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Berkshire Hathaway

In 2008, Berkshire Hathaway (Berkshire) was active in a variety of sectors, including insurance, regulated utilities, and retailing. Since the mid 1960s, when Warren Buffett had first purchased Berkshire, Berkshire had grown into a conglomerate with revenues of $81.7 billion. Over its 40 year history, Berkshire had generated an average annual percentage growth in book value of approximately 21.5%. Buffett had remained at its helm during this entire period. **Exhibits 1a, 1b and 1c** illustrate the trend in Berkshire's stock price, earnings and book value, and **Exhibit 2** illustrates the change in investments and pre-tax earnings between 1965 and 2005.

The final days of 2007 and the early months of 2008 had been busy ones for Berkshire. As the financial markets continued to be roiled by the credit crunch, Berkshire was actively deploying significant amounts of its capital. On Christmas Day of 2007, Berkshire had concluded the largest ever cash purchase in its history, paying $4.5 billion for a 60% stake in Marmon, an industrial conglomerate with $7 billion in sales and 20,000 employees. In January 2008, it had launched Berkshire Hathaway Assurance, Berkshire's first foray into municipal bond insurance established with the strong encouragement of New York State's insurance regulators. Berkshire Hathaway Assurance, with an AAA credit rating, had secured licenses to sell bond insurance in 44 states and the District of Columbia. It would compete with established players like MBIA and Ambac Financial who had suffered significant losses because of the credit crunch. Berkshire had also recently assumed the role of banker in a number of high profile transactions, providing a $3 billion commitment to finance Dow Chemical's purchase of Rohm and Haas, and $6.5 billion to help Mars Inc. acquire Wm Wrigley Jr. and Co.

Yet amidst these signs of strength, there were clear indications that Berkshire itself was being challenged by the difficult economic environment. In July 2008, Berkshire's shares were down by 20% from their recent peak in December 2007. Berkshire's financial services-heavy portfolio had taken a particular beating. On the insurance business, which played a central role in Berkshire's operations, Buffett himself noted: "that party is over. It's a *certainty* that insurance industry profits, including ours, will fall significantly in 2008. Prices are down and exposures inexorably rise."[1] Berkshire also faced a number of broader challenges, foremost of which seemed to be its size. Buffett admitted to this at the annual shareholders meeting on May 3, noting that there was "absolutely no question" that the returns would decline. In addition, the issue of succession loomed large in the minds of Berkshire's shareholders. To what extent could the company's success outlive its septuagenarian founder?

Professor Bharat N. Anand and independent researcher Samhita A.P. Jayanti prepared this case with the assistance of Ju-Hon Kwek (MBA 2008). This case was developed from published sources. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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The Beginnings

The Investment Philosopher

> *This is the cornerstone of our investment philosophy: Never count on making a good sale. Have the purchase price be so attractive that even a mediocre sale gives results.*
>
> *– Warren Buffett, 1963* [2]

At Columbia University, Buffett was taught by Benjamin Graham, the erstwhile "dean of the securities profession." Graham, along with his colleague, David Dodd, had written the textbook *Security Analysis* in 1934, which propounded a simple idea: The intrinsic value of a business could be determined by analyzing its past performance and future prospects, irrespective of its market price.[3] This idea flew in the face of the prevailing view – formed in the wake of the Depression – that "investing for profit was impossible" because one could never predict the behavior of other stock market participants.[4] Graham liked to say, "You are neither right nor wrong because the crowd disagrees with you."

Working for the Graham-Newman mutual fund in New York after graduating from Columbia, Buffett found it difficult to convince Graham to act on his investment ideas. Having watched speculators take big, ruinous bets, Graham was more risk averse than his young protégé. Buffett began investing in the stocks Graham rejected for his own account. It quickly became apparent that the student was surpassing the teacher: anything Graham did, Buffett did faster and better. For example, Graham-Newman had long used arbitrage to take advantage of price discrepancies. Buffett took it to the next level. When Rockwood, a Brooklyn-based chocolate company offered an unusual scheme to redeem its stock in exchange for cocoa beans, Buffett quickly made a tidy profit by purchasing Rockwood stock, redeeming the stock for beans and simultaneously selling the beans on the commodities market.

In 1956, Graham-Newman shut down after 21 years in the investment business. The end came not because of some spectacular investment failure but because Graham wanted a quieter life of teaching and relaxation. Buffett moved back to Omaha, Nebraska and Buffett Associates opened for business in the spring of the same year. Buffett's first fund took in capital of $105,000[5] from family and friends. From the very beginning Buffett laid down the ground rules: he would disclose only what he chose about the investment portfolio, and would allow investors to withdraw their money only once a year. Investors would be entitled to all the profits Buffett generated up to 4%; Buffett would be entitled to a 25% share of any profits he generated in excess of that. If Buffett did not generate the promised returns, he would not draw a salary or pay himself a fee. By the end of 1957, Buffett was running five investment partnerships with commitments of $500,000; by the end of 1961, Buffett's returns over the five years ranged between 10.1% and 45.9%. The Dow Jones Industrial Average returned between -8.4% and 22.2% over the same period.[6]

Also in 1961, Buffett made his biggest investment, investing $1 million in Dempster Mill Manufacturing, an 80-year old Nebraska-based business making windmills and farm implements – both old and low margin businesses. Buffett had bought a small stake a few years earlier, and when Dempster had become cheaper, he had put in additional money to increase his stake to 70%. Making himself the chairman and roping in a friend to be on the board, Buffett began spending much of his time at the company, trying to get his hands dirty and understand the business. This was Buffett's first foray beyond the investment realm. Unsuccessful at lowering costs, Buffett put the company up for sale but there were no takers. In 1962, Buffett consulted with his friend, Charlie Munger about bringing in a turnaround expert to run the business. Munger did not subscribe to the Graham school of investing. More important than a margin of safety, he felt it was always better to pay a fair price

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for a good business rather than a bargain price for a poor one. Fundamentally, bad businesses were difficult to turn around.

Munger suggested an individual to restructure the business. The next few years saw workers being laid off, costs reduced and inventory diminished while all the cash flow from the business was funneled back to Buffett. The restructuring helped the returns on the investment but Buffett came under heavy criticism in the company town. Buffett defended himself, arguing that layoffs and cost cuts had kept the company in business. Still, even though Buffett had not doubted the fundamental premise of his investment throughout, Buffett hated being labeled a "liquidator" and swore never to lay people off again. Still, the results spoke for themselves. The sale of Dempster netted Buffett $2.3 million in 1963. His dramatic investment record continued between 1962 and 1966, with results ranging from 13.9% to 47.2% per year. The Dow returned between -15.6% and 20.6% over the same period.[7]

The Big Lesson

> *I'd rather have a $10 million business making 15 percent than a $100 million business making 5 percent….I have other places I can put the money.*
>
> *– Warren Buffett, after buying Berkshire Hathaway in 1965.*[8]

Founded in 1805, Berkshire Hathaway was a family-controlled textile business when Buffett first came across it while at Graham-Newman. Buffett made his first purchase of Berkshire stock in 1962, and by 1963, Buffett was Berkshire's largest shareholder. When Buffett visited the mill, he was shown around for two days by Ken Chace, the vice president of manufacturing. Buffett pored through the company's historical financial statements and according to Chace, "asked questions like crazy" about the company's raw materials, production process, marketing, and customers. After familiarizing himself with the company, Buffett increased his stock position, getting himself appointed to Berkshire's board in the process, and replaced the chairman with Chace, whose views on improving Berkshire's performance concurred with Buffett's.

With Chace at the helm of Berkshire, Buffett outlined his requirements as the new owner. He would not interfere with the running of the business but he would retain control over the cash that the business generated. He refused to grant stock options to Chace or any other manager, instead offering to extend them loans to buy Berkshire stock. Buffett was supportive of ownership, but opposed to options because they conferred upside reward with no corresponding downside risk. Chace was initially opposed to taking such a loan but Buffett convinced him it could pay off. Then Buffett explained the key parameter on which he wanted Chace to run Berkshire – return on invested capital. For Chace, who had spent his entire career in the mold of pursuing growth above all else, this was a completely different approach, but he understood how important it was to Buffett. And Buffett remained true to his word. He was available to Chace but he kept their conversations short, with a clear memory of prior conversations so he could track the developments at Berkshire on their monthly calls. Once, when Chace presented a carefully researched investment opportunity, Buffett would listen patiently but then say, "Ken, you won't beat the historical average."[9] Buffett was loath to put more money into a business that had been in a state of secular decline for several decades.

To the company's local Massachusetts shareholders, a note in Berkshire's financial statements that the company was looking for acquisitions within *and* outside the textile industry was all that belied Buffett's influence. As it turned out, textile markets performed well in the first few years after Buffett took over, generating significant extra cash. Buffett put this to good use almost immediately. His first target was National Indemnity, an Omaha-based insurance firm whose owner, Jack Ringwalt, had laughed off Buffett's request for $50,000 when Buffett had raised his first investment partnership.

