normalized earnings is too conservative in light of the economic characteristics of the businesses, particularly if the housing market normalizes over the next few years.

The current book value of the Manufacturing, Service, and Retailing segment is $31,550 million which includes $16,976 million of Goodwill[24]. As Warren Buffett has noted in his letters to shareholders, Berkshire Hathaway's operating subsidiaries have economic goodwill that exceeds the goodwill carried on the balance sheet. This is confirmed when one looks at the earnings power of the businesses compared to tangible capital. Applying a multiple of 15 times our estimate of normalized net income of $2,550 million results in a valuation of $38,250 million for the group which only exceeds book value by 21 percent. This is likely to be a conservative estimate.

Valuation = Normalized Net Earnings x 15 P/E Multiple

Valuation = $2,550 Million x 15 = $38.25 Billion

Berkshire Hathaway Valuation Summary

As we described in the *Valuation Approach* section, we consider the float based valuation model for Berkshire Hathaway's insurance subsidiaries to be the most intellectually sound method for arriving at the intrinsic value of the business. We have made conservative estimates regarding the future of Berkshire's insurance subsidiaries to arrive at an estimate of the present value of the cash flows Berkshire is likely to generate on policyholder float. We then added this present value estimate to the adjusted statutory surplus of the insurance business to arrive at a valuation for the insurance group. We then examined Berkshire's other sources of value in Utilities and Energy, Railroads, Finance and Financial Products, and Manufacturing, Service, and Retailing. The table below provides a summary of the valuation of each of the components of value:

Business Group	Intrinsic Value Estimate *(figures in millions)*
Insurance Subsidiaries	184,586
Utilities and Energy	16,500
Railroads	35,500
Finance and Financial Products	5,500
Manufacturing, Service, and Retail	38,250
Total	**280,336**

Exhibit 36: Berkshire Hathaway Valuation Summary

The total of $280,336 million implies a valuation of $170,094 per A share. Berkshire Hathaway had a total of 1,648,120 Class A equivalent shares outstanding on December 31, 2010. Each B share has the economic interest of 1/1500 of one A share.

To avoid false precision, let us round the estimate to $170,000/A share and $113/B share.

As we noted in the *Sensitivity Analysis* of the Insurance section of this document, one objection to the float based valuation model is the fact that relatively small changes in variables such as the cost of float or growth of float produce large changes in the present value calculation. For example, a one percent increase in the growth of float assumption results in an additional $62.5 billion to our estimate of intrinsic value. A one percent increase in the cost of float would reduce our estimate of intrinsic value by $21.9 billion.

While the use of aggressive assumptions can indeed result in intrinsic value estimates that appear far too high, by using conservative assumptions well grounded in past experience and reasonable expectations of future developments, we believe that the valuation presented here is defensible and realistic. However, as we will point out in the next section, alternative ways of looking at Berkshire's intrinsic value may produce lower valuations that are more in line with Berkshire's typical trading levels in recent years.

Alternative Valuation Approaches

Charlie Munger and others have advocated the use of multiple mental models when evaluating investments. Through the use of multiple models, the analyst has an opportunity to examine a business from several perspectives. This process can sometimes lead to the conclusion that certain long held assumptions may be invalid or may require adjustments. When applied to the subject of valuation, multiple models allow us to perform useful reality checks. In this spirit, we will briefly outline two alternative methods that many analysts have used to evaluate Berkshire Hathaway's intrinsic value.

The "Two Column" Approach

In several recent annual reports, Warren Buffett has commented directly on the subject of intrinsic value by stating that Berkshire can be viewed as having two major "areas of value"[1]:

1. The first area of value is represented by Berkshire's investments in stocks, bonds, and cash equivalents, not including investments held in the railroad and utility operations.

2. The second area of value is represented by earnings coming from sources other than investments and insurance. Mr. Buffett excludes earnings coming from the insurance group because the value of the insurance operations comes from investable funds that are generated and included in the first area of value. In his 2010 annual report, Mr. Buffett updates his thinking on this approach by outlining the "three pillars" of value, with the third pillar involving the importance of intelligent capital allocation when it comes to estimating future performance[2].

At the end of 2010, Berkshire's consolidated cash and invested was approximately $158 billion[3]. We have outlined the results of Berkshire's non-insurance businesses in previous sections of this report and assigned an intrinsic value estimate of $95.75 billion to these businesses based on estimates of normalized income and conservative earnings multiples. Mr. Buffett has not specifically commented on how to value the earnings steam of the non insurance subsidiaries but the use of conservative multiples of normalized earnings seems like a reasonable approach.

One implicit assumption embedded in the two column approach is that insurance subsidiary float will continue to be cost free over long periods of time. Otherwise, it would not be appropriate to consider Berkshire's total investments without deducting part of the total funded by policyholder float. Furthermore, use of the two column approach assumes that Mr. Buffett's views regarding the role of management to preserve the "third pillar" of value will persist in the long run.

Our estimate of Berkshire's intrinsic value using the "two column" approach is $253.75 billion which is the sum of the two areas of value. This results in an intrinsic value estimate of approximately $154,000 per A share and $103 per B share.

The value of Berkshire based on the "Two Column" approach is $154,000/A share and $103/B share.

Multiple of Book Value Approach

One of the most easily obtained statistics on Berkshire Hathaway's progress is book value per share. This figure is reported in each quarterly and annual report and can be tracked over time. While there are serious limitations associated with using book value as a proxy for Berkshire's intrinsic value, *changes* in book value can signal corresponding *changes* in intrinsic value.

> ***"In aggregate, our businesses are worth considerably more than the values at which they are carried on our books. In our all-important insurance business, moreover, the difference is huge. Even so, Charlie and I believe that our book value – understated though it is – supplies the most useful tracking device for changes in intrinsic value." – Warren Buffett[4]***

Mr. Buffett has also commented directly on the relationship between book value and intrinsic value for the insurance subsidiaries:

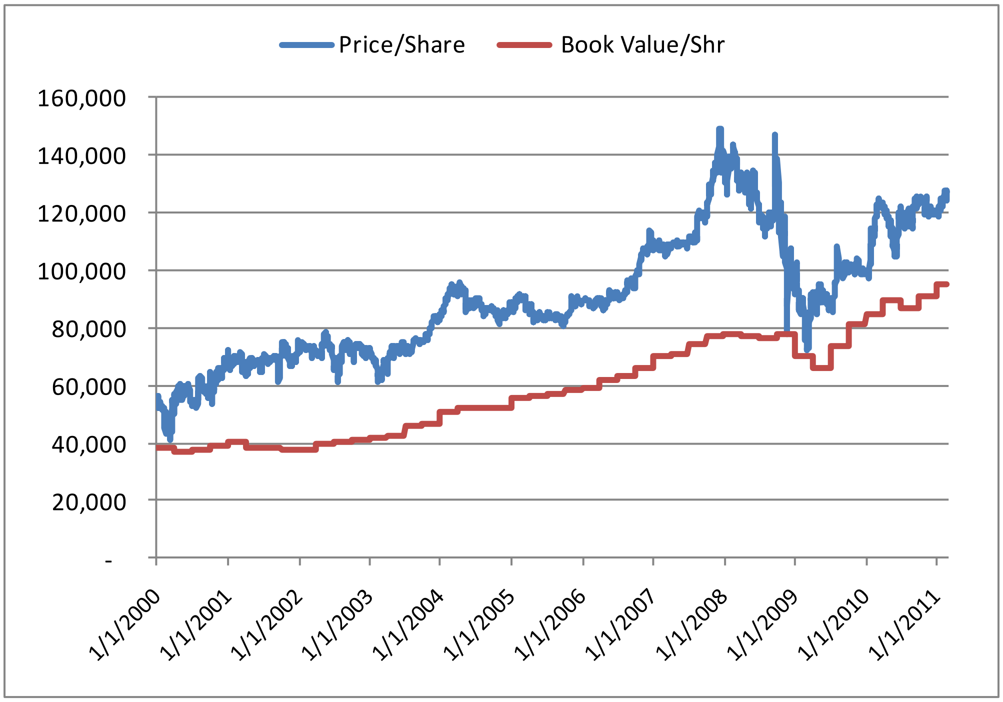
> ***"Our property-casualty (P/C) insurance business has been the engine behind Berkshire's growth and will continue to be. It has worked wonders for us. We carry our P/C companies on our books at $15.5 billion more than their net tangible assets, an amount lodged in our "Goodwill" account. These companies, however, are worth far more than their carrying value – and the following look at the economic model of the P/C industry will tell you why." – Warren Buffett[5]***

Book value is seriously limited as an intrinsic value proxy due to the fact that the carrying value of subsidiaries that were purchased in the distant past are reported at historic value rather than the current market value of the subsidiary. In certain cases, the difference can be very large. Warren Buffett explains the distinction between book value and intrinsic value in the Owner's Manual which every shareholder and potential shareholder should review[6].

In an attempt to examine the typical relationship between Berkshire's market value and book value, we obtained data for Berkshire's closing price for each trading day between December 31, 1999 and February 25, 2011[7]. We compared each daily closing price with the book value figure corresponding to the closing date of the last quarter. For example, we compared the closing price on February 25, 2011 to the book value figure on December 31, 2010.

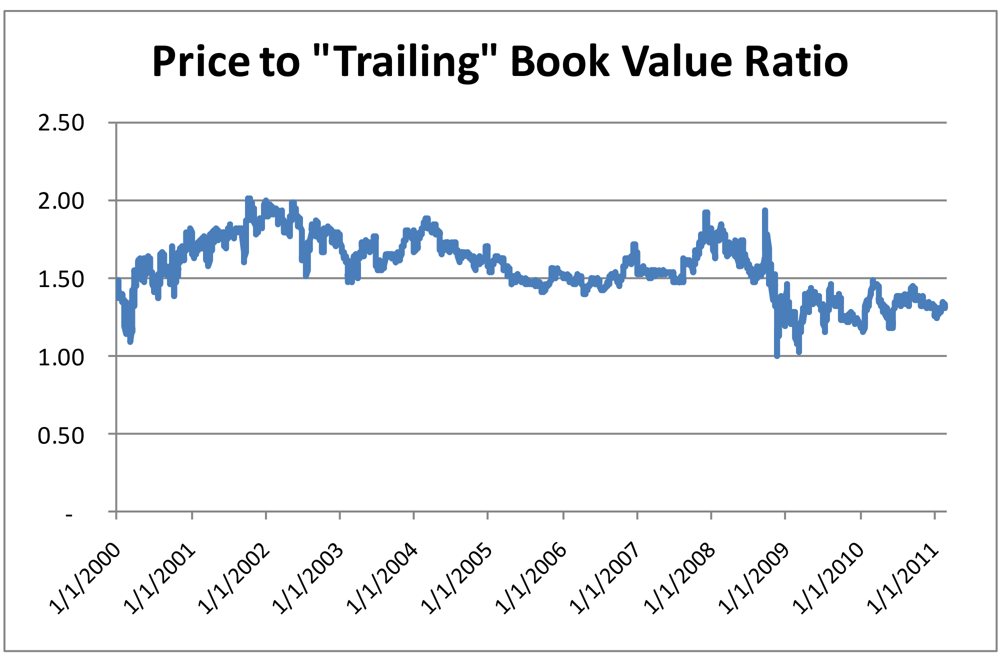
The result of this analysis revealed that the price to book value ratio has ranged between 1.0 and 2.0 with an average ratio of 1.57 over the past ten years. The standard deviation of price/book values was 0.19, meaning that price/book value ranged between 1.38 and 1.76 approximately 68 percent of the time.

The first chart displayed on the next page shows the closing price of Berkshire Hathaway A shares from February 26, 2000 to February 25, 2011 along with the book value per share figure for the fiscal period end date preceding the market value date. As we can see, Berkshire's market price is far more volatile than its book value. This is to be expected given the inherent mood swings that exist in markets, as embodied by Benjamin Graham's fictional "Mr. Market" character. At times, the market has been willing to pay only book value for Berkshire while at other times, Mr. Market has offered to pay twice book value.



Over the past three years, the volatility in Berkshire's market price has been quite high. Book value also took a hit during this period as the market value of Berkshire's investments declined precipitously in 2008 and 2009. Since the market bottom in the first quarter of 2009, Berkshire's book value has more than fully recovered and stands at a record high level of $95,453 as of December 31, 2010. The current market price to book value ratio is 1.38 based on Berkshire's closing price of $131,300 on Monday, February 28, 2011. While this is well above the lowest ratios recorded over the past two years, it is still far below the average ratio of 1.57.

The following chart shows the market price to book value ratio over the past eleven years:



We can see that the ratio has consistently been below the average level since the fall of 2008. Despite a recovery in Berkshire's share price since the 2009 market lows, market value has failed to fully reflect the recovery of book value. It appears that the price/book ratio assigned by the market has fallen to a range of 1.0 to 1.5 from a previous range where 1.5 served as a "floor". We do not see any rationale that would support the premise that Berkshire Hathaway's long run price/book ratio should be lower as a consequence of the financial turmoil of the last few years. In fact, Berkshire's rapid recovery could point to the opposite conclusion.

If we use the average price to book ratio of 1.57 and apply it to Berkshire's 2010 year end book value of $95,453, we arrive at a price of $149,861 per A share or $99.90 per B share. Although one can argue that the average ratio of the past ten years is too high or too low, it seems like a reasonable proxy of what the market has been willing to pay for each dollar of book value. We will round the estimate to $150,000 per A share and $100 per B share.

The value of Berkshire based on the Multiple of Book Value approach is $150,000/A share and $100/B share.

For those who wish to arrive at a broad range of potential values for Berkshire Hathaway, it is possible to take the "price to book value" approach as a minimum value and the "float based" approach as a maximum value noting that the $170,000/A share float model estimate would imply a valuation somewhat above the average price/book ratio.

Using a composite of the three valuation methods, we can view Berkshire's intrinsic value range as between $150,000 and $170,000 per A share and $100 to $113 per B share.

Succession Planning and The Buffett Premium

It seems like every few months, a major financial publication rediscovers the fact that Warren Buffett is now over 80 and has not publicly named his successor. A good example appeared in The Wall Street Journal in October 2009[1]. Most articles express the obvious concern that Berkshire Hathaway will no longer benefit from Mr. Buffett's unique management and investing abilities after he is no longer running Berkshire.

Warren Buffett's leadership over nearly five decades has resulted in an unparalleled track record and thousands of loyal shareholders, many of whom have invested in the company mainly due to Mr. Buffett's presence. Succession planning in a situation where the manager is clearly irreplaceable is obviously an unenviable task for board members. There is a widespread perception that Berkshire's succession planning is unclear or non-existent. However, a look at the actual facts show that we do know quite a bit regarding Berkshire's succession planning.

The Berkshire Hathaway Owner's Manual, which is included in the company's annual report each year, contains a section regarding management succession. Mr. Buffett clearly explains his intentions for running Berkshire Hathaway in the future and tells shareholders that plans are in place if the management succession is needed immediately:

> ***"At my death, the Buffett family will not be involved in managing the business but, as very substantial shareholders, will help in picking and overseeing the managers who do. Just who those managers will be, of course, depends on the date of my death. But I can anticipate what the management structure will be: Essentially my job will be split into two parts. One executive will become CEO and responsible for operations. The responsibility for investments will be given to one or more executives. If the acquisition of new businesses is in prospect, these executives will cooperate in making the decisions needed, subject, of course, to board approval. We will continue to have an extraordinarily shareholder-minded board, one whose interests are solidly aligned with yours.***
>
> ***Were we to need the management structure I have just described on an immediate basis, our directors know my recommendations for both posts. All candidates currently work for or are available to Berkshire and are people in whom I have total confidence."***

In this section, we will attempt to outline what we know *as well as what we do not know* based on publicly available statements and facts. While it is *possible* that certain individuals currently speculating about succession issues may have information from insiders, Berkshire's board is comprised of individuals who are very unlikely to leak confidential information or issue "trial balloons".

When Will Warren Buffett Retire?

