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BERKSHIRE HATHAWAY INC.

1974

ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.

1974 Annual Report to the Stockholders

BUSINESS OF THE COMPANY

The Company is engaged in the manufacture and sale of woven textiles in the United States and through a subsidiary in the sale of textile products in Canada. Through subsidiaries collectively referred to in this annual report as the Insurance Group, the Company is engaged in the underwriting of fire and casualty insurance throughout the United States. The Company owns approximately 98% of The Illinois National Bank & Trust Co. of Rockford, Illinois which is engaged in the commercial banking business. The company and subsidiary members of the Insurance Group have significant holdings in Blue Chip Stamps, a California corporation – the businesses of which are more fully described herein.

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Berkshire Hathaway Inc.

To the Stockholders of
Berkshire Hathaway Inc.:

Operating results for 1974 overall were unsatisfactory due to the poor performance of our insurance business. In last year's annual report some decline in profitability was predicted but the extent of this decline, which accelerated during the year, was a surprise. Operating earnings for 1974 were $8,383,576, or $8.56 per share, for a return on beginning shareholders' equity of 10.3%. This is the lowest return on equity realized since 1970. Our textile division and our bank both performed very well, turning in improved results against the already good figures of 1973. However, insurance underwriting, which has been mentioned in the last several annual reports as running at levels of unsustainable profitability, turned dramatically worse as the year progressed.

The outlook for 1975 is not encouraging. We undoubtedly will have sharply negative comparisons in our textile operation and probably a moderate decline in banking earnings. Insurance underwriting is a large question mark at this time – it certainly won't be a satisfactory year in this area, and could be an extremely poor one. Prospects are reasonably good for an improvement in both insurance investment income and our equity in earnings of Blue Chip Stamps. During this period we plan to continue to build financial strength and liquidity, preparing for the time when insurance rates become adequate and we can once again aggressively pursue opportunities for growth in this area.

Textile Operations

During the first nine months of 1974 textile demand was exceptionally strong, resulting in very firm prices. However, in the fourth quarter significant weaknesses began to appear, which have continued into 1975.

We currently are operating at about one-third of capacity. Obviously, at such levels operating losses must result. As shipments have fallen, we continuously have adjusted our level of operations downward so as to avoid building inventory.

Our products are largely in the curtain goods area. During a period of consumer uncertainty, curtains may well be high on the list of deferrable purchases. Very low levels of housing starts also serve to dampen demand. In addition, retailers have been pressing to cut inventories generally, and we probably are feeling some effect from these efforts. These negative trends should reverse in due course, and we are attempting to minimize losses until that time comes.

Insurance Underwriting

In the last few years we consistently have commented on the unusual profitability in insurance underwriting. This seemed certain eventually to attract unintelligent competition with consequent inadequate rates. It also has been apparent that many insurance organizations, major as well as minor, have been guilty of significant underreserving of losses, which inevitably produces faulty information as to the true cost of the product being sold. In 1974, these factors, along with a high rate of inflation, combined to produce a rapid erosion in underwriting results.

The costs of the product we deliver (auto repair, medical payments, compensation benefits, etc.) are increasing at a rate we estimate to be in the area of 1% per month. Of course, this increase doesn't proceed in an even flow but, inexorably, inflation grinds very heavily at the repair services – to humans and to property – that we provide. However, rates virtually have been unchanged in the property and casualty field for the last few years. With costs moving forward rapidly and prices remaining unchanged, it was not hard to predict what would happen to profit margins.

Best's, the authoritative voice of the insurance industry, estimates that in 1974 all auto insurance premiums in the United States increased only about 2%. Such a growth in the pool of dollars available to pay insured losses and expenses was woefully inadequate. Obviously, medical costs applicable to people injured during the year, jury awards for pain and suffering, and body shop charges for repairing damaged cars increased at a dramatically greater rate during the year. Since premiums represent the sales dollar and the latter items represent the cost of goods sold, profit margins turned sharply negative.

As this report is being written, such deterioration continues. Loss reserves for many giant companies still appear to be understated by significant amounts, which means that these competitors continue to underestimate their true costs. Not only must rates be increased sufficiently to match the month-by-month increase in cost levels, but the existing expense-revenue gap must be overcome. At this time it appears that insurors must experience even more devastating underwriting results before they take appropriate pricing action.

All major areas of insurance operations, except for the "home state" companies, experienced significantly poorer results for the year.

The direct business of National Indemnity Company, our largest area of insurance activity, produced an underwriting loss of approximately 4% after several years of high profitability. Volume increased somewhat, but we are not encouraging such increases until rates are more adequate. At some point in the cycle, after major insurance companies have had their fill of red ink, history indicates that we will experience an inflow of business at compensatory rates. This operation, headed by Phil Liesche, a most able underwriter, is staffed by highly profit-oriented people and we believe it will provide excellent earnings in most future years, as it has in the past.

Intense competition in the reinsurance business has produced major losses for practically every company operating in the area. We have been no exception. Our underwriting loss was something over 12% – a horrendous figure, but probably little different from the average of the industry. What is even more frightening is that, while about the usual number of insurance catastrophes occurred during 1974, there really was no "super disaster" which might have accounted for the poor figures of the industry. Rather, a condition of inadequate rates prevails, particularly in the casualty area where we have significant exposure. Our reinsurance department is run by George Young, an exceptionally competent and hard-working manager. He has cancelled a great many contracts where prices are totally inadequate, and is making no attempt to increase volume except in areas where premiums are commensurate with risk. Based upon present rate levels, it seems highly unlikely that the reinsurance industry generally, or we, specifically, will have a profitable year in 1975.

Our "home state" companies, under the leadership of John Ringwalt, made good progress in 1974. We appear to be developing a sound agency group, capable of producing business with acceptable loss ratios. Our expense ratios still are much too high, but will come down as the operation develops into units of economic size. The Texas problem which was commented upon in last year's report seems to be improving. We consider the "home state" operation one of our more promising areas for the future.