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Each had followed the other's success since their first encounter. Buffett was particularly interested in the philosophy with which Ringwalt had built his business. National Indemnity insured risks that no one else was willing to insure. In Ringwalt's view, there was no such thing as a "bad" risk, it was just a question of what premium would justify taking on the risk. Like Buffett, Ringwalt was also tremendously frugal and had built his business from scratch. Buffett convinced Ringwalt to sell his company in the course of a short conversation at the latter's office. Ringwalt insisted that all shareholders get paid the same price for their shares, employees not be laid off, and that the company remain in Omaha. Then he named his price, explaining what the stock was worth relative to the depressed market price. Buffett agreed to Ringwalt's ask, having come to a similar conclusion about National Indemnity's value relative to its stock price. It was Berkshire Hathaway's first foray in to the insurance business.

With National Indemnity, Buffett was flush with cash. The insurance business generated low cost funds labeled the "float" in industry parlance – premiums were paid up front and claims needed to be paid out only much further down the line. In the interim, the unused premiums were essentially a free source of funding for investments. Buffett went on a buying spree, purchasing controlling stakes in businesses typically run by an owner/manager that Buffett wanted to retain. He was looking for managers who had built successful, profitable businesses and who wanted to continue to run them; and each of these managers stayed despite being bought out. Before long, Berkshire had moved far from its textile activities, having entered the insurance, banking and publishing businesses. By 1968, Berkshire's textile business was down to operating a single mill – the only one remaining in Massachusetts. Textiles had by then become a commodity and no matter what Berkshire did, they had no ability to influence the incredibly low margins in the industry. Still, Buffett could not bring himself to shut the company down. He simply diversified Berkshire into higher margin businesses so that textile profits became a mere drop in the bucket. **Exhibit 3** outlines the history of Berkshire Hathaway's key acquisitions. The textile business taught Buffett an important lesson: going forward, he would only invest in sustainable businesses whose cash flows he could predict with some certainty.

Warren's World

In 2008, Berkshire was active in a variety of business sectors in the US. The first group was the insurance businesses which generated much of the capital Berkshire used to fund the rest of its activities. The key companies in the insurance sector were GEICO, a provider of auto insurance, and the Berkshire Hathaway Reinsurance Group. In addition, Berkshire owned General Re, one of the four largest reinsurers in the world. Berkshire's non-insurance businesses included both manufacturing and service companies, and it held an extensive portfolio of equity investments. Berkshire was very clear about its investment criteria, publishing them each year at the end of its annual report. Berkshire looked for large stakes in businesses in traditional industries with good management teams and demonstrated earnings potential.[10] When Berkshire bought into companies, it bet large and it held its investments for several years. **Exhibit 4** illustrates Berkshire Hathaway's acquisition criteria.

Berkshire sourced its deals in two ways. The first was through its vast network of corporate and financial services relationships. Second, Buffett asked for leads from portfolio company CEOs based on Berkshire's acquisition criteria. Often, owners-managers would contact Berkshire directly. The high degree of autonomy afforded portfolio companies, Berkshire's insistence on acquiring businesses with committed management, and the long tenures of Berkshire portfolio company CEOs, presented a uniquely attractive proposition to sellers.

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GEICO

> *One of the things I have learned over the years is how important management is in building or subtracting from value. We will try to see a senior person, and prefer to visit the company at their office, almost like kicking the tires. You can have all the written information in the world, but I think it is important to figure out how senior people in the company think.*
>
> *– Lou Simpson, GEICO Head of Investments*[11]

Leo Goodwin founded GEICO in 1936 to provide car insurance to "statistically proven lower-risk military personnel and government employees."[12] At the time, insurance companies sold insurance exclusively through agents. Insurers charged high prices and agents earned high commissions, all to the detriment of the customer. Auto insurance was mandatory and expensive and Goodwin saw an opportunity for GEICO to sell insurance directly to customers at lower prices. After going public in 1948, GEICO entered the business of insuring state, county, and municipal government workers in 1952, and quickly moved onto insuring non-governmental workers in 1958.

Buffett first learned about GEICO while at Columbia under the tutelage of Benjamin Graham. When Buffett made a trip to Washington, D.C. on a Saturday morning in 1951 to educate himself about GEICO, he found a single employee in the office that day – Lorimer Davidson, assistant to GEICO's President. Davidson spent half the day with Buffett explaining how the insurance industry functioned in general and how GEICO worked in particular. Buffett left the encounter "more excited than [he had] ever been about a stock"[13] and invested $10,282 to buy 350 shares immediately. After a run up in the stock, Buffett sold his shares the following year but continued to follow the company's progress.

By the mid 1970s, GEICO had achieved a 4%[14] market share, albeit at a cost: a significantly higher overhead structure from a spate of hiring and opening new offices, and higher loss rates from more lax underwriting standards. When Jack Byrne became the CEO of GEICO in 1976 during a difficult time at the company, Berkshire began buying GEICO stock. According to Buffett, "[GEICO's] competitive strength flows directly from its position as a low-cost operator. Low costs permit low prices, and low prices attract and retain good policyholders. The final segment of a virtuous circle is drawn when policyholders recommend us to their friends. GEICO gets more than one million referrals annually and these produce more than half of our new business, an advantage that gives us enormous savings in acquisition [of customers] expenses – and that makes our costs still lower."[15] Recognizing that GEICO's problems sprung from operational mismanagement (GEICO's market share had fallen to 1.8%[16]), Berkshire had purchased a 33.3% stake for a total of $45.7 million by 1980. When management did a stock buyback soon thereafter, Berkshire's stake increased to 51%.

GEICO was back on firmer footing by the 1980s and produced excellent underwriting and investment returns. When Byrne stepped down in 1985, a new set of problems came to the fore: low customer growth, the fallout from Hurricane Andrew in 1992, and a misguided expansion into non-core businesses. Buffett acted quickly, forcing a management change with the installation of Tony Nicely and Lou Simpson as co-CEOs of the company. The idea was to split the role of CEO into two discrete sets of responsibilities, with Nicely in charge of running the business and Simpson in charge of capital allocation. With GEICO's market share almost stagnant at 1.9%, Nicely acted immediately, divesting GEICO of its non-core businesses and returning the organization's focus back to the source of its competitive advantage: low cost auto insurance with excellent customer service. Nicely also launched a substantial advertising effort to allow GEICO to grow its customer base.

Buffett outlined his desire to buy the rest of the company to GEICO's board in late 1994 and almost exactly a year later, Buffett signed an agreement to buy the remaining 49% stake that Berkshire did not already own. Buying GEICO gave Berkshire a substantial, low cost float to make

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investments. Commenting on the deal, an anonymous analyst in the Washington Post opined that, "If you could incorporate Warren Buffett, he would be GEICO - unglamorous, unfashionable, and a gold mine."[17] Nicely was delighted to find in Buffett an investor who would be less focused on short-term earnings fluctuations than on the longer term development of the business. In 1995, GEICO's last year as a public company, GEICO was the 7th largest auto insurer in the US. Between 2003 and 2005, GEICO policies grew by 26% even as its number of employees fell by 4% and at the end of 2005, GEICO had a 6.1%[18] market share. In 2005, the company earned an underwriting profit of approximately $1.2 billion on underwriting revenues of approximately $10.1 billion. Buffett attributed GEICO's success to Nicely:

> Combine a great idea with a great manager…you're certain to obtain a great result…Quite simply, there is no one in the business world who could run GEICO better than Tony does. His instincts are unerring, his energy is boundless, and his execution is flawless.19

While Nicely took GEICO from strength to strength operationally, Simpson invested GEICO's capital, proving incredibly consistent at generating excess returns. Simpson was hired into GEICO by Byrne in 1979 as Chief Investment Officer and soon became part of Buffett's cabal of like-minded investment enthusiasts. The GEICO investment portfolio Simpson inherited was very heavily weighted towards US government bonds with the result that the 1970s inflation wiped out all gains. Simpson increased the portfolio's equity weighting to 32% (from 16%), putting money into a mix of industries ranging from utilities to food packaging. Simpson's strategy yielded a 23.7% return his first year when the market averaged 32.3%.[20] However, from 1983 onwards, over the following 17 year period, Simpson generated an average annual return of 24.7% (the S&P returned 17.8% during the same time), increasing the investment portfolio from $280 million in 1982 to approximately $2.5[21] billion in 2005.