From countless public statements, we know that Warren Buffett has no intention of retiring in order to pursue other activities and will only step down if health problems prevent him from executing his responsibilities in an effective manner. Anyone who claims that Mr. Buffett may want to retire at some point to pursue a job in government or pursue other business ventures is not basing the assertion on any known facts.

Obviously, we do not know exactly when Mr. Buffett will have to step down. We can look at actuarial tables and try to make projections, but this ghoulish effort is not likely to yield any certainty. Given Mr. Buffett's statements on his health, it seems more likely than not that Mr. Buffett will run Berkshire for at least five more years, possible that he may be running the company in ten years, but quite unlikely that he will still be at the helm in twenty years. Attempting to make a more precise projection is pointless.

How Will Berkshire Structure Top Management After Buffett?

Mr. Buffett currently has three distinct roles at Berkshire: Chairman of the Board, Chief Executive Officer, and Chief Investment Officer. We know that no single individual will replace Mr. Buffett in all three roles. Here is what we know about Berkshire's plans for each of the three roles:

Chairman of the Board

Mr. Buffett has stated that he hopes the board will select his son, Howard Buffett, to serve as non-executive chairman[2]. Howard Buffett's background is described in Berkshire's proxy statement and other biographical sources[3]. He is 55 years old and has been a Director at Berkshire since 1993. We know that Howard Buffett has experience mainly in agricultural businesses and has served on other boards in the past. His presence on the board will be to preserve Berkshire's unique culture rather than to actively play a role in running the business. As an aside, we also know that Bill Gates has made a lifetime pledge to remain on Berkshire's board and it seems likely that he could serve as a future chairman if the need arises[4].

Chief Executive Officer

Although Mr. Buffett has consistently refused to specifically name an heir apparent, he has on several occasions stated that three internal candidates have been identified who could step into the role at a moment's notice if needed. Here is his statement from the 2007 letter to shareholders:

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

This is exactly the same statement that has been made several times over the past few years and the board apparently discusses the candidates and the front runner at each board meeting. According to Berkshire's 2010 10-K, there are now four candidates under consideration. Obviously, we do not know who the front runner is. This has not stopped outside observers from speculating regarding who the front runner might be, but ultimately those who attempt to make predictions can only make educated guesses. This is particularly true because the actual time of succession is unknown.

The candidate pool can change as individuals get older, new managers are added to Berkshire, and existing candidates take actions to either solidify or erode their candidacy. For example, many Berkshire analysts consider Burlington Northern CEO Matthew Rose to be a potential successor now that Berkshire has acquired the railroad. When Mr. Buffett wrote his 2007 letter, Mr. Rose would not have been a candidate. Similarly, until Richard Santulli's resignation from NetJets in August 2009, most observers thought he was a strong candidate.

Currently, David Sokol seems to be the front runner for the CEO job based on the opinion of many Berkshire analysts, but this could also change in the future and ultimately those of us who make these projections are only making educated guesses. Naming a specific candidate today would serve no useful purpose for Berkshire given that Mr. Buffett does not intend to leave anytime soon and the individual meeting the established criteria could change over time.

Chief Investment Officer

In the past, Mr. Buffett has stated that he has identified four candidates who would be able to step into the investment job immediately if needed. Here is an excerpt from the 2007 letter to shareholders:

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

Todd Combs

In October 2010, Todd Combs was hired to manage a "substantial portion" of Berkshire's investment portfolio but he was *not* hired to serve in the role of Chief Investment Officer[5]. Mr. Buffett, in response to questions regarding Mr. Combs, told reporters that he would personally remain in the Chief Investment Officer role as long as he is at Berkshire. However, we can *infer* that Mr. Combs is a leading candidate to be promoted to Chief Investment Officer in the future since he is the only investment manager to be named up to this point.

We also know that Li Lu is not interested in an investment role with Berkshire at the current time. Here, we have a legitimate mystery regarding what took place since late July when Berkshire Vice Chairman Charlie Munger said that Li Lu's future role at Berkshire was a "foregone conclusion"[6]. Based on Mr. Buffett's statements, apparently Li Lu is happy managing his current partnership and not interested in the job at Berkshire. Also, there was one other unnamed candidate who turned down the job.

What happened to the four candidates who Mr. Buffett referred to in his 2007 letter to shareholders? Are these individuals no longer interested and is Mr. Combs the only candidate for Chief Investment Officer at this time? We simply do not know the answer at this point. Mr. Combs is the most likely candidate, but by no means guaranteed the job. We take a close look at Mr. Combs' track record and investing style in Appendix 6.

As an aside, we also know that Mr. Combs **is not** a candidate for Chief Executive Officer despite the many articles claiming that he would be taking over as Mr. Buffett's "replacement". Many articles appearing at the time of the announcement failed to distinguish between the CIO and CEO roles. Mr. Combs, if he ends up serving as Chief Investment Officer, will report to the next CEO of Berkshire.

Who Will Allocate Capital?

The next CEO of Berkshire Hathaway will be ultimately responsible for the operations of the overall company which includes the allocation of capital within and across subsidiaries. Although Mr. Buffett is not involved in the day-to-day operations of each Berkshire subsidiary, he is involved in all capital allocation decisions. This means that when subsidiaries have available free cash flow (funds available after necessary reinvestment in "maintenance capex"), Mr. Buffett evaluates investment opportunities within the subsidiary and compares these investment prospects with opportunities available in other Berkshire subsidiaries, potential acquisition of new subsidiaries, or investments in marketable securities.

Based on Mr. Buffett's statements, the next CEO will retain his approach as a capital allocator within and between subsidiaries and will make decisions regarding acquisition of new wholly owned subsidiaries. The portion of funds available for investment in marketable securities will be turned over to the Chief Investment Officer who will oversee the investment of the funds in consultation with the CEO who will retain ultimate responsibility for capital allocation.

Berkshire Seems Prepared

Mr. Buffett cannot be replaced and his role will be divided between three individuals in the future. We do not know the identity of the future CEO, but there is a strong likelihood that the future Chairman will be Howard Buffett. We can infer that Todd Combs is one of the most likely individuals to take over as Chief Investment Officer, but this is not assured at this time.

The question of whether Berkshire should be more open regarding succession planning is a legitimate one to raise, but there are no easy solutions. Naming a new CEO prematurely serves no useful purpose since the best candidate could change over time and it would potentially hurt shareholders to "lock in" a candidate well ahead of time. It seems like naming at least one or two additional investment managers would add confidence to the process of selecting the new Chief Investment Officer and there is reason to believe this will happen over the next few years.

Those who remain concerned about succession usually fall into two camps. The first camp consists of shareholders who are simply concerned regarding the prospect of *anyone other than Mr. Buffett* running the company. With the human condition being what it is, there is simply nothing that can be done to alleviate this concern. The day will inevitably come when management succession will be needed and the new CEO and investment officer are *virtually guaranteed* to be less capable than Warren Buffett even though they will still be excellent managers.

The second camp consists of shareholders who lack full confidence in the *succession planning process* and will not be satisfied unless the names of the leading candidates are disclosed immediately and shareholders are kept informed of the list of candidates as they change over time.

The question boils down to whether shareholders are willing to accept some uncertainty in terms of the identity of the eventual successor as CEO in exchange for Mr. Buffett's management and investing skills even though his tenure is of unknown duration. The only other choice is for shareholders to impose substantial tangible and intangible costs on the company immediately by demanding a timetable for succession that would sideline the most successful investor of the past sixty years prematurely.

The path forward seems obvious, even though it is a moot point given Mr. Buffett's ability to control this decision through his ownership interest in the company. Ultimately, Berkshire Hathaway shareholders must trust that Mr. Buffett and the Board have established solid succession plans. The presence of highly talented managers such as David Sokol should reassure shareholders that the company will have a captain at the helm when Mr. Buffett finally steps down[7].

Buffett Premium or Free Buffett Option?

We began this report by asking whether the current share price of Berkshire Hathaway implies the existence of a "Buffett Premium". It appears clear that are at least three major areas where Mr. Buffett has historically provided Berkshire with advantages that cannot be easily replicated. To sum up our previous discussion:

1. **Acquisitions of family-run businesses.** The prestige of "selling to Warren Buffett" will no longer exist in a post-Buffett Berkshire Hathaway but many businesses will still be attracted to Berkshire's philosophy of "permanent" ownership and could offer superior terms as a result.

2. **Opportunistic investments in times of economic distress.** Berkshire will still have resources to make meaningful investments in times of distress but recipients of the investments will not have the "Buffett Seal of Approval" and therefore terms may not be as favorable to Berkshire as they were in the past.

3. **Overall superior capital allocation skills.** Berkshire will have competent value investors in the future but it is unreasonable and unlikely to believe that anyone like Warren Buffett will be available. In fact, it would be dangerous for a new investment officer to feel that he needs to compete with Mr. Buffett's legacy. Investment returns will be more modest in a post-Buffett Berkshire Hathaway.

From the information provided in this report, it should be clear that tremendous value has been provided by Mr. Buffett's unique skills in each of these areas. However, to answer the question of whether a "Buffett Premium" exists today, one must ask whether the price shareholders are paying implies that Mr. Buffett will continue to add incremental value in the future through his activities in these areas.

Based on each of the three measures of intrinsic value presented in this report, Berkshire's current share price appears to be undervalued. We specifically avoided using aggressive assumptions in any of the valuation models that would depend upon Mr. Buffett's unique skill set. For example, nowhere do we assume that Mr. Buffett will engineer lucrative deals in the future such as the Goldman Sachs or Swiss Re investments. We do not assume that family-run businesses will present Berkshire with favorable terms due to the prestige of selling to Mr. Buffett or the stability that comes from Berkshire's "permanent" ownership philosophy. We have not assumed rates of returns in the float based model that appear to require heroic capital allocation skills.

If we are correct in our belief that Berkshire currently trades below intrinsic value based on valuation methods that specifically avoid reliance on Mr. Buffett's unique abilities, it follows that shareholders currently are not paying a "Buffett Premium" for the shares. To the contrary, shareholders may be acquiring the business at less than intrinsic value while also obtaining a free “Buffett option” that could pay off in a major way if Mr. Buffett continues to run the company for many years to come. To put it another way, investors are paying nothing for the added value that Mr. Buffett will provide to Berkshire as the “third pillar” of value representing superior capital allocation skills.

Any valuation approach is subject to debate and criticism. The three models we present are no different. The main risk to the float based model involves erosion in underwriting discipline leading to high cost float in the future. We have assumed that Mr. Buffett’s insistence on underwriting discipline will continue in the future. This view is based on the presence of seasoned insurance executives like Ajit Jain who will maintain the culture in reinsurance going forward. The sensitivity analysis we provided demonstrates that small changes in float based valuation model variables can dramatically change intrinsic value estimates. Therefore, investors who are unsure of Berkshire’s ability to maintain high underwriting standards in a post-Buffett management structure may wish to favor the “two column” or price to book valuation models instead. Even using those these more conservative valuation methods results in intrinsic value estimates meaningfully above Berkshire’s current quotation.

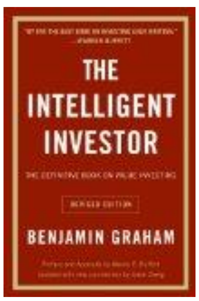
Warren Buffett and Charlie Munger have built a unique company and future management cannot possibly be as good as current management. However, we believe that this report demonstrates that Berkshire should continue to prosper in the future. Shares trade at a valuation where investors currently enjoy a free “Buffett Option”. Given Mr. Buffett’s good health and enthusiasm for running Berkshire, shareholders may be in a position to benefit from his unique abilities for many years to come.

Appendix 1: Further Reading

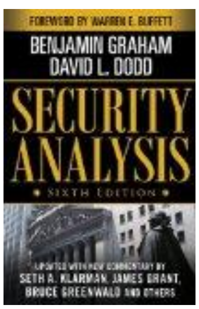
This section provides links to a number of resources for further reading. We list books in three categories first: Investing Principles, Warren Buffett and Charles Munger, and The Madness of Crowds and Human Misjudgment. In addition to books, we list several online resources that are worth monitoring on a regular basis.

Investing Principles

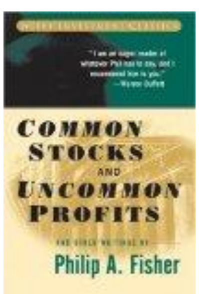
The following books form the foundation required for a solid understanding of value investing. It is impossible to provide a full listing of the large number of valuable books that are available. However, the reader who diligently follows the principles in the following books should not suffer poor results.



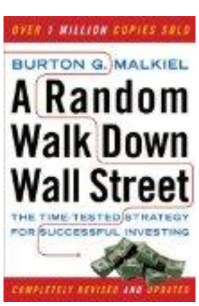
The Intelligent Investor by Benjamin Graham is perhaps the most widely cited but least followed book on investing. Few investors on Wall Street have failed to read this classic and countless individual investors have done so as well. Nevertheless, the vast majority have failed to absorb the lesson of "Mr. Market" that is the key to success or failure in the field of investing. For those who have the appropriate temperament and capabilities, *The Intelligent Investor* serves as an outstanding introduction to the field of value investing in a format that will not intimidate those without formal training in finance.



Security Analysis by Benjamin Graham and David Dodd is the classic investment textbook that every value investor must read. However, it is not nearly as accessible as *The Intelligent Investor* and some individuals grow frustrated with the book, particularly with some of the older editions. However, the sixth edition, reviewed in more detail on The Rational Walk in 2009, is greatly improved with introductions and examples from contemporary investors. Many investors believe that the essays by investors including Seth Klarman, James Grant, Bruce Berkowitz, Bruce Greenwald, and others justify the price of the book alone.



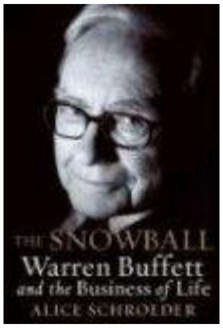
On the cover of *Common Stocks and Uncommon Profits* by Philip A. Fisher appears the following quote: "I am an eager reader of whatever Phil has to say, and I recommend him to you. — Warren Buffett". What is fascinating about Mr. Buffett's quote is that the investing approach described by Mr. Fisher is very different from the Graham style of value investing. In fact, Mr. Fisher's views are regarded as key foundations for the field of growth investing. The Rational Walk's review of the book provides more details regarding why Mr. Buffett finds the contents valuable.



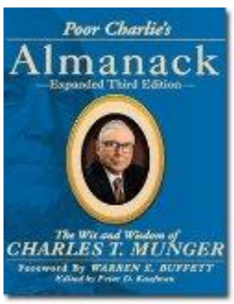
Readers may wonder why Burton Malkiel's *A Random Walk Down Wall Street* appears on the recommended reading list. Mr. Malkiel presents the argument for market efficiency in a very clear manner that is easily accessible to those new to investing. It is critical for value investors to understand the prevailing views driving the decision making process of the vast majority of investors. While most value investors reject the notion of market efficiency, there are worse outcomes than adopting an indexing strategy of the type advocated by Mr. Malkiel.

Warren Buffett and Charles Munger

The following books are "must read" items for anyone seriously interested in the history of the men who took a struggling textile maker destined for eventual failure and turned it into the business powerhouse that Berkshire Hathaway represents today. While Mr. Buffett is significantly more famous, much of Berkshire Hathaway's success over the past few decades must be credited to Mr. Munger's insistence that some high quality businesses are worth pursuing even if they cannot be obtained at bargain basement prices.

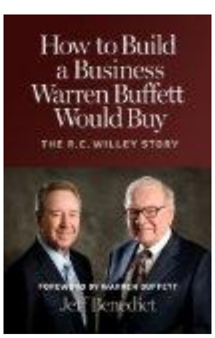


Alice Schroeder was granted unprecedented access to Warren Buffett himself, his files, and his family and colleagues over a number of years and the end result was *The Snowball: Warren Buffett and the Business of Life*. This is not a book that outlines Mr. Buffett's investing techniques in detail, but it is of interest to those who wish to know more about his history from a personal perspective. To be sure, business topics are discussed, but the new insights tend to be more on the personal side. For a full review of this book along with Roger Lowenstein's 1995 Buffett biography *The Making of an American Capitalist*, see The Rational Walk's book review.