Our efforts to expand Home and Automobile Insurance Company into Florida proved disastrous. The underwriting loss from operations in that market will come to over $2 million, a very large portion of which was realized in 1974. We made the decision to drop out of the Florida market in the middle of 1974, but losses in substantial amounts have continued since that time because of the term nature of insurance contracts, as well as adverse development on outstanding claims. We can't blame external insurance industry conditions for this mistake. In retrospect, it is apparent that our management simply did not have the underwriting information and the pricing knowledge necessary to be operating in the area. In Cook County, where Home and Auto's volume traditionally has been concentrated, evidence also became quite clear during 1974 that rates were inadequate. Therefore, rates were increased during the middle of the year but competition did not follow; consequently, our volume has dropped significantly in this area as competitors take business from us at prices that we regard as totally unrealistic.

While the tone of this section is pessimistic as to 1974 and 1975, we consider the insurance business to be inherently attractive. Our overall return on capital employed in this area – even including the poor results of 1974 – remains high. We have made every effort to be realistic in the calculation of loss and expense reserves. Many of our competitors are in a substantially weakened financial position, and our strong capital picture leaves us prepared to grow significantly when conditions become right.

Insurance Investment Results

Investment funds generated from the operation of our insurance companies continued to grow during 1974. Investment income grew correspondingly, and produced overall profitability for the insurance group despite the poor underwriting results. As the insurance group balance sheet shows, we have increased liquidity substantially. This trend has continued since yearend. With poor underwriting and with generally weakened capital ratios throughout the insurance industry, such a higher level of liquidity is appropriate and comforting. It eliminates the possible temptation to write business at any price, simply to maintain cash flow, which is a major problem faced by many companies.

Several comments regarding market value of securities may be appropriate. Between the insurance group and the bank, we have approximately $140 million invested in bonds. About $20 million of this investment is in very short-term Treasury securities or commercial paper, neither of which is subject to other than negligible market fluctuation. This leaves about $120 million in bonds of longer maturities, with a very large percentage of this sum in municipal bonds with an average maturity of perhaps twelve to fifteen years. Because of our large liquid position and inherent operating characteristics of our financial businesses, it is quite unlikely that we will be required to sell any quantity of such bonds under disadvantageous conditions. Rather, it is our expectation that these bonds either will be held to maturity or sold at times believed to be advantageous.

However, on any given day the market value of our bond portfolio is determined by yields available on comparable securities. Such market values can swing dramatically. For example, during 1974 a leading index of high-grade municipals increased in yield from a level of 5.18% at the beginning of the year to 7.08% at the end of the year. In the bond market, each 1/100 of 1% change in yield is referred to as a "basis point" and thus, a change of 1% in interest levels is referred to as 100 basis points. As measured by the index, bond yields increased 190 basis points during 1974. On a fifteen-year bond, an increase of 10 basis points translates to about a 1% downward change in market value. On $120 million of such bonds, it is therefore clear that a change of 10 basis points in yields (which easily can happen in one day) changes the market value of our bond portfolio by something over $1 million. Thus, in 1974 our bond portfolio, which probably had a market value roughly approximating its carrying value at the start of the year, had a market value substantially below carrying value at the end of the year. The market value of our bond portfolio will continue to move in both directions in response to changes in the general level of yields but we do not consider such movements, and the unrealized gains and losses that they produce, to be of great importance as long as adequate liquidity is maintained.

Our stock portfolio declined again in 1974 – along with most equity portfolios – to the point that at yearend it was worth approximately $17 million less than its carrying value. Again, we are under no pressure to sell such securities except at times that we deem advantageous and it is our belief that, over a period of years, the overall portfolio will prove to be worth more than its cost. A net capital loss was realized in 1974, and very likely again will occur in 1975. However, we consider several of our major holdings to have great potential for significantly increased values in future years, and therefore feel quite comfortable with our stock portfolio. At this writing, market depreciation of the portfolio has been reduced by more than half from yearend figures, reflecting higher general stock market levels.

Banking Operations

There is little new to say about Illinois National Bank and Trust. With Eugene Abegg running the operation, the exceptional has become the commonplace. Year after year he continues to run one of the most profitable banks in the United States, while paying maximum interest rates to depositors, operating with unusual levels of liquidity, and maintaining a superior level of loan quality.

Two factors specifically should be noted in looking at the separate income statement of the bank. The effect of filing a consolidated tax return is reflected in their figures, with the tax loss of the insurance operations used to offset the tax liability created by banking operations. Also, a property tax formerly paid by the bank now is assessed to the parent company and is reflected in corporate selling and

administrative expense. Because of accruals, this had a double effect at both the bank and corporate level in 1974.

Under present money market conditions, we expect bank earnings to be down somewhat in 1975 although we believe they still are likely to compare favorably with those of practically any banking institution in the country.

Blue Chip Stamps

During 1974 we increased our holdings of Blue Chip Stamps to approximately 25½% of the outstanding shares of that company. Overall, we are quite happy about the results of Blue Chip and its prospects for the future. Stamp sales continue at a greatly reduced level, but the Blue Chip management has done an excellent job of adjusting operating costs. The See's Candy Shops, Inc. subsidiary had an outstanding year, and has excellent prospects for the future.

Your Chairman is on the Board of Directors of Blue Chip Stamps, as well as Wesco Financial Corporation, a 64% owned subsidiary, and is Chairman of the Board of See's Candy Shops, Inc. We expect Blue Chip Stamps to be a source of continued substantial earning power for Berkshire Hathaway Inc.

The annual report of Blue Chip Stamps, which will contain financial statements for the year ended March 1, 1975 audited by Price, Waterhouse and Company, will be available in early May. Any shareholder of Berkshire Hathaway Inc. who desires an annual report of Blue Chip Stamps may obtain it at that time by writing Mr. Robert H. Bird, Secretary, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Merger with Diversified Retailing Company, Inc.

As you previously have been informed, the proposed merger with Diversified Retailing Company, Inc. was terminated by the respective Boards of Directors on January 28, 1975. We continue to view such a merger as eventually desirable, and hope to reopen the subject at some future time.

Warren E. Buffett,
Chairman of the Board

March 31, 1975

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
KIEWIT PLAZA
OMAHA, NEBRASKA 68131

The Board of Directors and Stockholders
Berkshire Hathaway Inc.:

We have examined the consolidated balance sheets of Berkshire Hathaway Inc. and consolidated subsidiaries as of December 28, 1974 and December 29, 1973, the statements of assets and liabilities of the Berkshire Hathaway Inc. - Insurance Group as of December 31, 1974 and 1973, and the related consolidated statements of earnings and retained earnings and changes in financial position of Berkshire Hathaway Inc. for the 52 weeks ended December 28, 1974 and December 29, 1973 and the statements of income and realized investment gains (losses), paid-in and unassigned surplus and changes in financial position of the Berkshire Hathaway Inc. - Insurance Group for the years ended December 31, 1974 and 1973. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances except as stated in the following paragraph.