Simpson shared Buffett's investment philosophy. He preferred portfolio concentration when the prevailing wisdom espoused diversification, and stressed: "If we could find 15 positions that we really had confidence in, we'd be in 15 positions. We'll never be in 100 positions because we're never going to know 100 companies that well. I think the merits of a concentrated portfolio are 'You live by the sword, you die by the sword.' If you're right, you're going to add value. If you're going to add value, you're going to have to look different than the market. That means either being concentrated, or, if you're not concentrated in a number of issues, you're concentrated in types of businesses or industries."[22] Simpson also believed in researching a prospective stock and meeting with senior management at their offices to understand their business. If managers were reluctant to meet with Simpson and his team, they would not pursue the investment. Simpson differed in this respect from both Buffett and Graham who always lent greater credence to quantitative methods of investment analysis.

Buffett played no part in Simpson's investment decisions. In fact, he typically found out about them a few weeks after they had happened. When asked how he viewed his investment responsibilities relative to Buffett's, Simpson opined that GEICO's smaller portfolio afforded it more anonymity in the market than Berkshire Hathaway although this also implied that buying a whole business was not an option. Buffett noted that Simpson typically made investments ranging from $200 to $300 million in smaller companies than those Buffett followed. In fact, Simpson had beat Buffett's returns in 7 out of 17 years and underperformed the S&P in only 4 years. **Exhibit 5** illustrates Simpson's returns between 1980 and 2007. Buffett's reserved the highest praise for Simpson:

> One point that goes beyond Lou's GEICO work: His presence on the scene assures us that Berkshire would have an extraordinary professional immediately able to handle its investments if something were to happen to Charlie [Munger] and me.23

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Berkshire Hathaway Reinsurance Division

> *That's what you need to get into this business…Capital. Lots of capital, patient capital, and a real stomach to put that capital to risk.*
>
> *– Ajit Jain, President, Reinsurance Division*[24]

Buffett started Berkshire Hathaway's Reinsurance Division in 1969, two years after he bought National Indemnity and National Fire & Marine Insurance. Reinsurance was the business of selling insurance to insurance companies that wanted to alleviate their risk in exchange for a part of their premiums. Buffett ran the reinsurance division himself until 1982, when he hired a McKinsey partner, Michael Goldberg as the COO of Berkshire's insurance operations. At McKinsey, Goldberg had worked with Ajit Jain – a graduate of the Indian Institute of Technology (IIT) – and Goldberg hired Jain into the reinsurance group at National Indemnity in 1986. In 1993, Jain became head of the reinsurance group and began reporting directly to Buffett.

Reinsurance was a highly capital intensive business, with the result that were few companies in the industry. Under Jain, Berkshire became the largest reinsurer in the US[1] and one of the largest providers of "super-cat" policies. Super-cat was the term used to describe the business of insuring insurance companies and other reinsurers against major losses from catastrophes. The catastrophes were typically natural – hurricanes or earthquakes. For example in 1997, Berkshire insured the State of California against $1.5 billion in losses after the first $5 billion in earthquake losses in exchange for a premium of $590 million payable over 4 years. Jain expected the super-cat business "to show large profits in most years – and to record a huge loss occasionally." In fact, he stressed "that a truly terrible year in the super-cat business [was] not a possibility – it [was] a certainty."[25] But Berkshire would also insure one-off events: In 2003, Pepsi held a promotion that promised a potential payout of $1 billion. Pepsi paid a premium of several million dollars for this protection even though the probability that someone would actually have won was remote.[26] A third type of policy Berkshire provided allowed insurance companies to take legacy losses off their balance sheets by buying coverage for past losses. The sizeable premiums on such policies made them very profitable for Berkshire.

Jain believed that the parent company's substantial net worth put the reinsurance operation in an advantageous position relative to its competitors. The company had an AAA rating and the Berkshire brand gave people the confidence that Berkshire would always make good on its commitments. Further, Buffett's focus on managing the business for the long-term rather than quarter to quarter, allowed Jain to take on more reinsurance risk than his competitors. Over its history, Jain's reinsurance division was the most profitable of all Berkshire's insurance operations. Reinsurance delivered the largest float in 2007 – a total of $23.7 billion, with underwriting profit of approximately $1.4 billion.[27] **Exhibit 6** contains a comparison of the underwriting profit and float generated by Berkshire's various insurance businesses. Buffett deeply respected Jain's business acumen:

> In Ajit, we have an underwriter equipped with the intelligence to properly rate most risks; the realism to forget about those he can't evaluate; the courage to write huge policies when the premium is appropriate; and the discipline to reject even the smallest risk when the premium is inadequate. It is rare to find a person possessing any one of these talents. For one person to have them all is simply remarkable.[28]

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[1] In terms of capital employed; Berkshire Reinsurance ranked third or fourth in terms of premiums.

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Manufacturing & Service Businesses

> *Here I was, starting a concept that no one believed could work, and I realized that unless we were absolutely perfect for the first 10, 15, 20 customers, the whole deal was going to blow. I knew that when I sat down and talked with someone about buying a quarter of an airplane, they would look at me strangely…*
>
> *– Rich Santulli, Founder & CEO, Executive Jet*[29]

Berkshire held large stakes in a variety of manufacturing and service businesses. The manufacturing businesses ranged from Shaw Industries, the world's largest maker of tufted broadloom carpet, to Nebraska Furniture Mart (NFM), a furniture superstore in Omaha. The service businesses included Flight Safety International and NetJets (previously Executive Jet Aviation). **Exhibit 7** contains summary financial information on Berkshire's manufacturing and service businesses. All of these businesses had been acquired by Berkshire over the years and, in many cases, the founders remained active managers.

NFM was founded by Rose Blumkin in 1937 and even in 2008 was managed by a member of the Blumkin family. In many ways, Blumkin's was a classic immigrant story: coming to the US in 1917, settling in Omaha in 1919, and using $500 to start NFM. From the beginning, Blumkin ensured that a simple principle stood at the core of NFM, "Sell cheap and tell the truth."[30] Having bought the merchandise at 5% above the wholesale price, Blumkin sold it at 10% above wholesale. This concept, of a no-frills business offering maximum value to the customer was a business model Blumkin pioneered in furniture retailing, and eventually her competitors were forced to follow suit in order to stay in business. As NFM grew and became more profitable, Blumkin drew her children into the business and refused to spend money on anything unless it benefited the consumer.

While Blumkin resembled Sam Walton of Walmart in her understanding of the ultimate consumer value proposition, she lacked the vision to expand her business beyond Omaha. When Buffett walked in to NFM in 1983 and offered to buy the business, she saw an opportunity to remain a part owner while gaining access to Buffett's management advice and Berkshire's resources. The deal, a sale of 80% of the business to Berkshire for $55 million, with Blumkin and her children keeping a 20% stake, was agreed on a handshake. Having gradually ceded most of her responsibilities to her grandsons, by 1989 Blumkin ran only the carpet department. The Blumkin grandsons were eager to run NFM their way and tried slowly to edge Blumkin out of the business. Finally, in October of that year, Rose Blumkin left NFM and opened up her own competing business – Mrs. B's Warehouse – across the street from NFM. She was tired of feeling marginalized by her grandsons and was disappointed that Buffett had sided with them. It did not take her long to turn Mrs. B's Warehouse profitable and into Omaha's third largest carpet outlet. Finally, two years after her new venture, Buffett came into the rival store to effect a truce; Mrs. B ended up selling her Warehouse to NFM for $4.94 million. Under Irvin Blumkin, NFM has continued to grow and prosper, perpetuating the dominant franchise created by Mrs. B. In addition to his management of NFM, Blumkin has helped Buffett expand Berkshire's interests in home furnishings so that Berkshire now owned several additional franchises.

Rich Santulli bought Executive Jet Aviation (EJA) in 1984 and realized quickly that the only way to turn around the money-losing enterprise was to change its business model. Executive Jet had been founded by a group of retired US Air Force pilots in 1964 with a passion for aircraft and no clear idea of how to turn a profit. Initially interested in buying an airplane and having EJA manage it for him, Santulli quickly realized that owning a plane made no sense unless he would be flying at least 400 hours a year. When Santulli gathered a group of friends to convince them to sign up for a fractional share of a jet, it became clear that if he could come up with a way to "take the economics of time-sharing or multiple ownership, but guarantee that when you wanted your airplane you could get it"

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EJA could have a viable business model. The detailed flight records that EJA's pilots had maintained allowed Santulli to assess flying patterns, and after puzzling through the math for a couple of years, Santulli introduced the NetJets fractional ownership concept in 1986. Santulli worked out that NetJets needed to keep 5.25 planes on hand for every 20 planes NetJets sold fractional shares in. This would allow NetJets to make its own planes be available 98% of the time (the balance 2% could be serviced by chartered aircraft) while allowing it to turn a profit. Customers purchased a fraction of a particular plane and paid a monthly fee that covered fuel, maintenance, pilots, training, and catering, and an hourly charge for actual flight time.