From first appearances, *Poor Charlie's Almanack*, edited by Peter Kaufman, might appear as a book that can be read casually. While it is true that the book is richly illustrated and produced, it would be an error to regard the content with any less reverence than *Security Analysis* or *The Intelligent Investor*. The great virtue of this book is the multi-disciplinary emphasis expressed in Mr. Munger's speeches and other writings. Those who are most likely to appreciate the message should have a grasp of basic concepts of investing. However, anyone can benefit from the life lessons expressed in these pages.

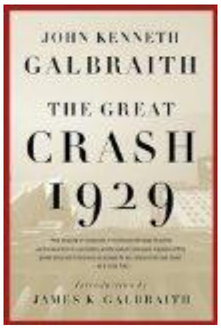
Lawrence Cunningham has done a great service for investors everywhere by compiling information from Warren Buffett's shareholder letters into a very accessible compilation in *Essays of Warren Buffett: Lessons For Corporate America*. Why would anyone pay to read letters that can be downloaded for free on Berkshire Hathaway's web site? Mr. Cunningham adds a great deal of value by arranging the letters into a convenient and topical format rather than a purely chronological format. Read a full review on The Rational Walk for more information on this book.



The R.C. Willey Story, skillfully told by author Jeff Benedict, is easily one of the most inspiring business stories one could hope to read. Anyone who is cynical about "up from the bootstraps" American success stories should read this book about Bill Child's life story. From an investment perspective, it is hard to come away from reading the book without thinking of at least a few attributes to look for when searching for investment candidates. Mr. Child's interactions with Warren Buffett represent a great case study of how Mr. Buffett approaches business acquisitions. Read a full review of the book on The Rational Walk for more details.

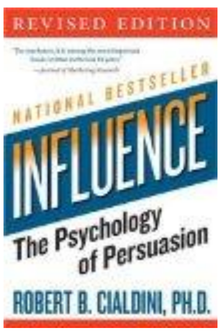
The Madness of Crowds and Human Misjudgment

Intelligent investing requires more than simply understanding how to read financial statements and evaluate the competitive position of a business. There are numerous psychological tendencies that individuals must be aware of in order to avoid repeating the mistakes of prior generations. It's a cliché to observe that those who neglect history are doomed to repeat it, but that does not make the observation any less true.



"What has been is what will be, and what has been done is what will be done; and there is nothing new under the sun." – Ecclesiastes 1:9.

In *The Great Crash of 1929*, John Kenneth Galbraith describes in excruciating detail the human follies that led to the 1929 stock market crash along with some of the well intentioned, yet futile steps taken by market participants and government officials to remedy the situation. This book was recommended by Warren Buffett at the 2009 Berkshire Hathaway annual meeting for a very important reason.



Robert B. Cialdini's *Influence: The Psychology of Persuasion* is critically important for anyone interested in understanding the psychological tricks than can be used to manipulate individuals in business and in life. From an investment perspective, Mr. Cialdini provides the tools required to determine whether your investment advisor is manipulating you using common psychological tricks. For example, it is hard to imagine that anyone who internalizes the techniques in this book would have fallen victim to Bernard Madoff's Ponzi scheme. It is therefore a "must read" for anyone who uses advisory services of any kind.

Online Resources

There are numerous resources available for value investors who wish to follow Berkshire Hathaway, Warren Buffett, and Charlie Munger, as well as to improve their own overall investing skill set. While this list is definitely not exhaustive, it represents a good selection of websites, blogs, and other resources that are worth monitoring.

- **The Rational Walk:** www.rationalwalk.com. The Rational Walk was created by Ravi Nagarajan, the author of this report, in February 2009 to serve as a platform for discussing various value investing topics inspired by the principles of Benjamin Graham, Warren Buffett, Charles Munger, and others. Berkshire Hathaway has been a frequent topic on the site with extensive coverage of all major events that have taken place over the past two years including the Burlington Northern Santa Fe acquisition.

- **Berkshire Hathaway Intrinsivaluator.** www.creativeacademics.com/finance/IV.html. The Berkshire Hathaway Intrinsivaluator attempts to calculate the intrinsic business value of Berkshire Hathaway using multiple models and pre-defined data sets. The site is often updated with data based on released financial statements and permits the user to adjust assumptions and see the impact on intrinsic value.

- **Guru Focus.** www.gurufocus.com. Guru Focus maintains extensive data on the portfolios of a number of prominent investors including Warren Buffett. Much of the content is free of charge but the site also has premium membership products.

- **The Manual of Ideas.** www.manualofideas.com. The Manual of Ideas publishes differentiated, idea-driven publications for serious investors. While the publications require a subscription, there is also a free blog that is often updated with items of interest. The Manual of Ideas is highly recommended for the intelligent enterprising investor.

- **Dataroma's Listing of Berkshire's Portfolio.** www.dataroma.com/m/holdings.php?m=brk. This site provides a very easy to use interface to monitor Berkshire Hathaway's portfolio of common stocks reported on SEC Form 13F each quarter. The site also has data for a number of additional well known investors.

- **Simoleon Sense.** www.simoleonsense.com. Simoleon Sense is a website dedicated to enriching sophisticated investors' latticework of mental models. The site is run by Miguel Barbosa who has dedicated his efforts to Charlie Munger and Warren Buffett among others. The site is updated very frequently and is a great resource for those who are interested in taking Charlie Munger's advice on interdisciplinary thinking seriously.

- **Property Casualty Insurers Association of America.** www.pciaa.net. This site is required reading for anyone interested in the Property-Casualty insurance industry. Most content appears to be free.

- **The Ben Graham Centre For Value Investing.** www.bengrahaminvesting.ca. This website is part of the Richard Ivey School of Business and was established in 2006. The Centre focuses on applied research in the value investing field and has interesting content and interviews available at no cost.

- **Heilbrunn Center for Graham & Dodd Investing.** http://www4.gsb.columbia.edu/valueinvesting The Heilbrunn Center for Graham & Dodd Investing at Columbia Business School is a leading center for the practice and theory of investing. The Center hosts the annual Columbia Investment Management Conference which features some of the top names in the investment management business.

- **SEC Company Search Database.** www.sec.gov/edgar/searchedgar/companysearch.html. This entry may seem self evident but far too few investors read SEC Filings. The first stop when considering an investment should be the Securities and Exchange Commission website. Use this search database to find information on any publicly traded company. The latest 10-K report provided by each company often contains the best summary of information available at no cost to any investor and should be the starting point for due diligence.

Appendix 2: Berkshire's Equity Portfolio

In this section, we examine Berkshire Hathaway's Equity Portfolio as reported to the Securities and Exchange Commission on Form 13F listing positions held as of December 31, 2010.

Lou Simpson's Retirement Prompts Portfolio Changes

Berkshire Hathaway's equity portfolio underwent significant changes during the fourth quarter of 2010 due to Lou Simpson's retirement from GEICO. Although most media reports attribute Berkshire Hathaway's portfolio moves exclusively to Warren Buffett, a significant portfolio has long been managed by Mr. Simpson.

According to Warren Buffett's 2004 letter to shareholders, Lou Simpson delivered average annual gains of 20.3 percent from 1980 to 2004 compared to average annual gains of 13.5 percent for the S&P 500. During the 25 year timeframe, Mr. Simpson posted only three annual losses and underperformed the S&P 500 only six times. Mr. Buffett appropriately stated that Lou Simpson is "a cinch to be inducted into the investment hall of fame."

Although Mr. Buffett has been effusive in his praise for Lou Simpson's stock picking acumen, he has not always agreed with specific stock picks in the past. In his 2004 letter to shareholders, Mr. Buffett noted that he typically learns of Mr. Simpson's transactions ten days after the end of each month. Although noting that Mr. Simpson is "usually right", sometimes Mr. Buffett "silently disagrees" with his decisions.

During the fourth quarter, eight positions held in GEICO's portfolio were liquidated. These positions had a combined market value of nearly $1.2 billion as of September 30, 2010. While many of the media reports stating that "Buffett has sold" the stocks in this list are technically true, it does not necessarily follow that he is bearish on these companies since he never initiated the positions to begin with. Warren Buffett and Charlie Munger have often spoken about "not backing into decisions" and perhaps these liquidations represent an example of this philosophy.

In addition to liquidating the eight GEICO holdings, Berkshire also reduced positions in Moody's and Bank of New York. Mr. Buffett has been reducing Berkshire's position in Moody's for several quarters with the most recent reduction reported in late October in a Form 4 filing. The position in Bank of New York was reduced by 10 percent and is a relatively small position for Berkshire with a market value of $54 million as of December 31, 2010.

Berkshire added 6,215,080 shares of Wells Fargo which is ranked as the portfolio's #2 holding.

Top 10 Holdings

Security	% of Total
Coca Cola	25.0
Wells Fargo	20.2
American Express	12.4
Procter & Gamble	9.4
Kraft	6.3
Johnson & Johnson	5.0
Wal-Mart	4.0
Wesco Financial	4.0
ConocoPhillips	3.8
U.S. Bancorp	3.5
All Others	6.4

Q4 2010 Portfolio Changes

New Positions:
None

Liquidated Positions:
Nike Inc. (NKE)
Fiserv Inc. (FISV)
Nestle (NSRGY – ADR)
Nalco Holdings Co. (NLC)
Lowes Corporation (LOW)
Becton Dickinson (BDX)
Bank of America (BAC)
Comcast Corp. (CMCSK)

Reduced Positions:
Moody's Corporation (MCO)
Bank of New York (BK)

Increased Positions:
Wells Fargo (WFC)

Portfolio Value:

$52,560,379,000 as of 12/31/2010

Berkshire's 13F: Behind The Numbers

Berkshire Hathaway files a "combination report" with the Securities and Exchange Commission approximately six weeks after the end of each calendar quarter. The filing, on Form 13F, presents each equity position held in stocks traded on American exchanges at the end of the reporting period. **The filing does not include positions traded directly on foreign exchanges but does include American Depository Receipts (ADRs) of foreign issuers.** This means that significant minority equity positions such as Berkshire's investment in BYD are *not included* in the 13F quarterly filings. For purposes of our analysis, we limit our review to positions included in the 13F and reconcile to the totals provided in the 13F.

Berkshire has numerous subsidiaries which own equity securities. Rather than filing a separate 13F report for each subsidiary, Berkshire files what is known as a "combination report" with the SEC that includes positions held by numerous reporting entities. This can create some confusion regarding Berkshire's portfolio moves and is the primary reason why reporters historically confused investments made by Lou Simpson with those made directly by Warren Buffett. The exhibit below lists each of the reporting entities in Berkshire's 13F report along with the codes used for each entity in Q3 2010 and Q4 2010. The Q4 2010 13F report may be found at this link: http://bit.ly/dMPnWO.

Reporting Entity	Description	Code: Q4 2010 13F	Code: Q3 2010 13F
Berkshire Hathaway Life Insurance Co. of Nebraska	This insurance group offers the BRKDirect annuity products and is part of the Finance and Financial Products reporting segment.	1	1
BH Columbia Inc.	Subsidiary of National Indemnity and parent of Columbia Insurance Company	2	2
BH Finance LLC	First appearance in 13F report for Q4. Did not appear in Q3 report. Possible that this reporting entity will hold Todd Combs' future activity?	3	N/A
Blue Chip Stamps	Holding Company owns 80.1% of Wesco Financial.	4	3
Warren Buffett	Every line item in the report has Warren Buffett's reporting code to signify his ultimate responsibility for the selection. Some have speculated that lines with only Buffett's code are part of his personal portfolio; however, this contradicts Buffett's prior statements regarding the approximate size of his personal portfolio. It is more likely that lines with Buffett's code alone represents Berkshire's pension plan which Buffett manages.	5	4
Columbia Insurance Co	Subsidiary of BH Columbia Inc.	6	5
Cornhusker Casualty Co.	Part of Berkshire Hathaway Homestate Companies	7	6
Cypress Insurance Company	Part of Berkshire Hathaway Homestate Companies	8	7
Fechheimer Brothers Company	Uniform manufacturing subsidiary part of Berkshire's diverse manufacturing, service, and retail group	9	8
GEC Investment Managers	This code represented Lou Simpson's GEICO portfolio and no longer appears in Berkshire's 13F report, apparently due to the wind down of Simpson's portfolio due to his retirement in Q4 2010.	N/A	9
GEICO Corp.	GEICO Corporation's reporting code. Almost always coincided with GEC Investment Managers in past 13F reports.	10	10
Government Employees Ins. Corp.	GEICO reporting code. Almost always coincided with GEC Investment Managers and GEICO Corp. reporting codes in past 13F Reports.	11	11
Medical Protective Corp.	Primary Insurer engaged in medical liability insurance	12	12
National Fire & Marine	National Indemnity Subsidiary	13	13
National Indemnity Co.	National Indemnity Code	14	14

Reporting Entity	Description	Code: Q4 2010 13F	Code: Q3 2010 13F
National Liability & Fire Ins. Co.	National Indemnity Subsidiary	15	15
Nebraska Furniture Mart	Nebraska Furniture Mart - Furniture Retailer	16	16
OBH LLC	"Old Berkshire Hathaway" OBH LLC – Merged into New Berkshire in General Re Transaction in 1998	17	17
U.S. Investment Corp.	Specialty Insurer acquired in 2000 and part of primary insurance reporting group.	18	18
Wesco Financial Corp.	Wesco reporting code	19	19
Wesco Financial Ins. Co.	Wesco reporting code	20	20
Wesco Holdings Midwest, Inc.	Wesco reporting code	21	21

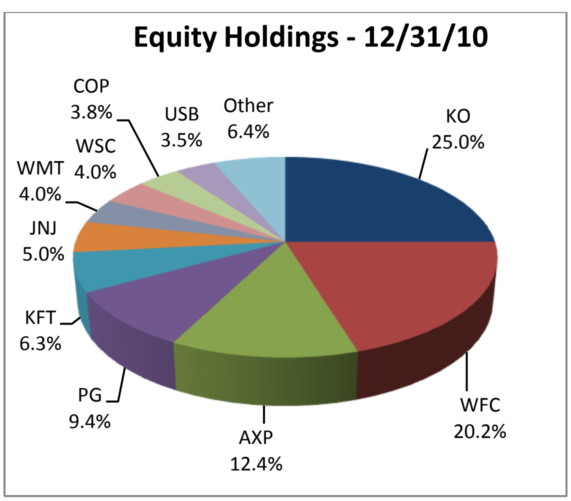
As we can see from the exhibit, Berkshire Hathaway has a complicated structure and many layers of subsidiaries. The majority of the subsidiaries listed in the report are those of Berkshire's insurance operations but some non-insurance subsidiaries such as Nebraska Furniture Mart and Fechheimer also own securities.

Historically, Warren Buffett has made all capital allocation decisions for Berkshire except those made by Lou Simpson and represented by the GEICO codes in the 13F report. In reports prior to the fourth quarter of 2010, there were three GEICO related codes: GEC Investment Managers, GEICO Corp, and Government Employees Ins. Corp. Starting in the fourth quarter, GEC Investment Managers no longer appears in the list.

We also note with interest the introduction of a new reporting code for the fourth quarter of 2010: BH Finance LLC – Reporting Code #3. Although this reporting code is associated with only a few of Berkshire's holdings, we suspect that it may be intended to track the investment activities of Todd Combs who was named as an investment manager for Berkshire during the fourth quarter. Mr. Combs was scheduled to begin work at Berkshire at the beginning of 2011.

Summary of Positions

Coca Cola, Wells Fargo, and American Express together represent nearly 58 percent of the portfolio as measured by market prices on December 31, 2010. Other major holdings include Procter & Gamble, Kraft, Johnson & Johnson, Wesco Financial, Wal-Mart, ConocoPhillips, and U.S. Bancorp. Although Berkshire currently has 25 positions in the portfolio, the bottom 15 only account for 6.4 percent of the total value.