Blue Chip Stamps, an investee of Berkshire Hathaway Inc., as described in note 4 to consolidated financial statements, was examined by other auditors for its most recent fiscal year ended March 2, 1974. Unaudited earnings of Blue Chip Stamps for the nine months ended November 30, 1974 was the basis in part for the amount of equity in earnings of Blue Chip Stamps recorded by Berkshire Hathaway Inc. Under the terms of our engagement, we did not examine evidence in support of the unaudited earnings and accordingly do not express an opinion as to the equity of $1,052,000 in earnings of Blue Chip Stamps for 1974.

In our opinion, except for the effect of the matter referred to in the preceding paragraph, the aforementioned consolidated financial statements present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries at December 28, 1974 and December 29, 1973 and the Berkshire Hathaway Inc. Insurance Group at December 31, 1974 and 1973 and the results of their operations and the changes in their financial position for the respective years then ended in accordance with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of January 1, 1973 in the method of determining inventory valuations, as described in note 7 to consolidated financial statements.

Peat, Marwick, Mitchell & Co.

March 14, 1975

Berkshire Hathaway Inc.
AND
CONSOLIDATED SUBSIDIARIES

Financial Statements
1974 and 1973

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	Dec. 28, 1974	Dec. 29, 1973
Cash	$ 4,230,559	$ 2,885,645
Investments:		
U. S. Treasury Bills and other short-term obligations, at cost which approximates market	11,108,163	1,400,435
Bonds, at amortized cost (notes 2 and 3)	71,530,651	73,074,026
Preferred stocks, at cost – market, 1974 – $1,842,817; 1973 – $2,186,960 (note 3)	2,855,185	2,298,348
Common stocks of unaffiliated companies, at cost – market, 1974 – $34,802,358; 1973 – $37,344,291 (note 3)	50,669,865	49,756,778
Common stock of Blue Chip Stamps (note 4)	16,923,998	13,717,274
Unconsolidated bank subsidiary (note 5)	22,416,879	21,003,034
Other unconsolidated subsidiaries (note 5)	1,187,333	1,333,832
Recoverable Federal income taxes	2,800,734	–
Accounts receivable from customers, agents and others, net (note 6)	17,891,227	14,056,574
Inventories (note 7)	5,999,552	7,136,676
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (note 8)	3,913,473	3,668,005
Deferred insurance premium acquisition costs	4,400,000	5,240,000
Other assets	285,954	560,987
	$216,213,573	$196,131,614

LIABILITIES AND STOCKHOLDERS' EQUITY		
Losses and loss adjustment expenses	$ 72,761,097	$ 61,675,768
Unearned premiums	21,704,867	21,281,980
Funds held under reinsurance treaties	2,857,284	1,318,205
Amounts due for purchase of securities	294,101	459,609
Accounts payable and accrued expenses	4,435,325	4,726,609
Income taxes:		
Current	163,809	262,357
Deferred	3,043,800	3,297,368
7½% debentures due 1987 (note 9)	555,780	598,540
8% promissory note due 1988 (note 10)	1,274,437	–
8% senior notes due 1993 (note 11)	20,000,000	20,000,000
Excess of net assets of consolidated subsidiaries over cost of investment	579,070	579,070
Other liabilities	345,376	776,642
	128,014,946	114,976,148
Stockholders' equity:		
Common stock of $5 par value. Authorized 1,100,000 shares; issued and outstanding, 979,569 shares	4,897,845	4,897,845
Retained earnings (note 11)	83,300,782	76,257,621
Total stockholders' equity	88,198,627	81,155,466
Commitment (note 13)		
	$216,213,573	$196,131,614

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

	52 weeks ended	
	Dec. 28, 1974	Dec. 29, 1973
Income items:		
Insurance premiums earned	$ 60,573,729	$ 52,929,257
Net sales of textile products	32,591,874	33,410,551
Interest and dividend income	8,029,876	7,378,109
Real estate income	286,307	287,017
	101,481,786	94,004,934
Cost and expense items:		
Insurance losses and loss adjustment expenses	47,119,846	32,835,798
Cost of textile products sold	27,429,277	28,305,725
Insurance underwriting expenses	20,345,744	16,774,167
Selling, administrative and other expenses	3,640,720	3,363,223
Interest expense	1,717,944	1,606,313
	100,253,531	82,885,226
Earnings from insurance underwriting and manufacturing operations before applicable income taxes	1,228,255	11,119,708
Income taxes (credit) applicable to operating earnings (note 12)	(2,010,321)	2,979,016
Earnings before equity in net earnings of other companies and realized investment gains (losses)	3,238,576	8,140,692
Equity in net earnings of bank subsidiary	4,093,000	2,781,900
Equity in net earnings of Blue Chip Stamps	1,052,000	1,008,000
Earnings before realized investment gains (losses)	8,383,576	11,930,592
Realized investment gains (losses)	(1,908,093)	1,331,550
Applicable income taxes (credit)	(567,678)	401,699
Net realized investment gains (losses)	(1,340,415)	929,851
In the absence of operating or investment reasons compelling liquidation, it is inappropriate to reflect in income temporary fluctuations in market values of long-term equity investments. Consequently, investment results exclude unrealized market decreases in investments in preferred and common stocks of unaffiliated companies of $4,356,000 in 1974 and $13,741,000 in 1973 (note 3).		
Net earnings	7,043,161	12,860,443
Retained earnings at beginning of year	76,257,621	64,024,663
Excess of cost over par value of treasury stock retired in 1973	–	(627,485)
Retained earnings at end of year	$ 83,300,782	$ 76,257,621
Earnings per share of common stock, based on 979,569 shares outstanding:		
Earnings before realized investment gains (losses)	$ 8.56	$12.18
Realized investment gains (losses)	(1.37)	.95
Net earnings	$ 7.19	$13.13