The first years were difficult, with NetJets selling few plane shares and having to build up a proper fleet despite having few customers. The 1989 recession was a double edged sword – signing in new users was almost impossible but CFOs at recession hit companies began selling off company aircraft and going to NetJets for their private plane needs. By 1993, customers knew NetJets was here to stay, having survived the preceding years and company's customer base began growing rapidly through referrals. Buffett signed up as a customer in 1994 after he was introduced to NetJets by one of Berkshire's portfolio company CEOs. Buffett immediately asked Santulli to get in touch if he ever considered selling the business. In 1995, in need of capital to expand, Santulli sold a 25% stake to Goldman Sachs and as soon as Buffett heard about the transaction, he called Santulli asking why he had not come to him instead. In 1998, with annual revenues approaching $1 billion, Goldman floated the idea of taking EJA public. Santulli disagreed and approached Buffett instead. He explained to a reporter, "I didn't want a 28-year-old analyst telling me how to run my business. Warren Buffett is a long-term player. He's not worried about the next 3 months or 6 months."[31]

Flight Safety International, a world leader in the pilot training business, was another Berkshire company. Because flight simulation equipment was very expensive, equipment usage rates were a critical factor in determining Flight Safety's profitability but as the first company to start using simulation equipment rather than actual planes to train pilots, the company had virtually a monopoly in the industry. As a result of common Berkshire ownership (Berkshire bought Flight Safety in 1996 for $1.5 billion), Flight Safety's top customer had become NetJets whose 2,100 pilots each spent an average of 18 days a year in training.

Investment Portfolio

> *We own pieces of excellent businesses…but their current prices reflect their excellence. The unpleasant corollary to this conclusion is that I made a big mistake in not selling several of our larger holdings during The Great Bubble. If these stocks are fully priced now, you may wonder what I was thinking four years ago when their intrinsic value was lower and their prices far higher. So do I.*
>
> *– Warren Buffett, Letter to Shareholders, 2003*[32]

Berkshire's criteria for making investment decisions regarding its public equity portfolio was identical to the criteria that it applied to its majority-owned subsidiaries. It looked at its equity positions as "fractional ownerships in businesses" and held its positions for the long-term. **Exhibit 8** contains a list of Berkshire's public equity investments between 1997 and 2007. Buffett's view of good investments had evolved over Berkshire's history, mostly due to his collaboration with Munger. In many ways, Munger replaced Graham in his role as Buffett's advisor and confidant. Munger's biggest difference with Graham was his "appreciation of the fact that some businesses were worth paying a premium for"[33] whereas Graham had been strictly focused on bargain basement opportunities. As a result, Berkshire stuck to its fundamental principles of value, but Munger described Berkshire's investment approach as "pure opportunism." The combined approach

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translated into Berkshire buying companies of better quality with strong long-term earnings potential. Munger believed that making fewer, larger bets cut down transaction costs, made the investment portfolio easier to monitor and the consequently longer holding period conferred a tax advantage.[34]

Berkshire's four biggest positions at the end of 2004 – American Express, Coca-Cola, Gillette, and Wells Fargo – were accumulated in a series of purchases between 1988 and 2003, implying a holding period of approximately 12.5 years. In the 1992 annual report, Buffett wrote, "We like to buy. Selling, however, is a different story."[35]

In addition to equities, Berkshire invested in a variety of securities, including various types of bonds and foreign exchange instruments. Foreign exchange was a relatively new segment for Berkshire and it entered this market in 2003 for the first time as a result of its views on the near term future of the dollar. Buffett pointed out in his discussion of Berkshire's 2004 foreign exchange activity that his view of the dollar's bleak prospects sprang from US trade policies rather than his view of the US economy. Buffet's analysis of the dollar's trajectory proved more variable, with Berkshire recording a loss of $955 million on its foreign exchange positions in 2005.[36]

In 2004, Berkshire began investing in derivatives, despite Buffett's having famously termed some of these "financial weapons of mass destruction" some time earlier. By 2008,. Berkshire was party to 94 derivatives contracts. 54 of these were credit default swaps – instruments that required Berkshire to make payments if certain bonds included in high yield indices defaulted in return for an annual premium. Berkshire had received $3.2 billion of premiums, paid out losses of $472 million, and was potentially liable for losses up to $4.7 billion. The second category of contracts were put options on the four stock indices (the S & P 500 and three foreign indices) with terms of 15-29 years. In return for premiums of $4.5 billion, Berkshire would be required to make payments if, at the expiry of the contract, the index in question fell below the level at which it was when the contract was written. These derivatives were unusual in that Berkshire held all of the money, resulting in no counterparty risk. However, Berkshire's entry into this market came at a price. Accounting rules required that changes in the market value of derivative contracts (unlike other securities) be applied to quarterly earnings, which in Berkshire's case could cause swings in reported earnings that could "could easily amount to up to $1 billion per quarter". Nonetheless Buffett likened Berkshire's approach here to the catastrophic insurance business where it was "willing to trade increased volatility in reported earnings in the short run for greater gains in net worth in the long run."[37]

Blowing Out the Lights

What Makes a Good Investment?

> *If you buy a bond, you know exactly what's going to happen, assuming it's a good bond, a U.S. Government bond.... Now when you buy a business, you're buying something with coupons on it, too, except, the only problem is, they don't print in the amount. And it's my job to print in [to figure out] the amount on the coupon.*[38]
>
> *– Warren Buffett*

Buffett's views on investment strategies had evolved over time and had been inextricably shaped not only by individuals he studied under and worked with, but by market events as well. His remarkable and sustained success over several decades, however, was harder to explain. Indeed, as theories of financial valuation had become more sophisticated over the years, all started with some

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version of what was known as the "efficient markets theory" (EMT). The EMT premised, simply, that "at any moment, all publicly information about a company was reflected in the price of its stock." [39] Furthermore, the market clearing price was the result of transactions between numerous rational buyers and sellers. The implications of this basic logic were profound. For example, since market prices always reflected value, no individual investor could have a sustained edge over others, security analysis was "logically incomplete and valueless," and stock price movements were a "random walk." Moreover, since prices were accurate indicators of value, foreseeable business risks were already incorporated into the price and this risk was quantified by historical volatility.

Buffett, too, maintained that different investors, based on their distinct views and circumstances could value a stock differently. But he firmly believed as well that investors did not always behave "rationally", sometimes factoring other considerations into their buying and selling decisions. Furthermore, Buffett understood risk as the probability that one was "paying more than a business would prove to be worth;" and believed an infinite number of variables could influence this risk. Since it was impossible to assess the risk factors precisely, Buffett looked for companies with tolerable risk levels and some value cushion in case the risks did play out. To those who considered his views on risk as being too simplistic, Buffett often responded with a single question: "If you're so smart, how come I'm so rich?"[40]

Indeed, if price movements were truly random, Buffett's investment record was the result of sheer, blind luck. But Buffett's investment success had been a little too consistent even for his skeptics. MIT Nobel prize economist Paul Samuelson explained that Buffett succeeded because he was "good at figuring out which fundamentals are fundamental and which new data are worth paying high costs to get." Access to this data, he opined, turned managers such as Buffett into superstars who could charge investors high fees (Buffett charged no fees) for their knowledge. Buffett in turn summed up his view of (the extreme version of) EMT in a nutshell:

> Observing correctly that the market was *frequently* efficient, [EMT adherents] went onto conclude incorrectly that it was *always* efficient. The difference between these propositions is night and day.[41]

Buffett's investment strategy had always been driven by a simple objective: try to find stocks whose prices were below their fair value. His rules for investing could be summarized into five principles to which Berkshire adhered. First, Buffett paid no attention to market or macroeconomic trends in evaluating a business. He always focused on the long-term business in the belief that, over the long-term, the market would ultimately efficiently reflect value. Second, Berkshire stuck steadfastly to its "circle of competence,"[42] investing only in sectors and companies that it understood well. Third, Berkshire liked managers with substantial stakes in their companies. If managers were not substantial shareholders when Berkshire made an investment, a condition of Berkshire's purchase would often be that the key managers invest personal capital to buy a stake in the business. Fourth, Buffett always used a company's financial statements to evaluate it; he placed little credence in equity research. The valuation exercise was less about arriving at a precise or correct answer than about developing an educated estimation of value. Last, Buffett believed that a majority of stocks would hold little interest for Berkshire. Buffett aimed to know a limited universe of companies extremely well; and when he pulled the trigger on a Berkshire investment, he bet big.