The following exhibit provides a summary of Berkshire's equity positions consolidated for all reporting entities:

Security	Ticker	Shares at 12/31/2010	Shares at 9/30/2010	Share Count Change in Q4 2010	Price/Share 12/31/2010	Price/Share 9/30/2010	Market Value 12/31/2010	Market Value 9/30/2010
American Express Co.	AXP	151,610,700	151,610,700	0	42.92	42.03	6,507,132,000	6,372,197,000
Bank of America Corp.	BAC	0	5,000,000	(5,000,000)	13.34	13.10	0	65,512,000
Bank of New York Mellon Corp.	BK	1,793,915	1,992,759	(198,844)	30.20	26.13	54,176,000	52,070,000
Becton Dickinson & Co.	BDX	0	1,889,889	(1,889,889)	84.52	74.10	0	140,041,000
Coca Cola	KO	200,000,000	200,000,000	0	65.77	58.52	13,154,000,000	11,704,001,000
Comcast Corp	CMCSK	0	186,897	(186,897)	20.81	17.01	0	3,179,000
Comdisco Holding Co.	CDCO.OB	1,538,377	1,538,377	0	9.00	9.00	13,846,000	13,846,000
ConocoPhillips	COP	29,109,637	29,109,637	0	68.10	57.43	1,982,366,000	1,671,766,000
Costco Wholesale Corp.	COST	4,333,363	4,333,363	0	72.21	64.49	312,912,000	279,459,000
Exxon Mobil Corp.	XOM	421,800	421,800	0	73.12	61.79	30,842,000	26,063,000
Fiserv Inc.	FISV	0	3,910,800	(3,910,800)	58.56	53.82	0	210,479,000
Gannett Inc.	GCI	1,740,231	1,740,231	0	15.09	12.23	26,260,000	21,283,000
General Electric Co.	GE	7,777,900	7,777,900	0	18.29	16.25	142,258,000	126,391,000
GlaxoSmithKline	GSK	1,510,500	1,510,500	0	39.22	39.52	59,242,000	59,695,000
Ingersoll-Rd Company LTD.	IR	636,600	636,600	0	47.05	35.68	29,949,000	22,712,000
Johnson & Johnson	JNJ	42,624,563	42,624,563	0	61.85	61.96	2,636,330,000	2,641,018,000
Kraft Foods Inc.	KFT	105,214,584	105,214,584	0	31.51	30.86	3,315,311,000	3,246,922,000
Lowes Companies Inc.	LOW	0	6,500,000	(6,500,000)	25.08	22.29	0	144,885,000
M & T Bank Corporation	MTB	5,363,821	5,363,821	0	87.05	81.81	466,920,000	438,814,000
Moody's	MCO	28,415,250	28,873,756	(458,506)	26.54	24.98	754,141,000	721,267,000
Nalco Holding Co.	NLC	0	6,142,300	(6,142,300)	31.94	25.21	0	154,847,000
Nestle	NSRGY	0	3,400,000	(3,400,000)	58.82	53.59	0	182,189,000
Nike Inc.	NKE	0	3,642,929	(3,642,929)	85.42	80.14	0	291,944,000
Procter & Gamble Co.	PG	76,766,036	76,766,036	0	64.33	59.97	4,938,358,000	4,603,660,000
Sanofi Aventis	SNY	4,063,675	4,063,675	0	32.23	33.25	130,972,000	135,117,000
Torchmark Corp.	TMK	2,823,879	2,823,879	0	59.74	53.14	168,698,000	150,062,000
US Bancorp	USB	69,039,426	69,039,426	0	26.97	21.62	1,861,994,000	1,492,632,000
USG Corporation	USG	17,072,192	17,072,192	0	16.83	13.19	287,325,000	225,182,000
United Parcel Service Inc.	UPS	1,429,200	1,429,200	0	72.58	66.69	103,731,000	95,313,000
Wal-Mart Stores, Inc.	WSC	39,037,142	39,037,142	0	53.93	53.52	2,105,273,000	2,089,268,000
Washington Post Co.	WPO	1,727,765	1,727,765	0	439.50	399.41	759,354,000	690,087,000
Wells Fargo & Co. Del	WFC	342,623,925	336,408,845	6,215,080	30.99	25.11	10,617,915,000	8,448,907,000
Wesco Financial	WSC	5,703,087	5,703,087	0	368.41	358.15	2,101,074,000	2,042,561,000
					TOTALS		**52,560,379,000**	**48,563,369,000**

With the exception of Johnson & Johnson, GlaxoSmithKline, and Sonofi Aventis which were each down slightly for the quarter, all of Berkshire's equity positions advanced over the course of the fourth quarter along with the overall bull market in equities that prevailed during this period.

Portfolio Drill Down by Reporting Entity

Although few analysts currently examine Berkshire's equity positions by reporting entity, we find it interesting to do so primarily because Berkshire's portfolio will likely be managed by several investment managers in the future, particularly after Warren Buffett steps down from his role as Berkshire's primary capital allocator. While Mr. Buffett has no plans to retire, a gradual shift in responsibility will begin in the current quarter as Todd Combs begins to allocate capital for Berkshire. Mr. Combs' portfolio is expected to be a small portion of Berkshire's portfolio initially and could amount to $1 to $2 billion. As noted previously, Berkshire introduced a new reporting entity in the 13F combination report for Q4 2010 (BH Finance LLC) and we will be watching for signs that Mr. Combs will operate within this entity.

The following exhibit breaks down Berkshire's holdings as of December 31, 2010 based on identified reporting entities within the 13F report. We have included our interpretation of which subsidiary is the ultimate owner of each line item, although this is not always entirely clear because multiple entities (or "managers") often appear for each line item in the 13F report. We generally attribute a position to the highest level subsidiary identified. For example, if manager codes appear for both National Indemnity and for one of its subsidiaries, we attribute the position to National Indemnity.

Security	Shares	Share Price	Market Value	Managers	Primary Entity Ownership
American Express Co.	17,225,400		739,314,000	5, 2, 6, 17	National Indemnity
	7,994,634		343,130,000	5, 13, 17	National Indemnity
	120,255,879		5,161,382,000	5, 14, 17	National Indemnity
	1,943,100		83,398,000	5, 4, 17, 19, 20, 21	Wesco
	1,399,713		60,076,000	5, 16, 17	Nebraska Furniture Mart
	839,832		36,046,000	5, 9, 17	Fechheimer Brothers
	1,952,142		83,786,000	5, 17	Berkshire Hathaway Inc.
Total American Express Co.	**151,610,700**	**42.92**	**6,507,132,000**		
Bank of New York Mellon	**1,793,915**	30.20	**54,176,000**	5, 1, 14, 17	National Indemnity
Coca Cola	400,000		26,308,000	5, 17	Berkshire Hathaway Inc.
	1,776,000		116,808,000	5, 15, 17	National Indemnity
	7,205,600		473,912,000	5, 4, 17, 19, 20, 21	Wesco
	40,141,600		2,640,113,000	5, 2, 6, 17	National Indemnity
	139,945,600		9,204,222,000	5, 14, 17	National Indemnity
	9,139,200		601,085,000	5, 13, 17	National Indemnity
	480,000		31,570,000	5, 16, 17	Nebraska Furniture Mart
	912,000		59,982,000	5, 8, 17	Homestate Group (Primary Insurance)
Total Coca Cola	**200,000,000**	**65.77**	**13,154,000,000**		
Comdisco Holding Co.	1,218,199		10,964,000	5, 14, 17	National Indemnity
	302,963		2,727,000	5, 3, 14, 17	National Indemnity
	17,215		155,000	5, 13, 17	National Indemnity
Total Comdisco Holding Co.	**1,538,377**	**9.00**	**13,846,000**		
ConocoPhillips	21,109,637		1,437,566,000	5, 14, 17	National Indemnity
	2,000,000		136,200,000	5, 13, 17	National Indemnity
	6,000,000		408,600,000	5, 10, 11, 14, 17	GEICO
Total ConocoPhillips	**29,109,637**	**68.10**	**1,982,366,000**		
Costco Wholesale Corp.	4,333,363	72.21	**312,912,000**	5, 14, 17	National Indemnity
Exxon Mobil Corp.	421,800	73.12	**30,842,000**	5	Berkshire Hathaway Inc.
Gannett Inc.	1,740,231	15.09	**26,260,000**	5, 14, 17	National Indemnity
General Electric Co.	7,777,900	18.29	**142,258,000**	5	Berkshire Hathaway Inc.
GlaxoSmithKline	1,510,500	39.22	**59,242,000**	5, 14, 17	National Indemnity

Security	Shares	Share Price	Market Value	Managers	Primary Entity Ownership
Ingersoll-Rd Company LTD.	636,600	47.05	**29,949,000**	5	Berkshire Hathaway Inc.
Johnson & Johnson	4,322,500		267,347,000	5	Berkshire Hathaway Inc.
	1,974,648		122,132,000	5, 1, 14, 17	National Indemnity
	14,991,217		927,207,000	5, 14, 17	National Indemnity
	13,936,841		861,994,000	5, 2, 6, 17	National Indemnity
	144,357		8,928,000	5, 4, 17, 19, 20, 21	Wesco
	2,132,000		131,864,000	5, 2, 6, 12, 17	Medical Protective (Primary Insurance)
	575,000		35,564,000	5, 18	U.S. Investment Corp. (Primary Insurance)
	4,548,000		281,294,000	5, 10, 11, 14, 17	GEICO
Total Johnson & Johnson	**42,624,563**	**61.85**	**2,636,330,000**		
Kraft Foods Inc.	56,164,484		1,769,743,000	5, 14, 17	National Indemnity
	30,790,300		970,202,000	5, 2, 6, 17	National Indemnity
	10,000,000		315,100,000	5, 4, 17, 19, 20, 21	Wesco
	259,800		8,186,000	5, 2, 6, 12, 17	Medical Protective (Primary Insurance)
	8,000,000		252,080,000	5	Berkshire Hathaway Inc.
Total Kraft Foods Inc.	**105,214,584**	**31.51**	**3,315,311,000**		
M & T Bank Corporation	4,653,026		405,046,000	5, 14, 17	National Indemnity
	546,000		47,529,000	5, 10, 11, 14, 17	GEICO
	164,795		14,345,000	5, 13, 17	National Indemnity
Total M&T Bank Corporation	**5,363,821**	**87.05**	**466,920,000**		
Moody's	12,695,850		336,948,000	5, 14, 17	National Indemnity
	15,719,400		417,193,000	5, 10, 11, 14, 17	GEICO
Total Moody's	**28,415,250**	**26.54**	**754,141,000**		
Procter & Gamble Co.	37,291,036		2,398,932,000	5, 14, 17	National Indemnity
	20,280,000		1,304,612,000	5, 2, 6, 17	National Indemnity
	6,240,000		401,419,000	5, 13, 17	National Indemnity
	6,240,000		401,419,000	5, 4, 17, 19, 20, 21	Wesco
	780,000		50,177,000	5, 15, 17	National Indemnity
	1,560,000		100,355,000	5, 8, 17	Homestate Group (Primary Insurance)
	4,375,000		281,444,000	5	Berkshire Hathaway Inc.
Total Procter & Gamble Co.	**76,766,036**	**64.33**	**4,938,358,000**		
Sanofi Aventis	488,500		15,744,000	5, 10, 11, 14, 17	GEICO
	2,896,133		93,342,000	5, 14, 17	National Indemnity
	169,300		5,457,000	5, 13, 17	National Indemnity
	509,742		16,429,000	5, 2, 6, 12, 17	Medical Protective (Primary Insurance)
Total Sanofi Aventis	**4,063,675**	**32.23**	**130,972,000**		
Torchmark Corp.	77,551		4,632,000	5, 1, 14, 17	National Indemnity
	449,728		26,867,000	5, 2, 6, 17	National Indemnity
	1,656,900		98,983,000	5, 14, 17	National Indemnity
	639,700		38,216,000	5, 13, 17	National Indemnity
Total Torchmark Corp.	**2,823,879**	**59.74**	**168,698,000**		
US Bancorp	23,307,300		628,598,000	5, 2, 6, 17	National Indemnity
	20,768,826		560,135,000	5, 14, 17	National Indemnity
	8,365,000		225,604,000	5	Berkshire Hathaway Inc.
	10,000,000		269,700,000	5, 4, 17, 19, 20, 21	Wesco
	2,174,000		58,633,000	5, 2, 6, 12, 17	Medical Protective (Primary Insurance)
	1,745,000		47,063,000	5, 18	U.S. Investment Corp. (Primary Insurance)
	2,679,300		72,261,000	5, 10, 11, 14, 17	GEICO
Total US Bancorp	**69,039,426**	**26.97**	**1,861,994,000**		
USG Corporation	17,072,192	16.83	**287,325,000**	5, 14, 17	National Indemnity
United Parcel Service Inc.	1,429,200	72.58	**103,731,000**	5	Berkshire Hathaway Inc.
Wal-Mart Stores, Inc.	33,891,142		1,827,749,000	5, 14, 17	National Indemnity

Security	Shares	Share Price	Market Value	Managers	Primary Entity Ownership
	4,200,000		226,506,000	5, 3, 14, 17	National Indemnity
	946,000		51,018,000	5, 10, 11, 14, 17	GEICO
Total Wal-Mart Stores, Inc.	**39,037,142**	**53.93**	**2,105,273,000**		
Washington Post Co.	894,304		393,047,000	5, 14, 17	National Indemnity
	148,311		65,183,000	5, 1, 7, 14, 17	National Indemnity
	648,165		284,869,000	5, 13, 17	National Indemnity
	36,985		16,255,000	5, 15, 17	National Indemnity
Total Washington Post. Co.	**1,727,765**	**439.50**	**759,354,000**		
Wells Fargo & Co.	62,052,396		1,923,004,000	5, 2, 6, 17	National Indemnity
	12,643,200		391,813,000	5, 4, 17, 19, 20, 21	Wesco
	46,560,770		1,442,918,000	5, 13, 17	National Indemnity
	2,788,000		86,400,000	5, 15, 17	National Indemnity
	1,000,000		30,990,000	5, 17	Berkshire Hathaway Inc.
	150,686,982		4,669,790,000	5, 14, 17	National Indemnity
	1,609,720		49,885,000	5, 16, 17	Nebraska Furniture Mart
	1,700,000		52,683,000	5, 9, 17	Fechheimer Brothers
	820,000		25,412,000	5, 8, 17	Homestate Group (Primary Insurance)
	22,000,000		681,780,000	5, 10, 11, 14, 17	GEICO
	16,000,000		495,840,000	5, 1, 7, 14, 17	Homestate Group (Primary Insurance)
	8,000,000		247,920,000	5	Berkshire Hathaway Inc.
	2,700,000		83,673,000	5, 2, 6, 12, 17	Medical Protective (Primary Insurance)
	2,000,000		61,980,000	5, 18	U.S. Investment Corp. (Primary Insurance)
	5,250,000		162,697,000	5, 1, 14, 17	National Indemnity
	6,812,857		211,130,000	5, 3, 14, 17	National Indemnity
Total Wells Fargo & Co.	**342,623,925**	**30.99**	**10,617,915,000**		
Wesco Finl Corp.	5,703,087	368.41	**2,101,074,000**	5, 4, 17	National Indemnity
GRAND TOTAL			**52,560,379,000**		

Does Buffett Report Personal Portfolio on 13F?