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	52 weeks ended	
	Dec. 28, 1974	Dec. 29, 1973
Funds provided:		
From operations:		
Net earnings	$ 7,043,161	$ 12,860,443
Charges (credits) to earnings not requiring (providing) funds:		
Equity in undistributed earnings of bank subsidiary	(1,406,345)	(530,444)
Equity in undistributed earnings of Blue Chip Stamps	(889,410)	(900,000)
Accretion of discount on bonds	(442,153)	(481,767)
Depreciation and amortization	538,063	519,608
Increase in unpaid losses and loss expense	11,085,329	1,400,750
Increase (decrease) in unearned premiums	422,887	(2,557,417)
Increase in funds held under reinsurance treaties	1,539,079	360,360
Increase in accounts receivable from customers, agents and others	(3,834,653)	(1,202,693)
Decrease (increase) in inventories	1,137,124	(309,633)
Decrease in deferred insurance premium acquisition costs	840,000	384,000
Decrease in liability for income taxes	(352,116)	(3,230,468)
Increase in recoverable income taxes	(2,800,734)	–
Increase (decrease) in accounts payable and accrued expenses	(291,284)	342,851
Other, net	(329,243)	(27,860)
	5,216,544	(6,232,713)
Funds provided from operations	12,259,705	6,627,730
Dividends received from unconsolidated subsidiary	191,500	–
Proceeds from issuance of long-term debt	1,305,623	20,000,000
Decrease in cash	–	2,112,580
	$ 13,756,828	$ 28,740,310
Funds used:		
Net purchase (sale) of investments:		
U. S. Treasury Bills and other short-term obligations	9,707,728	(2,189,809)
Bonds	(1,985,528)	(11,965,977)
Preferred stocks	556,837	(643,904)
Common stocks of unaffiliated companies	913,087	32,344,998
Common stock of Blue Chip Stamps	2,317,313	1,529,878
Investment in unconsolidated subsidiary	45,000	75,000
	11,554,437	19,150,186
Additions to real estate, equipment, furniture and leasehold improvements	783,531	547,364
Repayment of long-term debt	73,946	9,042,760
Increase in cash	1,344,914	–
	$ 13,756,828	$ 28,740,310

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 28, 1974 and December 29, 1973

(1) **Summary of Significant Accounting Policies and Practices**

(a) Basis of Presentation

The accounts of Berkshire Hathaway Inc., the parent Company, are consolidated with the accounts of Bourne Mills of Canada, Ltd., a wholly-owned Canadian textile sales subsidiary, and the accounts of subsidiary insurance companies (The "Insurance Group"), wholly-owned by Berkshire Hathaway Inc. Certain 1973 amounts have been reclassified to conform with 1974 presentation.

The parent Company's investment in The Illinois National Bank & Trust Co. of Rockford is accounted for on the equity basis.

Immaterial subsidiaries are not consolidated and investments therein are carried at cost less dividends received from such subsidiaries.

The accounts of the parent Company and its noninsurance subsidiary are maintained on the basis of a fiscal year ending on the Saturday nearest to December 31, while the accounts of the Insurance Group are maintained on the basis of the calendar year.

(b) Investment in Securities, Other than Affiliates

Investments in bonds are stated at amortized cost, while investments in preferred and common stocks other than affiliates are carried at cost. The aggregate market values of these investments, at both December 31, 1974 and December 31, 1973 were substantially less than their cost. The Company generally intends to hold the bonds to maturity and does not expect to realize significant losses from disposition of bonds. The investment in equity securities are held by the Insurance Group and generally consist of a relatively few issues acquired with a general view to holding as long-term investments. In view of the fact that market value quotations fluctuate daily, management considers the cost method as most appropriate for such long-term investments in the absence of operating reasons compelling their liquidation, and in the absence of evidence supporting a conclusion that their net cost will not eventually be recovered.

(c) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps ("Blue Chip") is accounted for on the equity basis. Deferred income taxes are provided for with respect to undistributed earnings of Blue Chip under the assumption that such earnings will ultimately be distributed as taxable dividends. Blue Chip determines income on the basis of a fiscal year ending on or about February 28. Berkshire Hathaway Inc. reflects its equity in the earnings of Blue Chip on the basis of that company's twelve months ending on or about November 30.

(d) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the terms of the policies. Unearned premiums are computed on the monthly pro rata basis and are stated after deduction for reinsurance placed with insurers in the amount of $4,583,628 at December 31, 1974 and $3,281,480 at December 31, 1973. Premium acquisition costs such as commission, premium taxes and certain other underwriting expenses are, pursuant to statutory insurance accounting rules, charged against income when incurred. However, for financial statement purposes, a portion of such costs are deferred and charged against income as the related premiums are earned.

(e) Losses and Loss Adjustment Expenses

The Insurance Group provides for losses and loss adjustment expenses based upon (1) aggregate case basis estimates for losses reported, in respect to direct premiums written, (2) estimates of unreported losses based upon past experience, (3) estimates received relating to assumed reinsurance, and (4) deduction of amounts for reinsurance placed with reinsurers in the amount of $5,518,385 at December 31, 1974 and $4,421,537 at December 31, 1973.

(f) Catastrophe Reserves

The Insurance Group does not provide a reserve for catastrophe losses. The Financial Accounting Standards Board in cooperation with industry representatives is working toward the development of a definitive statement as to the appropriate accounting for catastrophe losses and resolution may lead to changes in the accounting practices being followed.

(g) Real Estate, Equipment, Furniture and Leasehold Improvements

These items of property (including significant betterments and renewals) are carried at cost depreciated over their useful lives estimated at the date of acquisition. The double-declining balance method is used to calculate depreciation of new items of textile properties acquired after 1965; the straight-line method is applied for other items. Maintenance, repairs and renewals of a minor nature are generally charged to operations as incurred.

(h) Inventories

Inventories relate to the textile operation and are stated at cost determined under the last-in, first-out method.

(i) Income Taxes

A consolidated Federal income tax return is filed by the parent Company and its eligible subsidiaries. The recoverable amount or liability for current income taxes reflected in the consolidated balance sheets includes the apportioned Federal tax amounts of the companies whose accounts are consolidated.

A provision for deferred taxes is made in recognition of timing differences created by the manner in which the Insurance Group accounts for certain income and expense items for financial reporting purposes and the accounting treatment of these items for income tax purposes.

Investment tax credits on qualifying property and equipment acquisitions are applied as a reduction of income tax expense in the year realized.

(2) Bonds Deposited with Others

Bonds with amortized cost of $15,294,910 and $13,932,645 at December 31, 1974 and 1973, respectively, were deposited in trust with various regulatory authorities or others in accordance with the terms of certain reinsurance treaties.