Berkshire's investment in Coca Cola in 1988 served as a case in point. For the three preceding years, Berkshire did not buy a single stock, seeing no worthwhile opportunities. Apart from being an avid and frequent consumer of the product, Buffett loved the simplicity of Coca-Cola's business model: the brand name was universal and dominant over its next best competitor, Pepsi; its primary business was selling Coke concentrate and syrup to bottlers and soda fountains; and the business

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required relatively little capital.[43] After going through a difficult time during the 1970s and early 80s between investing in unrelated businesses like a Hollywood studio and introducing a new Coke formula that bombed with consumers, a new CEO began refocusing the company. Buffett had recognized the value of the Coke franchise long ago and loved the fact that company had consistently enhanced shareholder value over its long history, with the exception of recent performance. The change in strategy made Coca-Cola a compelling buy for Buffett and Berkshire began accumulating the stock in the fall of 1988. By spring of the following year, Berkshire had invested $1.02 billion[44] – approximately a third of Berkshire's value – to buy 7% of Coca-Cola at an average price of $10.96 per share. At the time, a Wall Street analyst described the stock as "very expensive."[45] By 1991, the value of Berkshire's stake stood at $3.75 billion.

Berkshire's portfolio mix had changed greatly over the years. When Berkshire Hathaway first became an investment vehicle, its portfolio was almost 90% equity investments and 10% operating businesses. This relationship had steadily reversed to the point where in 2004, 90% of Berkshire's assets were in operating businesses and 10% was in the form of securities. **Exhibit 9** and **Exhibit 10** list Berkshire's operating businesses in 2007 and provide summary financial data. This change was attributable to a variety of reasons, the most important of which was the increased number of insurance businesses that Berkshire owned. The greater emphasis on insurance had two implications. First, the size of the float generated by the insurance holdings allowed and indeed, necessitated Berkshire's making larger investments. Second, as Berkshire's insurance business grew and the likelihood of a small number of large claims wiping out the business diminished, it was no longer necessary to own large, liquid stakes in public companies. As liquidity became less of an issue, Berkshire took larger stakes in some of its businesses and in effect, took them private. Over time, Berkshire also tended to pay for purchases with cash rather than stock in order to not dilute Berkshire stockholders.[46]

Compensation

> *Chief Executives talk about 'diversity' but they don't care whether they've got men or women on the board, any of that kinda stuff. They just care about their comp. It's a very uneven balance. Usually in any negotiation people on both sides are dealing with something very real to them. On executive compensation, the CEO, the compensation is very real to him, but to the comp committee, to the directors, it's play money. There's never been such a transfer of wealth in our history. And it's obscene."*[47]
>
> *– Warren Buffett*

Buffett found option compensation problematic: he disliked that option holders were frequently treated like equity holders by companies when in fact only equity holders put capital at risk and that options, once granted, were blind to performance differences between managers. Over the years, he had publicly outlined his views on the ills of options and the failure of companies to account for their cost. He approved of their use in rewarding managers who had delivered consistent and good performance. Still, he preferred managers to own outright stakes in their businesses and Berkshire or Buffett personally would underwrite a loan if a manager needed funds to buy equity. In fact, when Berkshire had bought companies that had issued options as compensation, Berkshire had immediately recognized the cost of the outstanding options by switching to a cash compensation system equivalent in value to the old option system.[48]

Berkshire's incentive compensation system extended to all its key executives. Each CEO was evaluated and paid based on the financial results generated at his company. Berkshire was quick to recognize and reward above average performance and performance was defined distinctly and

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specifically for each business unit based on its underlying economics. Goals were set for each business at the beginning of each year and year-end compensation was determined based on whether these goals had been met. The goals were outlined simply and measured by clear yardsticks related to each manager's daily responsibilities to minimize ambiguity and maintain focus. In addition, performance was rewarded irrespective of the vagaries of Berkshire's stock price and there were no minimums or caps on bonuses. Neither the size of a business nor an individual's place in the hierarchy influenced bonuses – Berkshire was more concerned with profitability and long-term development. Berkshire paid out cash bonuses and managers were free to buy Berkshire stock if they chose.

Berkshire's key performance yardstick was return on capital and it drew a sharp distinction between businesses that were capital intensive and those that weren't. When a business unit required incremental capital, Berkshire charged it a cost of capital depending on the amount of capital already employed at the unit, and credited it for capital when the unit released some. Berkshire used a hurdle cost of capital which managers had to exceed in order to deploy it, and compensated its managers based on how much they exceeded it or underperformed it by.[49] When units did perform well or exceed expectations, Berkshire did not keep raising its performance bar. Buffett preferred achievable goals that were met, rather than unrealistic goals challenging to fulfill.

In compensating himself and Munger, Buffett stood by a ground rule he had laid down in 1956. Buffett wanted Munger and himself to be compensated in a similar fashion to Berkshire shareholders; to this end he had promised that neither Munger nor he would take cash compensation, restricted stock or option grants that would make their results superior to those of shareholders.[50]

Portfolio Companies & Capital Allocation

> *[We] try to buy not only good businesses, but ones run by high-grade, talented and likeable managers. If we make a mistake about the manager we link up with, the controlled company offers a certain advantage because we have the power to effect change. In practice, however, this advantage is somewhat illusory: Management changes, like marital changes, are painful, time-consuming and chancy.*
>
> *– Warren Buffett, Letter to Shareholders, 1987*[51]

One of Berkshire's key investment criteria was company management. Berkshire was not typically interested in turnaround situations that required new management or changes in management structure. Berkshire did not view this as an area that it possessed any particular expertise in. Consequently, Berkshire looked for managers who had founded and/or run their businesses for several years, and had a long-term vision. Berkshire also did not make its investments conditional on particular business decisions. When asked why Berkshire's relationship with the managers of its subsidiaries was so distinct, Buffett explained that it had developed as such because he had taken over a small company at a young age (34), and given that he was in no rush to retire or see his managers retire, he felt "he had enough time to establish momentum."[52]

Berkshire CEOs had remarkably long tenures, and when they did retire, they rarely, if ever, left and got involved with competing businesses, and they retained their Berkshire Hathaway stockholdings. Comparing these managers to executives at large in corporate America was difficult, however, because most of the CEOs were multimillionaires and often, founders, in their own right. When asked about their thoughts on selling their businesses to Berkshire, most of them conceded that they had not thought about selling their businesses before they encountered Buffett and considered Berkshire a different kind of parent from other potential buyers. The CEOs were often people who,

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although they had been in other jobs working for big corporations before setting up their own businesses, wanted to work for themselves and run their businesses as they saw fit. A purchase by Berkshire gave them the ability to continue running their business quite independently, a parent with deep pockets, and liquidity in the form of Berkshire Hathaway stock. They faced none of the obligations of public company CEOs – they faced no equity analysts, press or shareholders, had no capital limitations or expansion requirements, and few Berkshire requirements. And, through Berkshire, they enjoyed financial stability and top credit ratings.[53]

Berkshire did not seek to run any of its portfolio companies. With an extremely small staff at the Omaha headquarters, the onus of managing the individual businesses fell directly and solely on the company managers. Berkshire asked that managers create projections for each upcoming year and inform the parent company if performance was not as expected. As a result, some company CEO's did not talk to Buffett unless they were delivering meaningful news or strategizing with him, while others maintained a regular communication, asking Buffett's advice on myriad matters. Buffett made himself available to his managers as needed, and even spoke to some, such as Ajit Jain at Berkshire Reinsurance, on a daily basis. On the other hand, one CEO had never set foot in Omaha 20 years after his business was bought by Berkshire.

Berkshire's primary expectation was that, at the end of each financial year, operating companies would turn over their excess cash earnings to the parent, or explain their reasons for retaining it to reinvest in the business. Buffett's primary talent after all, was allocating capital to maximize risk-adjusted returns. However, in situations where operating businesses were in need of large amounts of capital investment, as Executive Jet Aviation had been for the last several years, Berkshire made the resources available. After signing off on a strategic decision made by an operating subsidiary, Buffett patiently waited, and gave managers a long leash to allow the strategy to play out, knowing that major strategic initiatives sometimes took longer than initially estimated. Buffett explained Berkshire's approach:

> At Berkshire, our managers will continue to earn extraordinary returns from what appear to be ordinary businesses. As a first step, these managers will look for ways to deploy their earnings advantageously in their businesses. What's left, they will send to Charlie and me. We will try to use those funds in ways that build per-share intrinsic value. Our goal will be to acquire either part or all of businesses that we believe we understand, that have good, sustainable underlying economics, and that are run by managers whom we like, admire and trust.[54]

Corporate Governance and Shareholder Profile

> *One sees him in Omaha, on a spring Sunday morning, the day before Berkshire's annual meeting. An ersatz trolley car, not too different from the one Buffett rode as a boy, is making the rounds of Omaha's hotels, picking up his guests. Buffett is at the front of the trolley. He heartily greets his visitors – the widow of a longtime friend from Wharton, a fellow student of Ben Graham's, the CEO of a company Buffett owns – who step from various pages of his life as from the pages in an album.*
>
> *– Roger Lowenstein*[55]

Where corporate America generally used its shareholder communications to outline changes in chief executives' vision and strategy, Berkshire's shareholder reports and Buffett's letters to shareholders were striking because of their constancy. Year after year, Berkshire outlined its business principles and Buffett stressed the importance of Berkshire's consistency. Since 1993, he had written on a fairly regular basis about corporate governance - a topic that came into popular business

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discourse generally only when there was perceived to be a problem. Buffett spent a great deal of time thinking about governance structures to suit different companies. He believed the governance structure for companies ought to vary based on whether or not they had a controlling shareholder, and whether the shareholder was involved in company management. Furthermore, Buffett believed in parity between ownership stakes and voting rights as a result of which he disliked companies in which owners held voting stakes greater than their equity stakes. A disproportionate voting stake, he believed, skewed management's incentives to treat shareholders unequally.