A special mention is required regarding our interpretation of the manager code for Warren Buffett (Code #5 in the Q4 2010 13F report). As we can see in the exhibit, every line item in the detail report includes Mr. Buffett's code which signals his ultimate responsibility for the position. However, there are a few lines where *only Code #5 appears* and no other entities are specified. These line items are highlighted in the exhibit below:

Security	Shares	Price Per Share	Market Value
Exxon Mobil Corp.	421,800	73.12	30,842,000
General Electric Co.	7,777,900	18.29	142,258,000
Ingersoll-Rd Company LTD.	636,600	47.05	29,949,000
Johnson & Johnson	4,322,500	61.85	267,347,000
Kraft Foods Inc.	8,000,000	31.51	252,080,000
Procter & Gamble Inc.	4,375,000	64.33	281,444,000
U.S. Bancorp	8,365,000	26.97	225,604,000
United Parcel Service Inc.	1,429,200	72.58	103,731,000
Wells Fargo	8,000,000	30.99	247,920,000
TOTAL			**1,581,175,000**

Positions With Buffett as Sole Reporting Manager

These line items have led some analysts to believe that these line items represents Mr. Buffett's personal portfolio and are unrelated to Berkshire Hathaway. We do not believe that this is the case for the following reasons:

Buffett's Personal Portfolio Was 100% Treasuries Prior to Q3 2008

In his article entitled *"Buy American. I Am"* published on October 16, 2008 in The New York Times, Mr. Buffett states that he was starting to buy U.S. equities and that his portfolio was previously invested entirely in government bonds (other than his Berkshire Hathaway holdings). However, if we look back at 13F filings for earlier quarters in 2008, there were several examples where Mr. Buffett's reporting code appeared as the sole reporting entity for a number of line items. For example, see the 13F filing for positions dated June 30, 2008: http://bit.ly/i48Dkr. Similar examples appeared in previous 13F reports as well. Therefore, these positions appear inconsistent with Mr. Buffett's characterization of his portfolio as 100 percent Treasuries prior to the fall of 2008.

Buffett's Portfolio Size Inconsistent With 13F Data

In a letter dated October 6, 2008 from Warren Buffett to Treasury Secretary Hank Paulson (http://bit.ly/gfh8TR), Mr. Buffett offered to invest $100 million in a public offering associated with his proposal for Treasury to create a Public-Private Partnership Fund (PPPF) to purchase distressed mortgages and securities. Mr. Buffett stated that $100 million was roughly 20 percent of his net worth outside Berkshire. This implies a net worth of approximately $500 million. According to Berkshire's 13F reporting positions held as of September 30, 2008, positions for which Mr. Buffett was the sole reporting manager had a value of nearly $1.8 billion. The list of positions at September 30, 2008 were nearly identical to the exhibit shown above for positions at December 31, 2010 except for the Exxon Mobil position which has been added since that time. Therefore, Mr. Buffett's characterization of his non-Berkshire net worth is inconsistent with the theory that 13F positions with his reporting code as the sole manager represent his personal portfolio. Link to 13F report for positions held on September 30, 2008: http://bit.ly/ed7egS.

Positions Likely Part of Defined Benefit Pension Plans

Berkshire's defined benefit pension plans have historically been a reconciling difference between Berkshire's 13F reporting and the company's annual reports. Berkshire's 13F reports appear to include pension assets while the company's annual reports do not. Mr. Buffett is believed to manage Berkshire's pension portfolios. This theory is bolstered by way of an example from the 2009 letter to shareholders. In the letter, Mr. Buffett states that Berkshire owned 83,128,411 shares of Procter & Gamble as of December 31, 2009. However, Berkshire's 13F report listing positions held on December 31, 2009 includes a total of 87,503,411 shares – a difference of 4,375,000 shares. This is the number of shares reported under Mr. Buffett's reporting code as of December 31, 2009. Link to 13F report as of December 31, 2009: http://bit.ly/fpjk4k.

We believe that the combination of the factors and evidence cited above provides support for the conclusion that Mr. Buffett's personal portfolio is not reported within Berkshire Hathaway's 13F combination report.

What Conclusions Can We Draw?

It is tempting to draw conclusions from Berkshire's quarterly 13F filing regarding Warren Buffett's views on the overall stock market or individual securities. In some cases, we can combine Mr. Buffett's public comments with quarterly moves and safely conclude that a bullish sentiment exists. For example, Mr. Buffett has long been bullish on Wells Fargo and backed this up with additional purchases during the fourth quarter of 2010, although the incremental purchases were small compared to the overall size of the portfolio.

As we mentioned previously, we cannot safely conclude that Mr. Buffett is bearish on the GEICO-owned positions that were liquidated during the quarter because this simply reflected a wind-down of Lou Simpson's portfolio. Mr. Buffett could be neutral or bearish on these companies, but we cannot draw either conclusion from the report. However, we may infer that he is not particularly bullish on any of these companies.

Mr. Buffett has been steadily reducing Berkshire's position in Moody's since the third quarter of 2009, although the pace of sales has slowed down in recent quarters. Berkshire's long held position of 48 million shares now stands at approximately 28.4 million and it is possible that sales will continue in the future. Moody's has been the subject of criticism associated with its AAA ratings of securities associated with subprime housing loans which subsequently defaulted in large numbers. Mr. Buffett defended Moody's management at hearings before the Financial Crisis Inquiry Commission in June 2010. However, Berkshire's steady reduction of its stake in Moody's likely reflects a recognition that the company's longstanding "moat" was seriously damaged by the fallout from the financial crisis.

Appendix 3: Quarterly Performance Q1 2008 to Q4 2010

The following exhibits present data for Berkshire Hathaway's reporting segments for the twelve quarters covering 2008, 2009, and 2010. We present this data to illustrate how Berkshire's diverse group of subsidiaries navigated the severe recession and subsequent recovery.

Quarterly Revenue Summary

Berkshire Hathaway's insurance subsidiaries are generally uncorrelated with overall economic activity and revenues were not adversely impacted due to the recession. The spikes in revenue for Berkshire Hathaway reinsurance in Q1 2009 and Q3 2010 were due to large retroactive insurance policy contracts with Swiss Re and CNA Financial respectively. Berkshire's economically sensitive subsidiaries clearly bore the brunt of the recession's impact on Berkshire's consolidated results. Marmon experienced steep revenue declines and has yet to recover fully. Shaw's revenues were impacted by the recession and likely recovered in 2010 although we lack visibility due to Berkshire's decision to stop reporting granular results for the company. Although not displayed in the exhibit, NetJets had severe revenue declines as we discussed in the NetJets section of this report. McLane and MidAmerican's revenues were not materially impacted by the recession.

All figures in millions	Q4 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Insurance Group:												
Premiums Earned:												
GEICO	3669	3606	3554	3454	3473	3448	3394	3261	3211	3150	3086	3032
General Re	1484	1396	1373	1440	1548	1476	1426	1379	1364	1458	1488	1704
Berkshire Hathaway Reinsurance	1805	3618	1546	2107	1180	1229	1210	3087	1559	1383	1156	984
Berkshire Hathaway Primary	447	434	391	425	420	442	455	456	486	474	501	489
Investment Income	1158	1226	1500	1302	1114	1362	1437	1310	1359	1080	1221	1099
Total Insurance Group	8563	10280	8364	8728	7735	7957	7922	9493	7979	7545	7452	7308
Burlington Northern Santa Fe	4501	4391	4094	2073	0	0	0	0	0	0	0	0
Finance and Financial Products	1087	1051	1149	977	1336	1143	1099	1009	1228	1258	1303	1158
Marmon	1483	1525	1562	1397	1221	1306	1286	1254	1485	1878	1901	265
McLane Company	8353	8611	8293	7430	8180	8170	7864	6993	7960	7634	7269	6989
MidAmerican	2832	2824	2672	2977	3027	2812	2655	2949	4244	3298	3035	3394
Shaw	Shaw is included in "Other Businesses"				923	1056	1029	1003	1134	1357	1337	1224
Other Businesses	7123	7122	7185	6526	5958	5423	5204	4795	5768	6521	6986	6391
	33942	35804	33319	30108	28380	27867	27059	27496	29798	29491	29283	26729
Reconciliation to Consolidated Amt:												
Investment and Derivatives Gains/Losses	2098	312	-1793	1729	1623	1817	2330	-4983	-5313	-1557	935	-1526
Unallocated Interest Expense			0	0	0	0	0	0	0	0	0	0
Eliminations and Other	125	158	183	200	195	220	218	271	107	-8	-125	-28
Totals	**36165**	**36274**	**31709**	**32037**	**30198**	**29904**	**29607**	**22784**	**24592**	**27926**	**30093**	**25175**

Quarterly Pre-Tax Earnings Summary

Berkshire Hathaway's insurance subsidiaries post earnings that are generally uncorrelated with overall economic activity. We can see that GEICO has consistently posted positive pre-tax earnings.

The absence of very large insured mega-catastrophes (at least on a Katrina-like scale) over the past three years has resulted in aggregate pre-tax underwriting profits for Berkshire's reinsurance subsidiaries. The unusually large pre-tax profit for Berkshire Hathaway Reinsurance in Q4 2008 was attributable to a one time foreign currency transaction gain and a $224 million gain from a transaction with the Florida Hurricane Catastrophe Fund Finance Corporation. Results at McLane and MidAmerican were not materially impacted during the recession. We can see the main impact of the recession in the "Other Business" line item which includes Berkshire's diverse manufacturing, retail, and service subsidiaries. These businesses were discussed in more detail in the main report.

The bottom line is that Berkshire's main exposure to economic weakness was confined to the company's manufacturing, service, and retail subsidiaries. Through Berkshire's insurance, utility, and finance operations, the overall company has large streams of earnings that are not directly correlated with economic activity.

All figures in millions	Q4 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Insurance Group:												
Premiums Earned:												
GEICO	200	289	329	299	190	200	111	148	186	246	298	186
General Re	68	201	222	-39	31	186	276	-16	144	54	102	42
Berkshire Hathaway Reinsurance	244	-237	117	52	270	167	-291	203	1382	-166	79	29
Berkshire Hathaway Primary	135	52	48	33	44	7	29	4	112	-8	81	25
Investment Income	1150	1218	1494	1283	1105	1348	1422	1298	1355	1074	1204	1089
Total Insurance Group	1797	1523	2210	1628	1640	1908	1547	1637	3179	1200	1764	1371
Burlington Northern Santa Fe	1034	1127	974	476	0	0	0	0	0	0	0	0
Finance and Financial Products	283	140	155	111	377	142	135	127	129	163	254	241
Marmon	192	212	219	190	160	194	170	162	197	247	261	28
McLane Company	91	89	109	80	71	64	66	143	67	68	68	73
MidAmerican	390	416	338	395	382	441	402	303	1592	526	329	516
Shaw	Shaw is included in "Other Businesses"				8	51	30	55	23	49	82	51
Other Businesses	805	844	860	583	263	299	171	151	493	749	874	693
	4592	4351	4865	3463	2901	3099	2521	2578	5680	3002	3632	2973
Reconciliation to Consolidated Amt:												
Investment and Derivatives Gains/Losses	2098	312	-1793	1729	1623	1817	2330	-4983	-5313	-1557	935	-1526
Unallocated Interest Expense	-53	-53	-53	-49	-8	-11	-15	-8	-9	-9	-9	-8
Eliminations and Other	-156	-76	-81	-45	-51	-66	-45	-130	-210	66	-87	14
Totals	**6481**	**4534**	**2938**	**5098**	**4465**	**4839**	**4791**	**-2543**	**148**	**1502**	**4471**	**1453**

Appendix 4: GEICO vs. Progressive

Since Berkshire Hathaway acquired full control of GEICO in 1995, the company has advanced from seventh to third position among auto insurers according to Warren Buffett's 2010 letter to shareholders[1]. GEICO's main competitive advantage is derived from its low cost operations which are made possible by the direct sales model the company uses to sell insurance policies. By selling products over the phone and online, significant efficiencies can be captured compared to a traditional agency distribution model. Progressive also employs a direct channel (although the company also has a sales channel through independent agents) and the company has a strong long term track record.

While this appendix is not in any way a complete review of Progressive, it is nonetheless interesting to compare GEICO and Progressive over an extended period in terms of overall volume of premiums earned, underwriting results, and operating efficiency.

Track Record: 1999 to 2010

The following exhibit shows selected underwriting results for GEICO and Progressive over the past twelve years. Both GEICO and Progressive have posted impressive results over an extended period of time as evidenced by consistent underwriting profits along with strong premium growth.

	GEICO					Progressive				
Year	Premiums Earned	Loss Ratio	Expense Ratio	Comb. Ratio	UW Profit	Premiums Earned	Loss Ratio	Expense Ratio	Comb. Ratio	UW Profit
1999	4,757	80.2%	19.3%	99.5%	24	5,684	74.9%	21.6%	96.5%	199
2000	5,610	85.7%	18.3%	104.0%	(224)	6,348	83.2%	21.7%	104.9%	(311)
2001	6,060	79.9%	16.5%	96.4%	221	7,162	73.5%	21.4%	94.9%	365
2002	6,670	77.0%	16.7%	93.7%	416	8,884	70.9%	21.5%	92.4%	675
2003	7,784	76.5%	17.7%	94.2%	452	11,341	67.4%	19.9%	87.3%	1,440
2004	8,915	71.3%	17.8%	89.1%	970	13,170	65.0%	20.2%	85.2%	1,949
2005	10,101	70.6%	17.3%	87.9%	1,221	13,764	68.0%	20.1%	88.1%	1,638
2006	11,055	70.1%	18.0%	88.1%	1,314	14,118	66.5%	20.1%	86.6%	1,892
2007	11,806	72.2%	18.4%	90.6%	1,113	13,877	71.5%	21.1%	92.6%	1,027
2008	12,479	74.8%	17.9%	92.7%	916	13,631	73.5%	21.1%	94.6%	736
2009	13,576	77.0%	18.2%	95.2%	649	14,013	70.6%	21.0%	91.6%	1,176
2010	14,283	74.4%	17.8%	92.2%	1,117	14,315	70.8%	21.6%	92.4%	1,084
Sources: Berkshire Annual Reports; Progressive's 2010 annual results reported in January 2011										

GEICO vs. Progressive: 1999 to 2010

The following exhibit provides key summary statistics regarding GEICO and Progressive's performance:

1999 to 2010	GEICO	Progressive
Avg Annual Growth in Premiums Earned	10.5%	8.8%
Avg Loss Ratio	75.8%	71.3%
Avg Expense Ratio	17.8%	20.9%
Avg Combined Ratio	93.6%	92.3%

GEICO and Progressive Key Statistics

Both Progressive and GEICO have shown strong results by nearly any measure during this timeframe. GEICO's compounded annual growth rate in premiums earned over the period was 10.5 percent while Progressive grew at a 8.8 percent rate. GEICO's average underwriting loss ratio was 75.8 percent while Progressive's average loss ratio was better at 71.3 percent. GEICO had the distinct advantage when it came to underwriting expenses with an average of 17.8% versus 20.9% for Progressive.

Over the past several years, we can conclusively see the benefits of GEICO's low cost model. Despite having consistently higher underwriting loss ratios as well as lower levels of earned premiums, GEICO ended up with higher pre-tax underwriting profits in many years (such as 2007, 2008, and 2010) due to significantly lower underwriting expenses compared to Progressive.

One way to look at the competitive picture is that GEICO has historically been able to accept premiums that realized a higher level of losses than Progressive while being more profitable in many years due to tighter expense controls. This presumably translated into lower premiums for policyholders and higher market share.

Advertising Campaigns

It's a war on the television screen. On one side you have GEICO's Gecko and the famously maligned Caveman. On the other side is Flo, the hyper enthusiastic Progressive sales clerk. It's hard to escape these characters during sporting events or prime time as they try to win market share through a combination of amusing brand building characters and claims of lower prices.