(3) Investments in Securities of Unaffiliated Companies

A summary of the aggregate cost and approximate market value of investments in securities of unaffiliated companies at December 31, 1974 and 1973 is as follows:

	1974		1973	
	Cost	*Market*	*Cost*	*Market*
Bonds	$71,530,651	$58,907,900	$73,074,026	(a)

(a) The aggregate market value for the bond portfolio as of December 31, 1973 was not specifically determined. Management believed that the aggregate cost as of that date approximated market valuation.

	1974		1973	
	Cost	*Market*	*Cost*	*Market*
Preferred stocks	$ 2,855,185	$ 1,842,817	$ 2,298,348	$ 2,186,960
Common stocks	50,669,865	34,802,358	49,756,778	37,344,291
	$53,525,050	$36,645,175	$52,055,126	$39,531,251

The excess of cost over quoted market value of investments in preferred and common stocks of unaffiliated companies increased by $4,355,950 in 1974 and $13,741,037 in 1973, and aggregated $16,879,857 at December 31, 1974. While the timing and extent of a recovery in the market prices of these stocks cannot be predicted, management noted a recovery exceeding $10,000,000 in the quoted market value of its equity securities during the first ten weeks of 1975, and does not believe that the excess of cost over market value at December 31, 1974 represents a decline which justifies a write-down in carrying values.

In the first ten weeks of 1975, the Company realized losses of approximately $1,500,000, net of income tax credit applicable to such losses, from sales of securities. However, management believes that over the long term, no significant net loss to the Company will result from its continued holding or sale of the securities which constituted its portfolio at December 31, 1974.

(4) Investment in Blue Chip Stamps

The carrying value of the investment in Blue Chip Stamps ("Blue Chip") represents the cost, less amortization of the net excess of cost over equity in net assets at dates

of acquisition, plus equity in undistributed earnings. Deferred taxes of $191,800 and $100,000 at December 31, 1974 and 1973, respectively, have been provided with respect to the equity in undistributed earnings assuming their ultimate distribution as a taxable dividend.

The investment in Blue Chip is summarized as follows:

	December 31, 1974	1973
Shares owned	1,325,233	989,483
Percentage of total outstanding shares	25.6%	19%
Cost, represented by:		
Underlying net asset values at dates of acquisition	$13,084,112	$ 9,115,779
Net excess cost, less amortization of $1,179,873, 1974 and $795,673, 1973	870,603	2,905,822
	13,954,715	12,021,601
Equity in post-acquisition undistributed earnings	2,969,283	1,695,673
	$16,923,998	$13,717,274

The excess of cost over equity in net assets is being amortized over eight years from the beginning of 1972. Amortization was $384,200 for 1974 and $480,000 for 1973.

Blue Chip, a California corporation, is engaged primarily in the business of furnishing a trading stamps service to retail merchants and their customers in the states of California, Nevada and Oregon. A separate division of Blue Chip, on a nationwide basis, develops incentive programs for all types of businesses and also programs under which oil companies and other large issuers of credit cards can offer merchandise to their credit card holders. A subsidiary of Blue Chip, See's Candy Shops, Incorporated, manufactures candies in its kitchens located in Los Angeles and South San Francisco. The candies are sold through company-operated stores, approximately 170 in number, located in nine western states including Hawaii. Blue Chip also controls Mutual Savings and Loan Association through its ownership of approximately 64% of the outstanding capital stock of Wesco Financial Corporation, a registered savings and loan holding company. Mutual's head office is in Pasadena, California, and its approximately 15 other locations are in Southern California.

As indicated above, Berkshire Hathaway Inc. and its subsidiaries own approximately 26% of Blue Chip; these holdings plus holdings of other persons who may be considered affiliates aggregate over 50% of Blue Chip's outstanding shares.

The financial statements of Blue Chip as of March 2, 1974, and for the 52 weeks then ended (audited), and as of November 30, 1974 and for the 52 weeks then ended (unaudited) reflect the following:

BLUE CHIP STAMPS
Consolidated Balance Sheets

Assets	($000 omitted) Mar. 2, 1974	Nov. 30, 1974 (Unaudited)
Cash	$ 3,013	$ 3,322
Marketable securities, at cost (market March 2 — $128,654; November 30 — $73,040)	132,743	97,072
Inventories	10,355	16,083
Other current assets	8,913	14,140
Property, fixtures and equipment, net	10,454	8,736
Unamortized debenture discount	982	708
Investment in Wesco Financial Corporation	17,446	26,053
Excess of cost over equity in net assets of consolidated subsidiary	16,314	15,992
	$200,220	$182,106
Liabilities and Stockholders' Equity		
Liability for unredeemed trading stamps	$ 78,776	$ 71,705
Current portion of long-term debt	8,881	1,805
Other current liabilities	11,004	11,585
Note payable to bank, less current portion	33,000	27,200
6¾% subordinated debentures due 1978, less current portion	8,672	6,504
Stockholders' equity	59,887	63,307
	$200,220	$182,106

BLUE CHIP STAMPS
Consolidated Earnings Summaries

	($000 omitted) 52 weeks ended Mar. 2, 1974	52 weeks ended Nov. 30, 1974 (Unaudited)
Stamp service revenues	$ 51,375	$ 28,476
Incentive sales	6,261	9,620
Candy sales	35,780	39,259
Other revenues	8,803	9,747
Total revenues	$102,219	$ 87,102
Earnings before securities losses and extraordinary credit	8,190	8,035
Per share	1.58	1.55
Net earnings	8,005	7,178
Per share	1.55	1.39

Blue Chip financial statements for their fiscal year ended March 2, 1974 (and for certain prior years) revealed significant litigation proceedings against the Company. The Company stated with regard to certain of these proceedings that a possible result could be "a materially adverse effect on revenues and earnings and under existing market conditions might have a materially adverse effect on its ability to continue its trading stamp business." Additional proceedings involve substantial contingent liabilities; the accountants' opinion covering the financial statements of Blue Chip Stamps as of March 2, 1974 and for the fiscal year then ended, as well as that for certain preceding years, was given subject to the effect, if any, of the legal proceedings referred to.