Buffett also had a strong opinion on the qualities required of a board member. Directors ought to be selected on the basis of achievement in business, their interest in the company in question, and their propensity to hold the interest of shareholders paramount in their decision making.[56] Far too often, in his view, directors were chosen for reasons other than these. In recent years, he felt boards had become socially self-conscious in their functioning. They tended never to question the CEO, and seemed to make CEO compensation decisions on the basis of compensation consultants who had a vested interest in ever-higher levels of CEO pay. This, he felt, had made it difficult to replace CEOs or non-functioning board members. Buffett also wanted regulators to tighten the definition of an "independent" director. Many independent directors were individuals who earned the bulk of their income from various board memberships. Such individuals were frequently seeking additional board memberships which prevented their making difficult decisions that would estrange prospective companies and CEOs who might invite them on to a board. Directors whose board fees were a small percentage of their income had a greater potential to make truly independent decisions.

Berkshire board members were compensated only nominally and were required to buy Berkshire stock as part of their board membership. This was an important distinction as board members who owned stock in the companies whose boards they sat on were generally given that stock or equivalent options as a form of compensation for their service on the board. Buffett and Munger wanted "the behavior of the directors to be driven by the effect their decisions [would] have on their family's net worth, not by their compensation."[57] In 2003, for example, Berkshire's eleven directors each owned Berkshire stock worth at least $4 million, and had held major stakes in the company for many years.[58] None of the shares were restricted and all had been acquired on the open market. Directors shared the upside of the shareholders they represented and in fact, bore some downside risk since Berkshire refused to carry any directors or officers liability insurance. In 2004, Berkshire put in place two governance reforms proposed in the aftermath of the post-bubble vacuum. The first was regular board meetings without the CEO present. The second was a "whistleblower line" a direct channel through which Berkshire employees could communicate with Buffett. **Exhibit 11** lists Berkshire's directors at the end of 2008.

Berkshire had two classes of common stock – Class A and Class B – and Class A stock was convertible into 30 shares of Class B. Berkshire shareholders were an unusual group. Most were long-term holders of the stock and, in many cases, their Berkshire position made up a large portion of their net worth. In keeping with this principle, Buffett and Munger stated they had 99% and 90% of their family's net worth, respectively, invested in Berkshire stock.[59] And Buffett believed that he, as the Chairman and CEO of Berkshire, was obligated to communicate directly with the shareholders about his views on the present and future of the business. As part of this communication, Buffett wrote a letter to shareholders accompanying the annual report. Buffett strived to provide the same degree of clarity to shareholders as he expected operating divisions to provide their parent company. In certain years, Buffett had opined that Berkshire stock was overvalued or that despite recent patterns of exemplary performance, the future was likely to bring periods of underperformance.

Buffett tracked his shareholders carefully so he always knew who was buying, selling, or holding on. He also tended to remember how long his shareholders had held the stock. Berkshire

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shareholders knew and admired this quality of Buffett's – a loyalty *towards* them that engendered a reciprocal loyalty *from* them. Shareholders admitted that there was a "Buffett premium" attached to Berkshire stock because of the "vested interest in Warren's good health." All Buffett would say about his age, only partly in jest, was that he aimed to become the oldest man in the country, having already become the richest. **Exhibit 12** lists Berkshire's top 20 shareholders.

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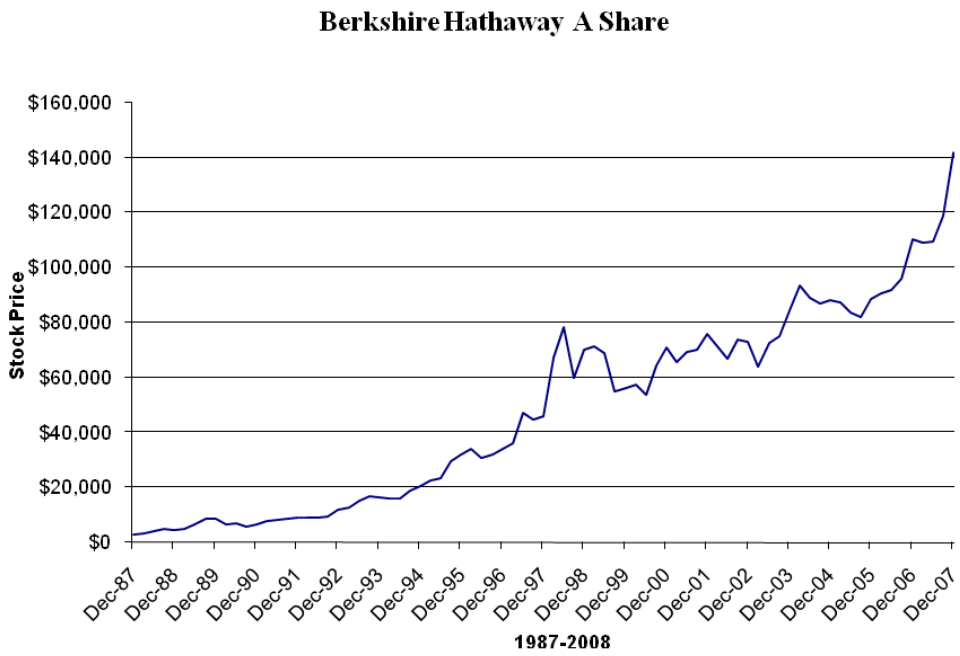
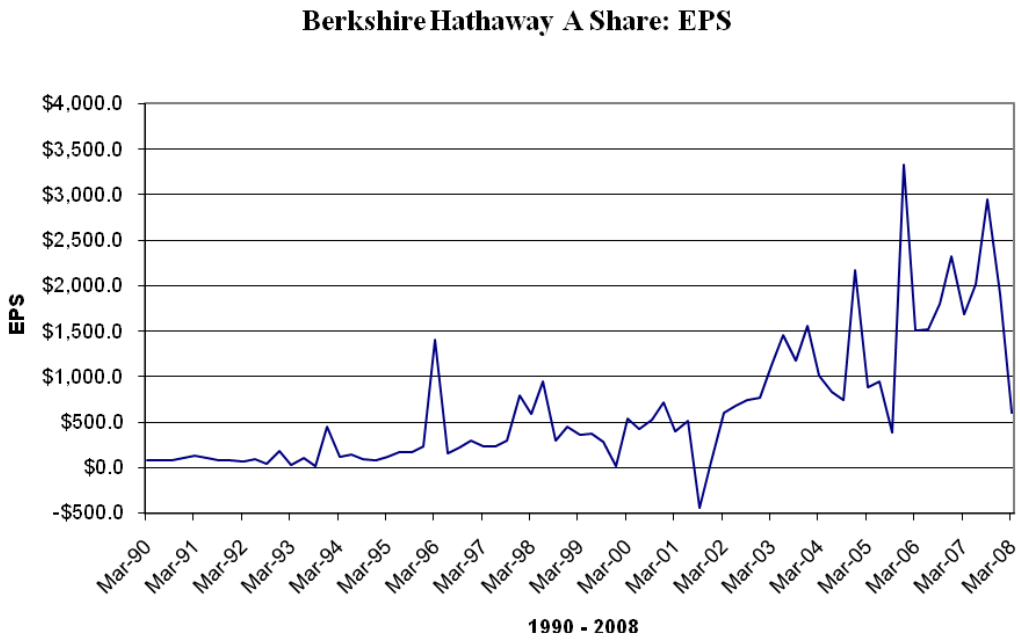
Exhibit 1a Berkshire Hathaway Stock Price 1987-2008



Source: Bloomberg LP, accessed August 2008.

Exhibit 1b Berkshire Hathaway EPS 1990-2007



Source: Bloomberg LP, accessed August 2008.