While some observers may dismiss these advertising campaigns as silly, both GEICO and Progressive are attempting to attach brand loyalty to auto insurance which has traditionally been known as a commodity product. The advertising campaigns rely on claims of price advantages but have also attracted a "cult following". In 2009, Progressive was able to attract a large number of participants who competed in the "Help Flo" campaign to appear in a Progressive advertisement with Flo. If nothing else, GEICO and Progressive's marketing efforts are a fascinating case study in how a commodity product might be differentiated. In our own highly unscientific survey on The Rational Walk, we asked readers to answer the following question: "Who is the most effective television personality selling auto insurance?" Here are the results of the survey taken over a four week period in January and February 2010[2]:

Flo (48%, 88 Votes)
The Gecko (36%, 66 Votes)
The Caveman (10%, 19 Votes)
The former President from "24" who does Allstate commercials (6%, 12 Votes)

Total Votes: 185

Appendix 5: Berkshire's Misunderstood Derivatives

Berkshire Hathaway's derivatives exposure has attracted a great deal of attention in recent years. In 2008, Warren Buffett devoted several pages of his letter to shareholders to explain the company's exposure in great detail. While some developments have taken place over the past two years, the basic message of Mr. Buffett's explanation in 2008 still holds true.

In his 2010 letter to shareholders, Warren Buffett provided an update to shareholders regarding Berkshire's derivatives position. Berkshire held 203 derivatives positions at the end of 2010 which is down from 251 derivatives contracts two years earlier. Mr. Buffett is personally responsible for all of Berkshire's derivatives positions. In late 2010, at the request of one of Berkshire's counterparties, eight contracts were unwound. Berkshire originally received $647 million in premiums for the contracts and unwinding the positions required payment of $425 million, yielding Berkshire a gain of $222 million on the contract (plus the income from investing the $647 million for three years)[1].

While the requirement to mark the derivatives to market has caused significant volatility in Berkshire's results in recent years, the ultimate impact on the company's intrinsic value will depend on the value of certain market indices at the expiration date of the options.

The general points outlined below should be considered when analyzing the ultimate impact of Berkshire's derivatives exposure.

Absence of Counter-Party Risk

Typical derivatives contracts carry substantial counter-party risk. For a derivatives contract to serve any purpose, one must hope that the counter-party will be good to make payment if the terms of the contract call for it. Sometimes the terms of the contract may reach far into the future. One of the main reasons for the government bailout of AIG was that AIG was a counter-party for derivatives entered into with many important financial institutions worldwide. If AIG defaulted on these derivatives, suddenly all of their counter-parties could have faced solvency issues.

With Berkshire's derivatives, there is no counter party risk because payment is made in advance when the contracts are initiated. This has two benefits. First, the counter-party cannot default because they have put up their obligations ahead of time. Second, Berkshire has use of the funds provided by the counter-party for the life of the contract. This is much like insurance float. The funds are available for Berkshire to use for investment purposes throughout the lifespan of the derivatives contract. At the end of 2010, Berkshire held $4.2 billion of "derivatives float" associated with equity put contracts that can be used for investment purposes. It should be noted that we have not included this "derivatives float" in our float based valuation model of the insurance business.

Minimal Collateral Requirements

Berkshire has minimal collateral requirements when the market moves against the company's derivatives positions. Most contracts do not require posting any collateral whatsoever. The contracts that require posting collateral are minimal. Even when Berkshire posts securities as collateral, the company continues to earn income from the posted collateral. At the low point in the stock and credit markets in 2009, Berkshire only had to post $1.7 billion[2] of collateral which is a small percentage of the derivatives related float held by the company. The Dodd-Frank financial regulatory law is not expected to have any retroactive impact on Berkshire's existing derivatives positions.

European Style Options

Berkshire's equity put option contracts are "European" options[3] and can only be exercised by the counter-party at the date of expiration of the contract. In contrast "American" options can be exercised by the counter-party at any time. Since Berkshire's options are European options, the company has no cash flow liability because the counter-parties cannot exercise the options until expiration which will not occur for nearly a decade. If these options were American options, the counter-parties could decide to exercise today and Berkshire would have to put up the cash. This is a key difference all but ignored in the media. It means that the paper gains and losses on the equity puts are just that – paper gains or losses. No cash flow is going to occur for nearly a decade, and only then if the index value remains at depressed levels. In the meantime, Berkshire has full use of the premium received for writing the index puts.

To summarize, Berkshire's derivatives holdings are not without risk of loss but important features of the contracts minimize the need to pay undue attention to short term swings in market indices which cause volatility in Berkshire's quarterly and annual results. For this reason, Berkshire management separates derivatives gains and losses from investment gains and losses to ensure that shareholders will have access to the relevant information. We suggest that readers interested in more information regarding Berkshire's derivatives refer to Mr. Buffett's 2008 and 2010 letters to shareholders where he clearly outlines the critical points.

Appendix 6: A Closer Look at Todd Combs and Castle Point Capital

On October 25, 2010, Berkshire Hathaway announced the appointment of Todd Combs to manage a "significant portion" of the company's investment portfolio[1]. At the time of the announcement, Mr. Combs was almost entirely unknown except within the hedge fund community. His hedge fund, Castle Point Capital, was heavily invested in financial companies and reporters quickly looked into his fund's holdings and investment style.

Castle Point Capital Portfolio

The following exhibit lists the positions held in the hedge fund as of June 30, 2010, the latest data available at the time of the announcement and prior to the wind-down of the fund that was announced concurrent with Mr. Combs' appointment at Berkshire:

Position	Type	Cusip	Market Value	Allocation
U.S. BANCORP CMN	COM	902973304	22,797,000	8.2%
MASTERCARD INCORPORATED CMN CLASS A	COM	57636Q104	20,352,000	7.3%
STATE STREET CORPORATION(NEW) CMN	COM	857477103	18,973,000	6.8%
WESTERN UNION COMPANY CMN	COM	959802109	18,250,000	6.5%
CME GROUP INC. CMN CLASS A	COM	12572Q105	14,360,000	5.1%
RENAISSANCE RE HOLDINGS LTD CMN	COM	G7496G103	14,349,000	5.1%
PENNYMAC MTG INVT TR CMN	COM	70931T103	12,974,000	4.6%
CHUBB CORP CMN	COM	171232101	12,753,000	4.6%
STARWOOD PROPERTY TRUST INC CMN	COM	85571B105	12,535,000	4.5%
ANNALY CAPITAL MANAGEMENT, INC CMN	COM	35710409	12,245,000	4.4%
CIT GROUP INC CMN CLASS A	COM	125581801	12,088,000	4.3%
PROGRESSIVE CORPORATION CMN	COM	743315103	11,457,000	4.1%
JPMORGAN CHASE & CO CMN	COM	46625H100	11,203,000	4.0%
GOLDMAN SACHS GROUP, INC. CMN	COM	38141G104	10,712,000	3.8%
CHARLES SCHWAB CORPORATION CMN	COM	808513105	10,125,000	3.6%
BROADRIDGE FINANCIAL SOLUTIONS INC	COM	11133T103	9,716,000	3.5%
AERCAP HOLDINGS NV ORD CMN	COM	N00985106	9,529,000	3.4%
MB FINANCIAL INC. NEW CMN	COM	55264U108	9,379,000	3.4%
GENWORTH FINANCIAL INC CMN CLASS A	COM	37247D106	7,999,000	2.9%
UNITED AMERICA INDEMNITY LTD CMN CL A	COM	90933T109	5,255,000	1.9%
BLACKROCK INC. CMN	COM	09247X101	5,119,000	1.8%
LEUCADIA NATIONAL CORP CMN	COM	527288104	4,976,000	1.8%
HARTFORD FINANCIAL SRVCS GROUP CMN	COM	416515104	4,515,000	1.6%
WTS/THE PNC FINANCIAL SERVICES GRP	WTS	693475121	2,144,000	0.8%
WTS/FIRST FINANCIAL BANCORP 12.90	WTS	320209117	2,135,000	0.8%
CHATHAM LODGING TR COM	COM	12608T102	1,914,000	0.7%
WELLS FARGO & COMPANY NON-CUM PERPET	CNV	949746804	1,862,000	0.7%
TOTAL			**279,716,000**	**100.0%**

Castle Point Capital's Positions as of June 30, 2010[2]

Much speculation ensued regarding the heavy financial concentration in Castle Point's portfolio and what this might mean for the funds entrusted to Mr. Combs at Berkshire Hathaway. Since Castle Point's fund had a mandate to invest in financial stocks, the concentration does not necessarily indicate that Mr. Combs will not invest elsewhere at Berkshire. However, financials obviously appears to be firmly within his circle of competence.

Western Union

While there are several areas of overlap between Castle Point's portfolio and companies in which Berkshire has invested in the past, we decided to take Western Union as a "case study" to find potential clues to Mr. Combs' investment style. Two factors led to the selection of Western Union. First, Berkshire Hathaway received shares of Western Union at the time of the spin-off from First Data in 2006 but liquidated the entire position over the course of three quarters[3]. Second, Western Union is the type of company that appears to have a "moat" of the type that Warren Buffett has previously found attractive.

Western Union is apparently one of Todd Combs' favorite investments based on news reports quoting letters sent to Castle Point investors[4]. Castle Point owned 1,224,000 shares of Western Union as of June 30 which made it the fund's fourth largest position. The analysis appearing below was prepared in late October 2010 in order to delve deeper into Mr. Combs' investment approach[5].

Background and Overview

In the interests of brevity, we will focus on Western Union's recent history as a company primarily occupied with money transfer and payment services. However, Western Union has a fascinating history dating back to the mid 19th century and a basic summary can be found on Wikipedia for those who are interested[6].

Western Union was a subsidiary of First Data until it was spun off in early 2006. The company currently operates in three segments: Consumer to Consumer, Global Business Payments, and Other. We will focus on the two most important segments: Consumer-to-Consumer and Global Business Payments. The other segment is primarily comprised of Western Union's money order business and accounted for less than two percent of total company revenues in 2009.

Consumer-to-Consumer Segment

Money transfers between two individuals is the most important business for Western Union and accounted for 84.6 percent of revenues in 2009. The vast majority of money transfers are cross-border transactions in which a customer in one country sends remittances to a recipient in another country. The business is heavily dependent on migrants who need to send funds to family members in their country of origin. As a result, transaction volumes can be sensitive to overall economic conditions in countries that have a high level of migrant workers. In 2009, the consumer-to-consumer segment processed $71 billion in principal transfers, of which $65 billion were cross-border transfers.

The exhibit on the next page presents some basic data for this segment based on information provided in company filings.

Selected Data: Consumer-to-Consumer Segment					
In Millions except per-transaction figures and percentages	**9M Ended 9/30/10**	**2009**	**2008**	**2007**	**2006**
Revenues:					
Transaction Fees	2,531.1	3,373.5	3,532.9	3,286.6	3,059.0
Foreign Exchange Revenues	667.3	877.1	893.1	769.3	652.4
Other Revenues	33.2	50.1	45.6	37.2	33.5
Total	**3,231.6**	**4,300.7**	**4,471.6**	**4,093.1**	**3,744.9**
Operating Income	**932.5**	**1,175.5**	**1,222.7**	**1,078.3**	**1,069.7**
Operating Income Margin	28.9%	27.3%	27.3%	26.3%	28.6%
Volume of Principal Transfers:					
Cross Border	50,500	65,000	67,000	57,000	No Break Down
Intra-Country	5,300	6,000	7,000	7,000	
Totals:	**55,800**	**71,000**	**74,000**	**64,000**	**53,000**
Total Worldwide transactions	157.6	196.1	188.1	167.7	147.1
Average Principal per Transaction	354.06	362.06	393.41	381.63	360.30
Average Trans. Fee per Transaction	16.06	17.20	18.78	19.60	20.80
Average Forex Fee per Transaction	4.23	4.47	4.75	4.59	4.44
Transaction Fees as % of Total Volume	4.5%	4.8%	4.8%	5.1%	5.8%
Forex as % of Cross Border Volume	1.3%	1.3%	1.3%	1.3%	N/A
Sources: Company 10-K Filings for full year data; Earnings Release for 9M Ending 9/30/2010 data					

Western Union Consumer-to-Consumer Segment Data

The business earns fees both based on explicit charges associated with the principal being transferred as well as foreign exchange income derived from a spread between the exchange rate used in the transfer and the exchange rate that Western Union pays to obtain funds. We can see that the business has attractive operating margins in the high twenty percent range. The average principal transferred per transaction is relatively modest and consistent with the small remittances that migrant workers are likely to be able to send to relatives in their home countries.

Over the past four years, we can see that total transaction fees as a percentage of total principal volume has fallen from 5.8 percent in 2006 to 4.5 percent in the first nine months of 2010. This is likely due to increased competition from other payment services. However, Western Union seems to be somewhat insulated from competition based on brand recognition and the fact that the company has a very large number of agents located in over 200 countries. While transaction fees as a percentage of total volume has fallen, the company's various restructuring initiatives appear to have been sufficient to maintain operating margins.

Global Business Payments

The global business payments segment provides several options for consumers to make payments to businesses such as utilities, auto finance companies, mortgage servicers, and government agencies. In September 2009, Western Union acquired Custom House which facilitates cross-border cross-currency services. One interesting service provided by the segment is the "Equity Accelerator" product which charges an up-front fee to customers who wish to schedule additional recurring principal payments on their mortgages, apparently targeting customers who do not have the discipline to simply make extra payments on their own.

The following exhibit presents selected data for the global business payments segment based on recent company filings:

Selected Data: Global Business Payments					
In Millions except per-transaction figures	**9M Ended 9/30/10**	**2009**	**2008**	**2007**	**2006**
Revenues:					
Transaction Fees	434.3	621.9	668.1	665.5	593.7
Foreign Exchange Revenues	83.2	33.2	3.2	2.0	0.0
Other Revenues	22.8	36.6	48.5	52.4	42.5
Total	**540.3**	**691.7**	**719.8**	**719.9**	**636.2**
Operating Income	**98.4**	**171.9**	**199.4**	**223.7**	**223.3**
Operating Income Margin	18.2%	24.9%	27.7%	31.1%	35.1%
Sources: Company 10-K Filings for full year data; Earnings Release for 9M Ending 9/30/2010 data					

Western Union Global Business Payments Segment Data

We can see that this segment also provides attractive operating income margins, although the acquisition of Custom House has somewhat depressed overall segment margins since the transaction took place in late 2009. The increase in foreign exchange revenues is mostly accounted for by the Custom House business.

Business Risks

There are a number of potential risks that should be considered when examining Western Union. Here is a list compiled based on a review of the company's recent filings and related research:

1. **High Debt Levels.** The company had $3.3 billion in borrowings as of September 30, 2010 which accounted for 88 percent of total capitalization. Although the current profitability of Western Union can easily service the interest on this debt and the company's credit rating should allow debt to be rolled over upon maturity, any potential erosion in the business over time could leave the company exposed.

2. **Competitive Landscape.** Western Union's consumer-to-consumer business model is built upon the ability to charge relatively high fees to consumers transferring small sums. The company's broad distribution network and brand name provides a significant amount of protection (the "moat") but as customers become more comfortable with electronic payment options, competition from services such as PayPal or Xoom could begin to take share.

3. **Increased Technological Sophistication of Customer Base.** As more customers in developing countries obtain cellular phones with increasingly sophisticated capabilities, the need for physical agency locations may somewhat diminish. Smart phones and electronic payment options could allow customers to use services such as PayPal to realize substantial cost savings. For example, typical PayPal fees for international transfers are in the 4 percent range[7]. Western Union fees vary but can be substantial especially for very small transfers. For example, the company has run "$50 for $5" promotions in which customers can transfer up to $50 for a flat $5 fee, and this is apparently a *discounted rate* compared to normal fees. This is hardly a low cost means of transferring funds.

4. **Dependency on Immigration.** The company's customer base is heavily dependent on immigrants who work in developed countries and send funds to family members in their home countries. There has been negative publicity surrounding some of the company's operations and the company recently paid $71 million to the state of Arizona to settle a lawsuit related to its business practices[8]. The political climate in the United States and in many parts of Western Europe has become increasingly critical of immigration. Major curtailment of immigration in general could adversely impact Western Union's business.