(5) Investments in Unconsolidated Subsidiaries

The investment in the unconsolidated bank subsidiary represents approximately 98% of the outstanding stock of The Illinois National Bank & Trust Co. of Rockford. The equity method is used in accounting for this investment. See note 13 regarding divestiture of this investment. Financial statements of The Illinois National Bank & Trust Co. of Rockford and subsidiary are presented elsewhere herein.

The carrying values of $23,604,212 at December 28, 1974 and $22,336,866 at December 29, 1973 for all unconsolidated subsidiaries were approximately $2,500,000 in excess of the parent Company's equity in the net assets as reflected in the financial statements of the subsidiaries at those dates. This excess cost originated prior to November 1, 1970 and is not being amortized since it is considered by management to have continuing value over an indefinite period.

(6) Receivables

Accounts receivable from customers, agents and others was made up of the following:

	December 31, 1974	December 31, 1973
Insurance Group:		
Agents' balances and premiums in course of collection	$ 9,583,769	$ 6,891,777
Investment income due and accrued	1,438,492	1,409,869
Reinsurance recoverable on loss payments	2,459,093	498,924
Amounts due from sale of securities	31,955	107,765
	13,513,309	8,908,335
Textile business trade accounts receivable (less allowance for doubtful accounts, 1974—$331,394; 1973—$332,679)	4,377,918	5,148,239
	$17,891,227	$14,056,574

(7) Inventories

A summary of inventories follows:

	Dec. 28, 1974	Dec. 29, 1973
Raw materials and supplies	$ 832,210	$ 1,047,827
Stock in process	1,425,670	1,604,824
Griege and finished cloth	3,741,672	4,484,025
	$ 5,999,552	$ 7,136,676

Effective with the year ended December 29, 1973, the Company changed its method of determining inventory valuations to cost determined on a basis of last-in, first-out (LIFO). This change was made because management believes the use of LIFO will reduce the effect of inflation on stated earnings; current cost will generally be more nearly matched against current revenues in the statements of earnings and retained earnings. The change had the effect of reducing inventories at December 29, 1973 by $588,348 and net earnings by $294,174 ($0.30 per share) for the 52 weeks then ended.

(8) Real Estate, Equipment, Furniture and Leasehold Improvements

The composition of plant and equipment is shown below:

December 28, 1974	Properties of textile operations	Properties of Insurance Group	Total
Land	$ 84,860	$ 83,847	$ 168,707
Buildings	2,409,214	1,254,363	3,663,577
Machinery and equipment	12,734,171	—	12,734,171
Furniture and fixtures and leasehold improvements	834,992	1,053,380	1,888,372
	16,063,237	2,391,590	18,454,827
Less accumulated depreciation and amortization	13,730,358	810,996	14,541,354
	$ 2,332,879	$1,580,594	$ 3,913,473
December 29, 1973			
Land	$ 84,860	$ 83,847	$ 168,707
Buildings	2,364,265	1,251,905	3,616,170
Machinery and equipment	12,361,378	—	12,361,378
Furniture and fixtures and leasehold improvements	593,900	935,745	1,529,645
	15,404,403	2,271,497	17,675,900
Less accumulated depreciation and amortization	13,341,570	666,325	14,007,895
	$ 2,062,833	$1,605,172	$ 3,668,005

(9) 7½% Subordinated Debentures

Debentures bear interest at the rate of 7½% payable February 1 and August 1 and will be due on August 1, 1987. The debentures are not secured by any lien and are not convertible; they are subordinated to senior indebtedness which includes indebtedness of the parent Company for money borrowed. The debentures may be redeemed at par at the Company's option. The indenture under which the debentures were issued requires the parent Company to redeem $42,800 principal amount of the debentures, through a sinking fund, annually on August 1 to and including 1986.

(10) 8% Promissory Note Due 1988

The parent Company issued in May 1974 a promissory note in the principal amount of $1,305,623, repayable in monthly installments of $13,071 including interest at 8% per annum, through February 1988.

(11) 8% Senior Notes Due 1993

On March 15, 1973, the parent Company issued at par $20,000,000, 8% Senior Notes due March 1, 1993. Part of the proceeds was used to repay $9,000,000 of outstanding bank notes; the remainder of the proceeds was used for additional capital contributions to the Insurance Group.

The notes call for mandatory annual prepayments of $1,143,000 on March 1 in each of the years from 1979 to 1992, inclusive. Optional prepayments are permitted without premium up to the amount of the required prepayments in each of the years 1979 to 1992; this right is not cumulative. Additionally, the parent Company may also prepay the notes at any time, in full or in part, at a premium of 8% in the twelve months commenced March 1, 1973; the premium declines ratably to par in 1992. The parent Company agreed it will not affect any optional prepayment prior to March 1, 1983 from proceeds of any refunding operation involving the incurring of any indebtedness at an effective annual interest rate of less than 8%.

In the note instruments the parent Company agreed, among other things, as to both the parent Company and restricted subsidiaries, as defined, to limitations as to permissible outstanding funded debt and subordinated funded debt and to a limitation on mortgage debt except as to after-acquired property. Further, the parent Company covenanted that it would not make "restricted payments", which term includes dividends or other equity distributions plus investment in unrestricted subsidiaries (those not bound by the terms of the loan agreement), in excess of stated formula amounts. Retained earnings of approximately $25,000,000 as of December 28, 1974 and $21,000,000 as of December 29, 1973 are unrestricted by this provision; the remainder is restricted.

The loan agreement also contains limiting terms relating to sales of the Company's assets, mergers and consolidations, and allows the noteholders to demand prepayment, at par, within 60 days of notice that, during the lifetime of Warren E. Buffett, stock ownership in the parent Company by Warren E. Buffett and the members of his immediate family, including certain trusts and charitable organizations, has decreased to less than 15% of the outstanding capital stock of the parent Company.