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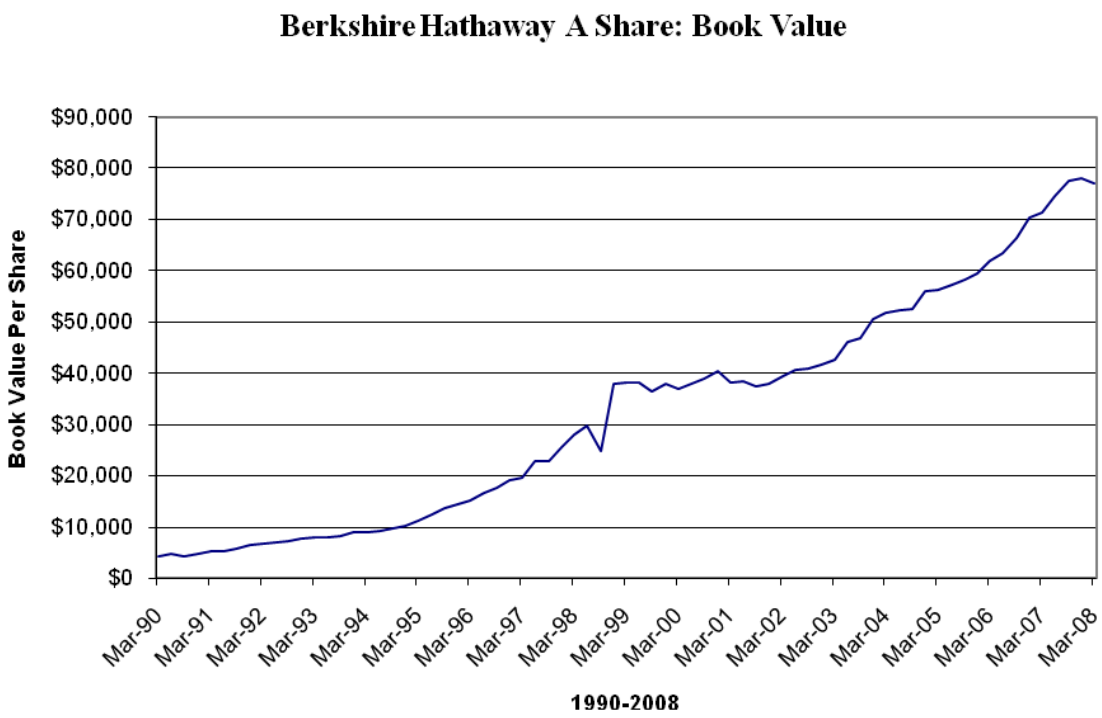
Exhibit 1c Berkshire Hathaway Book Value per Share 1990-2008



Source: Bloomberg LP, accessed August 2008.

Exhibit 2 Berkshire Hathaway Investments & Pretax Earnings 1965-2005

Year	Per Share Investments	Per Share Pretax Earnings
1965	$ 4	$ 4
1979	$ 577	$ 18
1993	$ 13,961	$ 12
2007	$ 90,343	$ 4,093
CAGR 1965-1979	42.8%	11.1%
CAGR 1979-1993	25.6%	19.1%
CAGR 1993-2007	14.3%	23.5%

Note: Per Share Pretax Earnings are for non-insurance businesses Per Share Investments and Per Share Pretax Earnings are both net of minority interests

Source: Berkshire Hathaway Annual Report 2007.

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Exhibit 3 Berkshire Hathaway Acquisition History

Year	Transaction
1954	Berkshire Hathaway formed
1967	Buffett begins managing Berkshire Hathaway
1972	See's Candies acquired for $25 million cash
1973	15% of The Washington Post acquired for $11 million cash
1976	GEICO stake acquired for cash
1977	Buffalo News acquired for $34 million cash
1983	80% of Nebraska Furniture Mart acquired for $55 million cash
1985	Berkshire Hathaway textile business discontinued
1986	Scott Fetzer acquired for $315 million cash
1989	Borsheim's Jewelry acquired for cash
1991	H. H. Brown Shoes acquired for cash
1992	Lowell Shoe acquired
1993	Dexter Shoe acquired for $420 million
1995	Helzberg Diamonds acquired
	and R.C. Wiley Home Furnishings acquired
1996	Balance of GEICO acquired for $2.3 billion
	Flight Safety acquired for $1.5 billion cash
1997	Star Furniture acquired
1998	Executive Jet acquired for $725 million
1999	Jordan's Furniture acquired for cash and
	General Re acquired
2000	Acme Brick acquired for cash
	76% of MidAmerican Energy acquired
	CORT Busines Services for $386 million cash
	US Liability acquired for half cash, half stock
	Ben Bridge Jeweler acquired
	87% of Shaw Industries acquired
	Justin Boot acquired for $570 million cash
2001	XTRA acquired
	Larson-Juhl acquired
	Fruit of the Loom acquired
2002	The Pampered Chef acquired
2003	Clayton Homes acquired
	McLane acquired
2004	Medical Protective Company
	Forest River acquired
	Business Wire acquired
2005	81% of Applied Underwriters acquired
2006	Pacific Corp acquired
	80% Iscar Metalworking Companies acquired for $4 billion cash
2007	TTI acquired
	60% of Marmon Group acquired for $4.5 billion in cash

Note: This does not include add on acquisitions made by individual business units

Source: Compiled from Robert P. Miles, *The Warren Buffett CEO: Secrets of the Berkshire Hathaway Managers*, (New York: John Wiley & Sons, Inc., 2002) and Berkshire Hathaway Annual Reports.

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Exhibit 4 Berkshire Hathaway Acquisition Criteria

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

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

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

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer -- customarily within 5 minutes -- as to whether we are interested. We prefer to buy for cash but will consider issuing stock when we receive as much in intrinsic business value as we give. We don't participate in auctions.

Source: Berkshire Hathaway Annual Report 2007.

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Exhibit 5 Lou Simpson's Investment Returns 1980-2007

Year	GEICO Equities	Returns on: S&P	Comparison
1980	23.7%	32.3%	-8.6%
1981	5.4%	-5.0%	10.4%
1982	45.8%	21.4%	24.4%
1983	36.0%	22.4%	13.6%
1984	21.8%	6.1%	15.7%
1985	45.8%	31.6%	14.2%
1986	38.7%	18.6%	20.1%
1987	-10.0%	5.1%	-15.1%
1988	30.0%	16.6%	13.4%
1989	36.1%	31.7%	4.4%
1990	-9.9%	-3.1%	-6.8%
1991	56.5%	30.5%	26.0%
1992	10.8%	7.6%	3.2%
1993	4.6%	10.1%	-5.5%
1994	13.4%	1.3%	12.1%
1995	39.8%	37.6%	2.2%
1996	29.2%	23.0%	6.2%
1997	24.6%	33.4%	-8.8%
1998	18.6%	28.6%	-10.0%
1999	7.2%	21.0%	-13.8%
2000	20.9%	-9.1%	30.0%
2001	5.2%	-11.9%	17.1%
2002	-8.1%	-22.1%	14.0%
2003	38.3%	28.7%	9.6%
2004	16.9%	10.9%	6.0%
Average Annual Gain 1980-2004	21.7%	14.7%	7.0%
Average Annual Gain in BH Report	20.3%	13.5%	6.8%

Source: Berkshire Hathaway Annual Report 2004.

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Exhibit 6 Berkshire Hathaway Insurance: Underwriting Profit & Float

($ millions)	Underwriting Profit (Loss)		Year End Float	
Insurance Operations	**2007**	**2006**	**2007**	**2006**
General RE	$ 555	$ 526	$ 23,009	$ 22,827
B-H Reinsurance	$ 1,427	$ 1,658	$ 23,692	$ 16,860
GEICO	$ 1,113	$ 1,314	$ 7,768	$ 7,171
Other Primary	$ 279	$ 340	$ 4,229	$ 4,029
Total	$ 3,374	$ 3,838	$ 58,698	$ 50,887

Source: Berkshire Hathaway Annual Report 2007.

Exhibit 7 Berkshire Hathaway Manufacturing & Service Businesses

($ millions)	Pretax Earnings	
Business Area	**2005**	**2004**
Building Products	$ 751	$ 643
Shaw Industries	$ 485	$ 466
Apparel & Footwear	$ 348	$ 325
Retail of Jewelry, etc.	$ 257	$ 215
Flight Services	$ 120	$ 191
McLane	$ 217	$ 228
Other Businesses	$ 445	$ 413
Total	$ 2,623	$ 2,481

Source: Berkshire Hathaway Annual Report 2005.