5. **Brand May Not Fully Protect Moat.** Western Union's brand name is synonymous with safety. Customers know that funds sent to their relatives will arrive safely. They are willing to pay relatively steep fees to ensure the safety of their money. However, it is unlikely that customers necessarily have the same emotional attachment to Western Union that they may have to brands such as Johnson & Johnson or Coca Cola. In other words, if services of equal perceived safety are available at a lower cost, few emotional ties are likely to keep customers loyal to Western Union.

Summary

Our purpose in examining Western Union at some length is to determine what factors may have attracted Todd Combs to invest in the company. Clearly, the business has proven that it has a significant moat based on the margins that have been achieved historically and there appears to be no reason to think that this moat will erode in the very near future. Based on company filings and conference calls, management is well aware of competitive threats and is seeking to put in place services that should compete with PayPal and other electronic payment services[9].

Western Union resembles a "toll bridge" and fits many of the criteria that Warren Buffett likes to see in a business. The company has strong cash flows and is easily able to operate with minimal levels of capital. At a stock price of about $18 per share in late October 2010, the valuation did not appear to be particularly high given projected 2010 earnings of $1.30 to $1.40 per share. However, the business is not without risk and there appears to be a reasonable possibility that the moat may be eroded to some degree in the future which could lead to margin pressure.

It is not difficult to see why a value investor following Warren Buffett's investment approach would like Western Union shares, although one would have to be convinced that the risk factors are not severe enough to significantly pressure margins going forward. Our brief review of Western Union has not provided the level of confidence required to own shares at the current price, although further study of the severity of the risk factors and the company's strategy could very well lead to a more favorable conclusion.

As Todd Combs assumes his responsibilities at Berkshire Hathaway over the coming months, shareholders may begin to get a sense for his overall investment style if such information is disclosed in some form by the company. Since Berkshire's 13F reports are combination reports of investments made by all of Berkshire's subsidiaries, it may not be clear which positions are attributed to Mr. Combs. However, perhaps Warren Buffett will disclose some limited information regarding the Combs portfolio in shareholder letters or at future annual meetings once Mr. Combs has been in his position for a reasonable length of time.

In the past, such disclosures have been made on occasion for Lou Simpson's portfolio[10]. Mr. Simpson retired from GEICO in late 2010. With both Mr. Buffett and Mr. Simpson's track record, Todd Combs has big shoes to fill at Berkshire Hathaway.

Notes

The following notes and references are divided by major section in the document. All sources and web addresses were validated as of the date of this report but no assurance can be provided regarding web sites not under our administration and control.

In Search of the Buffett Premium

[1] Quote from Charlie Munger at the 2004 Wesco Financial annual meeting. Source: Whitney Tilson's Wesco Annual Meeting Notes. http://bit.ly/huI5G7

From Cigar Butts to Business Supermodels

[1] For example, see Mr. Buffett's preface to any recent edition of *The Intelligent Investor*.
[2] The Buffett Partnership track record is available in many publications. See, for example, Roger Lowenstein's *Buffett: The Making of an American Capitalist*, 1995 Hardcover Edition, Page 69. http://amzn.to/exEoA3
[3] See comment in Berkshire Hathaway Owner's Manual, Page 5. http://bit.ly/4bmvoz
[4] For a history of Mr. Buffett's involvement with Dempster, we recommend Andrew Kilpatrick's *Of Permanent Value: The Story of Warren Buffett,* Chapter 23. http://amzn.to/8trUAa
[5] Lowenstein, Pages 76-77.
[6] See Lowenstein, Page 76.
[7] Alice Schroeder goes into more detail regarding Dempster in Chapter 25 of *The Snowball.* http://amzn.to/i6r8T7
[8] Dempster is still in business in Beatrice, Nebraska and has operations in energy, recycling, water management, and agriculture. The company has changed hands several times since 1963 and is currently privately held. Website: http://www.dempsterllc.com
[9] Mr. Buffett directly stated that buying Berkshire was a mistake in his 1989 letter to shareholders (http://bit.ly/gGU8Ib) and later characterized the purchase as effectively a $200 billion mistake – see footnote 12.
[10] See Lowenstein, Page 133.
[11] For a good history of the National Indemnity purchase, see Lowenstein, pages 133 to 135.
[12] Mr. Buffett characterizes buying Berkshire Hathaway in 1962 as "the dumbest stock I ever bought." Source: CNBC interview transcript dated October 18, 2010. http://bit.ly/bKwhUG
[13] For a brief history of See's Candies, see Max Olson's paper entitled *Quality without Compromise*: http://bit.ly/7gOMBG
[14] See Mr. Munger's statement in *Poor Charlie's Almanack, Third Edition*, "Rebuttal: Munger on Buffett" http://amzn.to/efoU2g
[15] For example, see Alice Schroeder's account of the See's Candies purchase in *The Snowball*, Chapter 34.
[16] See the appendix to Warren Buffett's 1983 Letter to Shareholders. http://bit.ly/9jOxWf
[17] See Warren Buffett's 1991 Letter to Shareholders. http://bit.ly/exHNCE
[18] See Warren Buffett's 2007 Letter to Shareholders, page 6: http://bit.ly/9oZNiz
[19] See Warren Buffett's 1992 Letter to Shareholders: http://bit.ly/f7d8b7

Buffett Seizes Opportunities During Financial Crisis

[1] For an excellent biography of John D. Rockefeller Sr, we recommend Ron Chernow's biography of Rockefeller, *Titan: The Life of John D. Rockefeller*. Link to Amazon.com: http://amzn.to/fR2oBI
[2] See Warren Buffett's New York Times article: http://nyti.ms/hqADKq.
[3] We recommend Andrew Ross Sorkin's *Too Big to Fail* for those interested in a history of the financial crisis: http://amzn.to/i30rtt.
[4] See Goldman's Press Release: http://bit.ly/hVtPzK.
[5] See Goldman's Press Release: http://bit.ly/gN4ifx.

[6] See The New York Times coverage dated September 23, 2008 for one example of the coverage: http://nyti.ms/egSVOi.
[7] For a summary of the terms of the Goldman Sachs investment, please refer to Goldman's 10-Q released on October 8, 2008: http://bit.ly/ei8lOG.
[8] For the agreement with Goldman's executives, please see the following SEC filing: http://bit.ly/gKipC4.
[9] See Goldman Sachs 10-Q report dated October 8, 2008, page 62.
[10] See Goldman Sachs 8-K report dated October 30, 2008: http://bit.ly/gs49Wp
[11] For example, see this Bloomberg article dated February 18, 2011: http://bloom.bg/eldwLp.
[12] See GE's press release dated September 25, 2008: http://bit.ly/g2q3BS. See Q&A Section of conference call dated September 25, 2010 via Seeking Alpha for Mr. Immelt's comments on a potential capital raise: http://bit.ly/gK4mIY.
[13] See GE's press release dated October 1, 2008: http://bit.ly/ewvnPj.
[14] See GE's press release dated October 16, 2008: http://bit.ly/hygQ2z.
[15] For more information on the Swiss Re investment announcement, see The Rational Walk's coverage from March 2009: http://bit.ly/gFK3NQ.
[16] See The Rational Walk's coverage of the redemption announcement on November 4, 2010: http://bit.ly/gakQGo
[17] See The Rational Walk's analysis of the investment and final redemption: http://bit.ly/gvr6ky
[18] The exhibit displaying the results of Berkshire's investment in Swiss Re uses exchange rates from x-rates.com. Initial terms are from Swiss Re's Term Sheet and Berkshire's Q1 2009 10-Q report. Repayment terms are from Berkshire's Q3 2010 10-Q and Swiss Re's press release. IRR calculation is derived from Microsoft Excel's XIRR Function.
[19] For terms of the Dow Chemical transaction, see Berkshire Hathaway's 2009 10-K report, page 74.
[20] For terms of the Wrigley transaction, see Berkshire Hathaway's 2008 annual report, page 39.

Valuation Approach

[1] Explanations of the Capital Asset Pricing Model (CAPM) can be found in any current investment textbook. For a basic description see the Wikipedia entry at http://bit.ly/eXRli1.
[2] Berkshire Hathaway Owner's Manual, page 5: http://bit.ly/4bmvoz
[3] *Berkshire Hathaway: The Ultimate Conglomerate Discount* by Alice Schroeder and Gregory Lapin, January 1999. The report was written while the authors worked as analysts at PaineWebber. Ms. Schroeder later wrote a detailed account of Warren Buffett's life in *Snowball: Warren Buffett and the Business of Life.*
[4] See the "Yardsticks" section of Mr. Buffett's 2008 Letter to Shareholders, page 4: http://bit.ly/7rvtl
[5] Berkshire Hathaway Owner's Manual, page 5: http://bit.ly/4bmvoz

Insurance Subsidiaries

[1] Quote from Charlie Munger at the 2002 Wesco Financial annual meeting. Source: *Of Permanent Value: The Story of Warren Buffett*, *2009 Woodstock Edition*, page 376. http://amzn.to/gy8BwC
[2] Warren Buffett's 2006 Letter to Shareholders, page 6: http://bit.ly/3WDwz2
[3] In his 2004 Letter to Shareholders, Warren Buffett states that Berkshire "would be lucky to be worth half of what it is today" had the company not made the National Indemnity purchase in 1967. http://bit.ly/eu9MtI
[4] Warren Buffett's 2004 Letter to Shareholders, page 5: http://bit.ly/eu9MtI
[5] See Note 4 for link to the 2004 Letter to Shareholders.
[6] Certain types of insurance have "long-tails" meaning that liabilities are not known quickly. For example, float associated with reinsurance covering asbestos risk is typically long-tail while auto coverage tends to be short-tail.
[7] Berkshire's float is calculated by "adding net loss reserves, loss adjustment reserves, funds held under reinsurance assumed and unearned premium reserves, and then subtracting agents balances, prepaid acquisition costs, prepaid taxes and deferred charges applicable to assumed reinsurance." Warren Buffett's 1999 Letter to Shareholders, page 4: http://bit.ly/3AYOlk
[8] Warren Buffett's 2005 Letter to Shareholders, Page 5: http://bit.ly/4sY2gG
[9] For a dramatic example of how willing managers are to reject inadequately priced risk, see page six of Warren Buffett's 2004 Letter to Shareholders illustrating National Indemnity's multi-decade record. http://bit.ly/eu9MtI
[10] See Warren Buffett's 2004 Letter to Shareholders, page 7. http://bit.ly/eu9MtI

[11] All exhibits in this research report use data collected from Berkshire Hathaway annual reports and 10-K filings. Excel spreadsheets with the data and related calculations are available to accompany this report.
[12] Berkshire Hathaway: The Ultimate Conglomerate Discount by Alice Schroeder and Gregory Lapin, January 1999.
[13] As quoted in Schroeder's paper, page 19, from 1992 Annual Shareholder's Meeting.
[14] For an account of the meeting between Warren Buffett and Lorimer Davidson, see *Buffett: The Making of an American Capitalist*, Page 43. http://amzn.to/exEoA3. Also see Warren Buffett's 1995 Letter to Shareholders: http://bit.ly/hLL4zW
[15] See *The Security I Like Best*, by Warren Buffett, December 6, 1951: http://bit.ly/NKZ6S
[16] See Lowenstein, Page 49.
[17] See Lowenstein, Pages 194 to 202 and Warren Buffett's 1980 Shareholder Letter (http://bit.ly/eiuE8g) and 1995 Shareholder Letter (http://bit.ly/hLL4zW) for more details on GEICO's near death experience in the mid 1970s.
[18] See Warren Buffett's 2010 letter to shareholders, page 9: http://bit.ly/hPR58v.
[19] See Berkshire Hathaway 2008 Annual Report (http://bit.ly/eX3c9I) and GEICO's website for more details on market share.
[20] See GEICO's website: "GEICO at a Glance": http://bit.ly/fVd9D7
[21] 1998 market share figure from Schroeder's 1999 report, page 29. 2010 market share figure from Warren Buffett's 2010 letter to shareholders, page 9: http://bit.ly/hPR58v
[22] For an article covering GEICO's entry into Massachusetts, please see *GEICO Enters Massachusetts Market*, March 21, 2009, via The Rational Walk: http://bit.ly/ho7BIA
[23] For more information on the settlement, see *General Re Settlement in AIG Case Closes Difficult Chapter*, January 21, 2010 via The Rational Walk. The article also contains links to other information on the General Re/AIG Case. http://bit.ly/gcDeH5
[24] Warren Buffett's 2002 Letter to Shareholders, page 7: http://bit.ly/dJyqL5
[25] *Snowball: Warren Buffett and the Business of Life*, Page 513.
[26] See The Rational Walk's coverage of the CNA transaction: http://bit.ly/fTGn16
[27] For further details on Berkshire Hathaway's primary group, the reader is referred to the Berkshire Hathaway 2008 Annual Report, Management Discussion, Page 68: http://bit.ly/eX3c9I
[28] 2008 Annual Report, Chairman's Letter, page 9: http://bit.ly/eX3c9I
[29] For more information on the acquisition of Medical Protective, see Berkshire Hathaway 2005 Annual Report, page 60: http://bit.ly/i42CNk
[30] Warren Buffett's 2008 Letter to Shareholders, page 8: http://bit.ly/dP7wkI
[31] While we do not intend to dwell on macroeconomic factors or to offer predictions on the specific course of interest rates, we will note that unprecedented quantitative easing by the Federal Reserve cannot persist indefinitely. Additionally, foreign buyers of Treasuries such as China have been looking into ways to diversify their reserves over time. Higher rates in the long run are nearly certain even assuming a benign overall scenario.
[32] See previously referenced paper written by Alice Schroeder and Gregory Lapin, page 20.
[33] See Berkshire Hathaway 2010 Annual Report, page 54: http://bit.ly/h8J4qs
[34] See page 47 of the 2009 Annual Report for details on the treatment of goodwill for statutory accounting purposes vs. GAAP: http://bit.ly/f7eAQN

Utilities and Energy

[1] Warren Buffett's 2007 Letter to Shareholders, Page 11: http://bit.ly/fKm7Bi
[2] Warren Buffett's 2007 Letter to Shareholders, Page 10.
[3] For more detailed information regarding PacifiCorp, please visit the company's website at http://www.pacificorp.com. Among other resources, the company has provided service area maps that display coal mines, generation plans, and transmission lines.
[4] See MidAmerican Energy Holdings Company 2010 10-K, Page 14: http://bit.ly/eyqolY
[5] MidAmerican Energy Holding Company 2010 10-K, page 15: http://bit.ly/eyqolY
[6] See Berkshire Hathaway's 2002 annual report for information on the acquisitions of Northern Natural Gas and Kern River pipeline systems: http://bit.ly/idjbTt. See 2009 annual report for statement that both pipelines carry about 8 percent of natural gas used in the United States: http://bit.ly/f7eAQN
[7] See MidAmerican's 10-K for 2002, page 37: http://bit.ly/gmImrB
[8] See Warren Buffett's 2002 Letter to Shareholders: http://bit.ly/idjbTt

[9] See Warren Buffett's 2008 Letter to Shareholders: http://bit.ly/dP7wkI
[10] For capital expenditure information on Kern River and Northern Natural Gas, see segment information section MidAmerican's 10-K for 2003 (http://bit.ly/eQBP2A), 2006 (http://bit.ly/guiJtN), and 2009 (http://bit.ly/hqHYWs).
[11] For some basic background on the Public Utility Holding Company Act of 1935, see the Wikipedia entry at http://bit.ly/gw9HcB.
[12] For more details on the Constellation transaction, see page 71 of the 2008 Annual Report: http://bit.ly/eX3c9I
[13] Warren Buffett's 2009 Letter to Shareholders, page 8: http://bit.ly/g2RqbD
[14] Warren Buffett's 2010 Letter to Shareholders, page 14.
[15] See Value Line Investment Survey, "Electric Utility (East) Industry", page 139, dated February 25, 2011. While the industry page is specific to the Eastern United States, the composite data are for a composite of the western, central, and eastern regions.