(12) Income Taxes

Net recoverable income taxes credited to 1974 earnings were made up as follows:

	U. S. Federal	Foreign, state and local	Total
Totals:			
(Credit) charge applicable to operating earnings	$(2,187,851)	$177,530	$(2,010,321)
Charge applicable to equity in earnings of Blue Chip Stamps	112,090	—	112,090
(Credit) applicable to realized investment losses	(567,678)	—	(567,678)
	$(2,643,439)	$177,530	$(2,465,909)
Currently (recoverable) payable:			
From net operating loss from insurance underwriting and manufacturing operations	(1,842,483)	177,530	(1,664,953)
On dividends from Blue Chip Stamps	20,290	—	20,290
From carryback of realized investment losses	(567,678)	—	(567,678)
Total current	(2,389,871)	177,530	(2,212,341)
Deferred expense (credit):			
On equity in undistributed earnings of Blue Chip Stamps	91,800	—	91,800
On net accreted discount on bonds	75,632	—	75,632
Credit for tax effect of reduction in deferred insurance premium acquisition costs	(421,000)	—	(421,000)
Total deferred	(253,568)	—	(253,568)
Total income tax credits	$(2,643,439)	$177,530	$(2,465,909)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Total net income in 1974 after taking into account realized investment losses, but before income taxes, was $4,577,252. Income tax expense of approximately $2,197,000 would result if computed by applying the statutory U. S. Federal income tax rate of 48% to income before taxes. A reconciliation of the difference is as follows:

	Amount
Tax expense at statutory rate	$ 2,197,000
Increases (decreases) resulting from:	
Tax-exempt interest income	(2,082,000)
100% exclusion relating to equity in earnings of The Illinois National Bank	(1,965,000)
85% dividends received credit:	
On dividends from unaffiliated companies	(1,065,000)
On equity in earnings of Blue Chip Stamps	(632,000)
Amortization of excess of cost over net assets of subsidiary and investee (not deductible for tax purposes)	230,000
Capital loss rate differential (30% vs. 48%)	343,000
Tax benefits to unconsolidated subsidiary	620,000
Miscellaneous	(111,909)
Net income tax credits	$(2,465,909)

Total income tax expense for 1973 is made up of the following:

	U. S. Federal	Foreign state and local	Total
Totals applicable to:			
Earnings from insurance underwriting and manufacturing operations	$2,764,952	$214,064	$2,979,016
Equity in earnings of Blue Chip Stamps	116,000	–	116,000
Realized investment gains	401,699	–	401,699
	$3,282,651	$214,064	$3,496,715
Current tax expense:			
On earnings from insurance underwriting and manufacturing operations	$2,781,668	$214,064	$2,995,732
On dividends from Blue Chip Stamps	16,000	–	16,000
On realized investment gains	401,699	–	401,699
Total current	3,199,367	214,064	3,413,431
Deferred tax expense (credit):			
On equity in undistributed earnings of Blue Chip Stamps	100,000	–	100,000
On accreted discount on bonds	170,000	–	170,000
Credit for tax effect of reduction in deferred insurance premium acquisition costs	(186,716)	–	(186,716)
Total deferred	83,284	–	83,284
Total income tax expense	$3,282,651	$214,064	$3,496,715

Total income tax expense of $3,496,715 is less than the amount of $7,851,000 computed by applying the U. S. Federal income tax rate of 48% to income before taxes. The reasons for this difference for 1973 were as follows:

	Amount
Tax expense at statutory rate	$ 7,851,000
Increases (decreases) resulting from:	
Tax-exempt interest	(2,304,000)
100% exclusion relating to equity in earnings of The Illinois National Bank	(1,335,000)
85% dividends received credit:	
On dividends from unaffiliated companies	(542,000)
On equity in earnings of Blue Chip Stamps	(655,000)
Amortization of excess of cost over net assets of subsidiary and investee (not deductible for tax purposes)	290,000
Miscellaneous	191,715
Total income tax expense	$ 3,496,715

Consolidated income tax returns of the Company have been examined through 1970 by the Internal Revenue Service and deficiencies have been paid.

(13) "One-Bank Holding Company" Status

The Company is a bank holding company under Federal legislation enacted in 1970. It has filed with the Federal Reserve Board an irrevocable election to divest of its holdings in The Illinois National Bank & Trust Co. of Rockford prior to January 1, 1981. No determination has been made as to how it will effect such divestiture, and so long as the Company controls the bank it is subject to the restrictions imposed upon it by the Bank Holding Company Act.

(14) "Savings and Loan Holding Company" Status

The Company, as a result of its investment in Blue Chip Stamps which in turn holds controlling interest in a California savings and loan association, is a savings and loan holding company under the Savings and Loan Holding Company Amendments of 1967. As such, the Company is subject to the restrictions and regulatory requirements imposed upon it by the Savings and Loan Holding Company Act.

Berkshire Hathaway Inc.

INSURANCE GROUP

Financial Statements
1974 and 1973

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF ASSETS AND LIABILITIES

ASSETS	December 31, 1974	1973
Bonds, at amortized cost (note 2)	$ 71,530,651	$ 73,074,026
Investments in stocks of unaffiliated companies, at cost:		
Preferred stocks (market, 1974 – $1,842,817; 1973 – $2,186,960)	2,855,185	2,298,348
Common stocks (market, 1974 – $34,802,358; 1973 – $37,344,291)	50,669,865	49,756,778
Total common and preferred stocks	53,525,050	52,055,126
U. S. Treasury Bills, at cost which approximates market	9,138,663	1,400,435
Investment in Blue Chip Stamps (note C)	14,370,980	13,717,274
Real estate, furniture and equipment (note 8)	1,580,594	1,605,172
Cash and bank deposits	1,513,636	1,465,359
Recoverable Federal income taxes	2,600,734	—
Agents' balances and premiums in course of collection	9,583,769	6,891,777
Reinsurance recoverable on loss payments	2,459,093	498,924
Investment income due and accrued	1,438,492	1,409,869
Amounts due from sale of securities	31,955	107,765
Other assets	164,605	373,525
Deferred acquisition costs	4,400,000	5,240,000
	$172,338,222	$157,839,252
LIABILITIES, CAPITAL STOCK AND SURPLUS		
Losses and loss adjustment expenses	$ 72,761,097	$ 61,675,768
Unearned premiums	21,704,867	21,281,980
Funds held under reinsurance treaties	2,857,284	1,318,205
Accrued expenses	1,328,944	916,341
Income taxes:		
Current	—	442,302
Deferred	3,034,000	3,297,368
Amounts due for purchase of securities	259,476	459,609
Other liabilities	161,654	745,361
	102,107,322	90,136,934
Capital stock and surplus (note D):		
Common stock of National Indemnity Company of $10 par value. Authorized 750,000 shares; issued 550,000 shares	5,500,000	5,500,000
Common stock of National Fire & Marine Insurance Company of $100 par value. Authorized 50,000 shares; issued 25,000 shares	2,500,000	2,500,000
Paid-in surplus	20,601,250	20,601,250
Unassigned surplus (note 11)	41,629,650	39,101,068
Total capital stock and surplus	70,230,900	67,702,318
	$172,338,222	$157,839,252