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Exhibit 8 Berkshire Hathaway Equity Investments 1997-2007 (in $ millions)

1997			2002			2007		
Company	Cost	Market	Company	Cost	Market	Company	Cost	Market
American Express	$ 1,393	$ 4,414	American Express	$ 1,470	$ 5,359	American Express	$ 1,287	$ 7,887
Coca-Cola	$ 1,299	$ 13,376	Coca-Cola	$ 1,299	$ 8,769	Anheuser-Busch	$ 1,718	$ 1,861
Freddie Mac	$ 329	$ 2,683	Gillette	$ 600	$ 2,915	Burlington Northern Santa Fe	$ 4,731	$ 5,063
Gillette	$ 600	$ 4,821	H&R Block	$ 255	$ 643	Coca-Cola	$ 1,299	$ 12,274
Travelers Group	$ 604	$ 1,279	M&T Bank	$ 103	$ 532	Conoco Philips	$ 1,039	$ 1,546
Walt Disney	$ 381	$ 2,135	Moody's Corporation	$ 499	$ 991	Johnson & Johnson	$ 3,943	$ 4,287
Washington Post	$ 11	$ 841	Washington Post	$ 11	$ 1,275	Kraft Foods	$ 4,152	$ 4,059
Wells Fargo	$ 413	$ 2,271	Wells Fargo	$ 306	$ 2,497	Moody's Corporation	$ 499	$ 1,714
Others	$ 2,177	$ 4,467	Others	$ 4,621	$ 5,383	POSCO	$ 572	$ 2,136
Total	$ 7,207	$ 36,286	Total	$ 9,164	$ 28,364	Procter and Gamble	$ 1,030	$ 7,450
						Sanofi-Aventis	$ 1,466	$ 1,575
						Tesco plc	$ 1,326	$ 2,156
						U.S. Bancorp	$ 2,417	$ 2,386
						USG Corp	$ 536	$ 611
						Wal-Mart	$ 942	$ 948
						Washington Post	$ 11	$ 1,367
						Wells Fargo	$ 6,677	$ 9,160
						White Mountains Insurance	$ 369	$ 886
						Others	$ 5,238	$ 7,633
						Total	$ 39,252	$ 74,999

Source: Berkshire Hathaway Annual Reports, 1997, 2002 and 2007.

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Exhibit 9 Berkshire Hathaway Business Segment Data (in $ millions)

	2007		2006		2005	
Operating Business:	**Revenues**	**EBIT**	**Revenues**	**EBIT**	**Revenues**	**EBIT**
Insurance Group:						
GEICO Premiums	$ 11,806	$ 1,113	$ 11,055	$ 1,314	$ 10,101	$ 1,221
General Re Premiums	$ 6,076	$ 555	$ 6,075	$ 526	$ 6,435	$ (334)
Berkshire Reinsurance Premiums	$ 11,902	$ 1,427	$ 4,976	$ 1,658	$ 3,963	$ (1,069)
Berkshire Primary Premiums	$ 1,999	$ 279	$ 1,858	$ 340	$ 1,498	$ 235
Investment Income	$ 4,791	$ 4,758	$ 4,347	$ 4,316	$ 3,501	$ 3,480
Total Insurance Group	$ 36,574	$ 8,132	$ 28,311	$ 8,154	$ 25,498	$ 3,533
Finance & Financial Products	$ 5,119	$ 1,006	$ 5,124	$ 1,157	$ 4,559	$ 822
McLane Company	$ 28,079	$ 232	$ 25,693	$ 229	$ 24,074	$ 217
MidAmerican	$ 12,628	$ 1,774	$ 10,644	$ 1,476	$ -	$ -
Shaw Industries	$ 5,373	$ 436	$ 5,834	$ 594	$ 5,723	$ 485
Other Businesses	$ 25,648	$ 3,279	$ 21,133	$ 2,703	$ 17,099	$ 1,921
Total	$ 113,421	$ 14,859	$ 96,739	$ 14,313	$ 76,953	$ 6,978

Source: Berkshire Hathaway Annual Report 2007.

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Exhibit 10 Berkshire Hathaway Operating Companies

	Company	Employees		Company	Employees
1	Acme Building Brands	2,521	36	Kern River Gas Transmission	163
2	Adalet	248	37	Kingston	194
3	Altaquip	338	38	Kirby	646
4	Ben Bridge Jeweler	456	39	Larson-Juhl	1,862
5	Benjamin Moore	2,625	40	McLane	16,356
6	Berkshire Hathaway Homestate	650	41	Medical Protective Corp	414
7	Berkshire Hathaway Reinsurance	633	42	MidAmerican Energy	3,156
8	Borsheim's Jewelry	204	43	MidAmerican Energy Holdings	653
9	The Buffalo News	822	44	MiTek	1,575
10	CalEnergy	323	45	National Indemnity Group	389
11	Campbell Hausfeld	565	46	Nebraska Furniture Mart	2,571
12	Carefree of Colorado	249	47	NetJets	7,297
13	Central States Indemnity	426	48	Northern Natural Gas	889
14	Clayton Homes	14,288	49	Northern & Yorkshire Electric	2,398
15	Cleveland Wood Products	88	50	Northland	132
16	CORT Business Services	2,494	51	Pacific Corp	3,203
17	CTB International	1,450	52	Pacific Power	1,171
18	Dairy Queen	2,379	53	The Pampered Chef	808
19	Dougles/Quikut	64	54	Precision Steel Warehouse	197
20	Fechheimer Brothers	911	55	Richline Group	2,221
21	FlightSafety International	4,218	56	Rocky Mountain Power	2,096
22	Forest River Inc	5,282	57	Russell Corporation	13,694
23	France	117	58	Other Scott Fetzer Cos	150
24	Fruit of the Loom	26,643	59	See's Candies	3,000
25	Garan	4,403	60	Shaw Industries	30,874
26	GEICO	22,354	61	Stahl	271
27	General Re	2,647	62	Star Furniture	742
28	H. H. Brown Shoe Group	1,073	63	TTI, Inc	2,576
29	Halex	118	64	United Consumer Finance	211
30	Helzberg's Diamond Shops	2,170	65	Vanity Fair Brands	6,679
31	HomeServices of America	3,194	66	United States Liability Insurance	484
32	Iscar	7,198	67	Wayne Water Systems	148
33	Johns Manville	6,437	68	Wesco Financial	13
34	Jordan's Furniture	1,267	69	Western Enterprises	385
34	Justin Brands	911	70	R. C. Wiley Home Furnishings	2,841
35	The Kansas Bankers Surety	18	71	World Book	195
			72	XTRA	640
	Total Operating Company Employees				***231,078***
	Corporate Office Employees				***19***
	Total Employees				***231,097***

Source: Berkshire Hathaway Annual Report 2007.

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Exhibit 11 Berkshire Hathaway Board of Directors, 2008

1. Warren E. Buffett, Chairman and CEO of Berkshire
2. Charles T. Munger, Vice Chairman of Berkshire
3. Howard G. Buffett, President of Buffett Farms
4. Susan L. Decker, President of Yahoo! Inc.
5. William H. Gates III, Chairman of the Board of Directors of Microsoft Corp.
6. David S. Gottesman, Senior Managing Director of First Manhattan Co.
7. Charlotte Guyman, Chairman of Finance Committee of the Board of Directors of UW Medicine
8. Donald R. Keough, Chairman of Allen & Company Inc.
9. Thomas H. Murphy, Former Chairman of the Board and CEO of Capital Cities/ ABC
10. Ronald L. Olson, Partner of the law firm of Munger, Tolles & Olson LLP
11. Walter Scott, Jr., Chairman of Level 3 Communications

Source: Berkshire Hathaway Annual Report 2007.

Exhibit 12 Berkshire Hathaway Top 20 Shareholders

	Stockholder	Type	Stake
1	Buffett (Warren)	Individual Investor	32.41%
2	Fidelity Management & Research	Investment Advisor	2.45%
3	Capital World Investors	Investment Advisor	2.12%
4	First Manhattan Company	Investment Advisor	2.10%
5	Ruane, Cunniff & Goldfarb, Inc.	Investment Advisor	1.94%
6	Gottesman (David S)	Individual Investor	1.90%
7	Davis Selected Advisers, L.P.	Investment Advisor	1.90%
8	Munger (Charles T)	Individual Investor	1.41%
9	Capital Research Global Investors	Investment Advisor	1.23%
10	Barclays Global Investors, N.A.	Investment Advisor	0.89%
11	Fairholme Capital Management, L.L.C.	Investment Advisor	0.88%
12	California Public Employees' Retirement System	Pension Fund	0.57%
13	Arnhold and S. Bleichroeder Advisers, LLC	Investment Advisor/Hedge Fund	0.47%
14	Cascade Investment, L.L.C.	Investment Advisor	0.40%
15	ClearBridge Advisors	Investment Advisor	0.39%
16	Franklin Mutual Advisers, LLC	Investment Advisor/Hedge Fund	0.37%
17	Gardner Russo & Gardner	Investment Advisor/Hedge Fund	0.33%
18	BNY Mellon Wealth Management	Investment Advisor	0.30%
19	Renaissance Technologies Corp.	Hedge Fund	0.29%
20	PNC Wealth Management	Investment Advisor	0.27%
Top 20 Holders			***52.62%***

Source: Thomson Research, accessed August 2008.

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