Burlington Northern Santa Fe

[1] Charlie Munger made this comment at the 2007 Wesco Financial annual meeting. See Whitney Tilson's meeting notes at http://bit.ly/hQqNqX.
[2] For a brief description of the Interstate Commerce Act of 1887, please see the Wikipedia entry on the Act along with the footnoted sources within the article: http://bit.ly/dGs3sZ
[3] Data cited in this report related to the Staggers Act and industry conditions in the 1970s were primarily sourced from the AAR's report entitled "The Impact of the Staggers Act of 1980" http://bit.ly/awwEqr.
[4] AAR Report: "The Impact of the Staggers Act of 1980", page 4. See previous note for link.
[5] For a number of statistics related to the environmental issues surrounding freight rail, please see the Freight Rail Works Environment Page at http://bit.ly/aES1Cw
[6] See The Rational Walk's coverage of AAR's January 2010 Rail Time Indicators Report: http://bit.ly/hoDveA
[7] Some efforts have been made in Congress to revisit certain aspects of the Staggers Act of 1980. This has generated vigorous industry response. See this article on The Rational Walk for more details: http://bit.ly/c92s2m
[8] Berkshire actually reported purchases of shares in three railroads in an amended 13F-HR filing dated May 15, 2007. In addition to BNSF, Berkshire acquired shares of Norfolk Southern and Union Pacific: http://bit.ly/fpPN7U
[9] Berkshire's 13F-HR Report disclosing positions as of September 30, 2009 was the last regulatory filing prior to announcement of the acquisition on November 3, 2009. Source: http://bit.ly/fPiZ5g
[10] See Berkshire's press release (pdf file): http://bit.ly/22Q6B3
[11] We count ourselves among those who believed that Berkshire traded well below intrinsic value at the time, as we discussed in our 2010 Berkshire Hathaway Briefing Book.
[12] See Berkshire's press release on final merger terms on February 12, 2010: http://bit.ly/iivp1F. For additional analysis, see The Rational Walk's article on the same subject on the same date: http://bit.ly/dv9Lce
[13] See Warren Buffett's 2009 Letter to Shareholders, page 17
[14] See Prof. Greenwald's comments dated November 17, 2009 on the Advisor Perspectives website: http://bit.ly/4y3HXD
[15] See this article dated January 12, 2010 on The Rational Walk for more details on Mr. Berkowitz's comments: http://bit.ly/efn1de
[16] For more discussion on Burlington Northern's capital expenditure history, please see the following article on The Rational Walk: http://bit.ly/gvAihK
[17] See "Subsequent Event" note in BNSF's 2010 10-K, page 25: http://bit.ly/dGly6K
[18] For more information and links to *Nightly Business Report's* website, please see The Rational Walk's coverage of the interview: http://bit.ly/ahHwVq
[19] See Dow Jones Newswire Article *Burlington Northern CEO Expects '11 GDP Growth In High 3% Range*: http://on.wsj.com/dPi8CF. Also see the Star-Telegram's article dated February 8, 2011: *BNSF Railway to spend $3.5 billion this year on upgrades, equipment* http://bit.ly/g51kvM
[20] For those interested in a longer history of Burlington Northern Santa Fe, we suggest *The History of BNSF: A Legacy for the 21st Century*, published on the BNSF website (pdf file): http://bit.ly/dNge6P
[21] For a brief look at Union Pacific including its route map, please see the company's Wikipedia entry: http://bit.ly/c3m6qN

[22] A railroad's operating ratio is calculated as follows: Operating Expense / Operating Revenues. It is an efficiency measure with lower percentage figures indicating more efficient operations.

Finance and Financial Products

[1] For a description of the Gen Re derivatives runoff, see Warren Buffett's 2003 Letter to Shareholders, page 14: http://bit.ly/fMfhwc. In Mr. Buffett's 2006 Letter to Shareholders (http://bit.ly/i3gqd9), he declares that the unwinding was nearly complete after $409 million in pre-tax losses.
[2] See Warren Buffett's 2010 Letter to Shareholders, page 16.
[3] For a more complete description of Clayton's experiences in the late 1990s, please read the following article on The Rational Walk, "Clayton Homes: An Admirable Track Record": http://bit.ly/gPp63p. For an article on Clayton's Payment Protection Plan, see http://bit.ly/gn4VhM.
[4] See Warren Buffett's 2009 Letter to Shareholders, page 12: http://bit.ly/g2RqbD
[5] See The Rational Walk's article from March 2010: http://bit.ly/hndTyJ
[6] Warren Buffett's account of the Clayton purchase and the history of the company appears in his 2003 Letter to Shareholders, pages 4-5: http://bit.ly/fMfhwc
[7] Please see The Rational Walk's coverage of the Wesco transaction: http://bit.ly/hVbDnJ

Manufacturing, Service, and Retailing

[1] For more information, see The Rational Walk's coverage of McLane's purchase of Kahn Ventures in March 2010: http://bit.ly/e2mMKs
[2] See Berkshire Hathaway 1999 Annual Report, page 41: http://bit.ly/ftTq4j
[3] Berkshire Hathaway 2007 Annual Report, Page 5: http://bit.ly/e1FOtm
[4] See Warren Buffett's 2010 Letter to Shareholders, Page 13: http://bit.ly/h8J4qs
[5] For a listing of Marmon's subsidiaries, follow this link: http://bit.ly/fGTJxT
[6] See Warren Buffett's 2007 Letter to Shareholders, page 5: http://bit.ly/fKm7Bi
[7] See Warren Buffett's 2009 Letter to Shareholders, page 11: http://bit.ly/g2RqbD
[8] See Warren Buffett's 2003 Letter to Shareholders, page 6: http://bit.ly/fMfhwc
[9] See discussion in Warren Buffett's 2001 Letter to Shareholders, page 13: http://bit.ly/hB8r76
[10] Warren Buffett's 2007 Letter to Shareholders, page 13: http://bit.ly/fKm7Bi
[11] See Reuters article at http://reut.rs/hP0Yyo
[12] Warren Buffett's 2006 Letter to Shareholders, page 5: http://bit.ly/i3gqd9. For an interview of Mr. Wertheimer, please see the following link: http://bit.ly/fEBEK2
[13] See Warren Buffett's 2009 Letter to Shareholders, Page 11: http://bit.ly/g2RqbD
[14] See Warren Buffett's 2009 Letter to Shareholders, Page 12: http://bit.ly/g2RqbD
[15] See the following article on The Rational Walk for more information and links to additional articles on Mr. Sokol: http://bit.ly/hVUy0k. For more articles and continuing coverage of Mr. Sokol, follow this link: http://bit.ly/ePJHhi
[16] Please see The Rational Walk's coverage of Mr. Sokol's interview with The Columbus Dispatch: http://bit.ly/fddGTc
[17] See NetJets statement on the Marquis Jet acquisition: http://bit.ly/eMiTxh
[18] Berkshire's reporting for NetJets has not appeared in a consistent format over the past three years. As a result, we had to estimate a number of figures in our exhibit. The following notes provide more information regarding the estimates that were made:

(1) Berkshire does not have a consistent format for presenting NetJets results and categorizes the business in "other service". We have attempted to piece together data from the narrative.
(2) There are no granular statements regarding NetJets quarterly revenues or pre-tax earnings in the Q1, Q2, or Q3 10-Q Reports from 2008.
(3) Q4 2008 Write-down is stated as $54 million in Berkshire's 2008 10-K, page 74.
(4) Q1 2008 and Q1 2009 Pre-Tax earnings and Q1 2009 writedowns as reported in Berkshire's 2009 Q1 10-Q, Page 26.
(5) Q2 2009 10-Q p. 29: Q2 2009 Revenues were reported as "declining $550 million" compared to Q2 2008 revenues "a 43% decline", implying revenues of $1,279 m in Q2 2008 and $729 m in Q2 2009

(6) Q2 2009 10-Q p. 29: 1H 2009 Revenues were reported as "declining $1,024 m" compared to 1H 2008 revenues, "a 42% decline", implying revenues of $2,438 m in 1H2008 and $1,414 m in 1H 2009.
(7) From (5) and (6): We calculate Q1 2009 Revenues as $685 m by taking 1H 2009 Revenues of $1,414 million and subtracting Q2 2009 Revenues of $729 million.
(8) From (5) and (6): We calculate Q1 2008 Revenues by taking 1H 2008 Revenues of $2,438 million and subtracting Q2 2008 Revenues of $1,279 million.
(9) Q2 2009 10-Q p.29: Pre-Tax Q2 2009 Loss stated as $253 million and 1H 2009 loss at $349 million. Therefore Q1 2009 Loss was $96 million
(10) Q2 2009 10-Q p. 29: Writedown for Q2 2009 of $192 m and $255 m for 1H 2009. We use resulting figure of $63m for Q1 rather than orig. reported $55m in Q1 2009 10-Q
(11) Q3 2009 10-Q p.30: Revenue declined $471 million, or 41% for Q3 2009, indicating Q3 2008 revenue of $1,149 million and Q3 2009 revenue of $678 million.
(12) Q3 2009 10-Q p. 30: Pre-tax loss and writedown figure for Q3 2009 provided as $183 million and $181 million respectively.
(13) 2009 10-K p 72: NetJets Revenues declined $1,465 million, or 32% compared to 2008 indicating 2008 revenue of $4,578 m and 2009 revenue of $3,113 million. We obtain Q4 2009 and Q4 2008 revenue figures by subtracting our calculated figures for Q1-Q3 for each respective year from the total year figures reported in the 10-K. Therefore, Q4 2008 Revenues were $991 million and Q4 2009 revenues were $1,021 million.
(14) 2009 10-K p 72: Pre-Tax loss of $711 million reported for 2009. Subtracting Q1-Q3 results, we arrive at $179 million loss for Q4 2009. Writedowns were $676 million for 2009, indicating $240 million of write-downs for Q4 2009.
(15) 2009 10-K reported NetJets 2008 pre-tax earnings of $213 million. We cannot find NetJets Q2 and Q3 2008 pre-tax earnings figures anywhere in the filings. In aggregate, Q2-Q4 earnings were $168 million based on $45 m reported for Q1 2008 and $213 million for the full year.
(16) Q1 2010 10-Q p. 29: Q1 2010 Revenues increased 18% over Q1 2009 Revenues: $685 million x 1.18 = $808.3; $57 million pre-tax earnings; Asset impairments declined $50 million from Q1 2009 levels of $63 million implying that there were $13 million writedowns in Q1 2010.
(17) Q2 2010 10-Q: Q2 2010 Revenues increased 16% over Q2 2009 Revenues: $729 million x 1.16 = $845.6 million. 1H 2010 pre-tax earnings reported as $114 million which indicates Q2 2010 pre-tax earnings of $57 million. Write-downs were "relatively minor" in Q2, we don't enter a figure as a result.
(18) Q3 2010 10-Q: Q3 2010 Revenues increased 17% over comparable prior year period >> $678 million x 1.17 = $793 million. First nine month earnings were $158 million pre-tax indicating Q3 earnings were $44 million based on already disclosed numbers for Q1 and Q2 2010.

[19] We have followed the controversy surrounding David Sokol's management of NetJets on The Rational Walk. See *Sokol Complains About 'Deceit' Among Disgruntled NetJets Employees:* http://bit.ly/gTWCOH and *NetJets Mired in Controversy Over Possible Brand Erosion:* http://bit.ly/eozLmR
[20] We quote several of the anonymous critics in the following article: http://bit.ly/eozLmR
[21] We provide exclusive details on the nature of the NetJets customer satisfaction survey in this article: http://bit.ly/eozLmR
[22] For additional commentary on David Sokol's Aviation Week interview dated February 3, 2011, please see The Rational Walk's article on the subject: http://bit.ly/eLYLmS
[23] For a fascinating account of R.C. Willey, please read *The R.C. Willey Story: How to Build a Business Warren Buffett Would Buy*. Amazon Link: http://amzn.to/fli041. Book Review: http://bit.ly/e5ZUW9.
[24] Berkshire Hathaway 2009 Annual Report, page 10: http://bit.ly/f7eAQN

Alternative Valuation Approaches

[1] For example, see the 2008 Annual Report, page 5: http://bit.ly/eX3c9I.
[2] See The Rational Walk's coverage of Mr. Buffett's 2010 Letter to Shareholders for more on the "Three Pillars of Value": http://bit.ly/eHgg7N
[3] See Warren Buffett's 2010 Letter to Shareholders, page 4
[4] See 2009 Letter to Shareholders, page 3: http://bit.ly/g2RqbD
[5] See 2009 Letter to Shareholders, page 6: http://bit.ly/g2RqbD
[6] The Owner's Manual is available in every annual report and as a separate document on the Berkshire Hathaway website: http://bit.ly/fseJCq.
[7] The full data set is available in the Excel workbook that accompanies this report. Source: Google Finance.

Management Succession Concerns

[1] The Wall Street Journal, *Finding Value in Berkshire After Buffett,* by Scott Patterson on October 9, 2009: http://on.wsj.com/gpY8F7

[2] See this article in the Sydney Morning Herald: http://bit.ly/eg3O7N. Mr. Buffett has made similar statements regarding his son assuming the Chairman role during past annual meetings.
[3] See Berkshire's 2010 Proxy Statement: http://bit.ly/huT7Jr.
[4] In 2009, Mr. Gates indicated that he would remain on Berkshire's board for the rest of his life. http://bloom.bg/g3BO7W.
[5] See The Rational Walk's coverage of the Combs announcement: http://bit.ly/gouOBY.
[6] For more background information on Li Lu, see The Rational Walk's coverage from 2010: http://bit.ly/ggRPns.
[7] We consider Mr. Sokol to be the front runner to eventually replace Mr. Buffett as CEO. We have covered Mr. Sokol extensively on The Rational Walk. For a list of articles referencing Mr. Sokol on The Rational Walk, please refer to the following link: http://bit.ly/ePJHhi

Appendix 4: GEICO vs. Progressive

[1] Warren Buffett's account of Berkshire's purchase of GEICO in his 1995 shareholder letter is well worth reviewing for those interested in a more complete history: http://bit.ly/fRatc3
[2] See http://bit.ly/gFdlO5 for the full survey results.

Appendix 5: Berkshire's Misunderstood Derivatives

[1] See Warren Buffett's 2010 Letter to Shareholders, pages 19-20
[2] See Warren Buffett's 2009 Letter to Shareholders, page 15.: http://bit.ly/g2RqbD
[3] For a brief description of European vs. American style options, see this Wikipedia entry: http://bit.ly/eVohI1.

Appendix 6: A Closer Look at Todd Combs and Castle Point Capital

[1] See The Rational Walk's coverage of the announcement at http://bit.ly/gouOBY.
[2] Data derived from SEC 13F report: http://bit.ly/iiEFDC. Note that short positions are not listed in the 13F and some offsetting shorts may exist against the long positions. Alice Schroeder posted details regarding Castle Point's historical performance citing the partnership letters as a source: http://bit.ly/gZxDE0. The portfolio outperformed the S&P 500 by a wide margin from 2006 to 2010 thanks to the short portfolio.
[3] See Dataroma's report of Berkshire's historical positions in Western Union: http://bit.ly/gJoJGz
[4] See the following Market Watch article for an account of the partner letter: http://bit.ly/fMYU6O
[5] See the original article that appeared on The Rational Walk on October 27, 2010: http://bit.ly/hfxeGW. We have not updated the article to incorporate year-end 2010 results for Western Union since incorporating one additional quarter of data is not material to the observations made in this appendix.
[6] See Wikipedia entry at http://bit.ly/e7Cp8e.
[7] See PayPal fee schedule: http://bit.ly/hG98hf
[8] See the New York Times coverage of this situation: http://nyti.ms/gucHAM
[9] Western Union Q3 2010 Conference Call Transcript: http://bit.ly/hJ5vEX
[10] See the section of Warren Buffett's 2004 letter to shareholders entitled "Portrait of a Disciplined Investor" for Lou Simpson's outstanding track record: http://bit.ly/gJCiC6. At the age of 74, Mr. Simpson recently started a new investment partnership after retiring from GEICO in late 2010: http://bloom.bg/e58mIQ.