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF INCOME AND REALIZED INVESTMENT GAINS (LOSSES)

	Year ended December 31, 1974	1973
Underwriting income:		
Net premiums written	$ 60,996,616	$ 50,371,841
(Increase) decrease in unearned premiums	(422,887)	2,557,416
Premiums earned	60,573,729	52,929,257
Losses and loss expenses incurred	47,119,846	32,835,798
	13,453,883	20,093,459
Underwriting expenses:		
Commissions and brokerage	13,016,977	11,033,458
Salaries and other compensation	2,816,024	2,323,863
Taxes, licenses and fees	1,396,162	1,060,329
Other underwriting expenses	2,276,581	1,972,517
Decrease in deferred acquisition costs	840,000	384,000
	20,345,744	16,774,167
Net underwriting gain (loss)	(6,891,861)	3,319,292
Investment income:		
Interest on bonds	5,103,543	5,621,743
Dividends on stock (other than from Blue Chip Stamps)	2,811,980	1,688,024
Real estate income	286,307	287,017
	8,201,830	7,596,784
Investment expenses	322,010	313,894
Net investment income	7,879,820	7,282,890
Profit from underwriting and investments	987,959	10,602,182
Other expense	95,708	322,287
Income before income taxes, equity in earnings of Blue Chip Stamps and realized investment gains (losses)	892,251	10,279,895
Applicable income taxes (credit) (note E)	(2,184,761)	2,346,719
Income before equity in earnings of Blue Chip Stamps and realized investment gains (losses)	3,077,012	7,933,176
Equity in earnings of Blue Chip Stamps (note C)	791,985	1,008,000
Income before realized investment gains (losses)	3,868,997	8,941,176
Realized investment gains (losses)	(1,908,093)	1,331,550
Applicable income taxes (credit)	(567,678)	401,699
Net realized investment gains (losses)	(1,340,415)	929,851
Net income	$ 2,528,582	$ 9,871,027

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF PAID-IN AND UNASSIGNED SURPLUS

PAID-IN SURPLUS	Year ended December 31, 1974	1973
Beginning of year	$ 20,601,250	$ 9,851,250
Contribution from parent	—	9,750,000
Excess of proceeds over par value of capital stock issued	—	1,000,000
End of year	$ 20,601,250	$ 20,601,250

UNASSIGNED SURPLUS	1974	1973
Beginning of year	$ 39,101,068	$ 29,230,041
Net income	2,528,582	9,871,027
End of year	$ 41,629,650	$ 39,101,068

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31, 1974	1973
Funds provided:		
From operations:		
Net income	$ 2,528,582	$ 9,871,027
Charges (credits) to income not requiring (providing) funds:		
Equity in undistributed earnings of Blue Chip Stamps	(653,706)	(900,000)
Accretion of discount on bonds	(442,153)	(481,767)
Depreciation	147,972	128,689
Increase in unpaid losses and loss expense	11,085,329	1,400,750
Increase (decrease) in unearned premiums	422,887	(2,557,417)
Increase in funds held under reinsurance treaties	1,539,079	360,360
Increase in agents' balances and premiums in course of collection	(2,691,992)	(511)
Increase in reinsurance recoverable on loss payments	(1,960,169)	(221,183)
Decrease in deferred acquisition costs	840,000	384,000
Decrease in liability for income taxes	(705,670)	(2,615,563)
Increase in recoverable income taxes	(2,600,734)	—
Other, net	(115,130)	(62,460)
	4,865,713	(4,565,102)
Funds provided from operations	7,394,295	5,305,925
Additional capital paid in by shareholders	—	12,250,000
Decrease in cash	—	1,579,008
	$ 7,394,295	$ 19,134,933
Funds used:		
Net purchase (sale) of investments:		
U. S. Treasury Bills	7,738,228	(2,189,809)
Bonds	(1,985,528)	(11,965,977)
Preferred stocks	556,837	(643,904)
Common stocks of unaffiliated companies	913,087	32,344,998
Common stock of Blue Chip Stamps	—	1,529,878
	7,222,624	19,075,186
Purchase of real estate, furniture and equipment	123,394	59,747
Increase in cash	48,277	—
	$ 7,394,295	$ 19,134,933

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
December 31, 1974 and 1973

(A) Note References

Numerical note references are to the notes to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries. Note 1 to such statements includes a summary of significant accounting policies and practices of the Insurance Group.

(B) Basis of Presentation

The financial statements of Berkshire Hathaway Inc. – Insurance Group include the accounts of wholly-owned subsidiaries of Berkshire Hathaway Inc. which are engaged in fire and casualty insurance underwriting. The statements are presented on a combined basis with significant intercompany transactions and balances eliminated, and in accordance with generally accepted accounting principles (GAAP) which differ in some respects from principles prescribed or permitted by insurance regulatory authorities (statutory methods) in accordance with which the companies maintain their records. A reconciliation of the aggregate capital stock and surplus ("Surplus as regards Policyholders") as determined under the statutory method to that determined and reported herewith in accordance with GAAP is as follows:

	December 31, 1974	1973
Statutory surplus as regards Policyholders	$37,201,793	$41,595,522
Excess of cost over NAIC market valuations of investments in equity securities (excluding stock of Blue Chip Stamps)	16,449,675	12,523,925
Excess of carrying value of investment in Blue Chip Stamps (determined under GAAP pursuant to the equity method) over NAIC market valuation	9,176,194	6,545,772
Deferred insurance premium acquisition costs	4,400,000	5,240,000
Excess statutory liability loss reserves	1,850,644	1,469,116
Net recoverable from unauthorized reinsurers	1,788,012	1,483,393
Sundry nonadmitted assets	1,042,892	977,590
Income tax effects and adjustments	(1,678,310)	(2,133,000)
Capital stock and surplus – GAAP	$70,230,900	$67,702,318

Statutory net income is reconciled to GAAP net income as follows:

	1974	1973
Statutory net income	$2,354,072	$8,893,491
Decrease in deferred acquisition costs	(840,000)	(384,000)
Equity in undistributed earnings of Blue Chip Stamps, net of amortization of excess cost	653,706	900,000
Amortization of excess cost of investment in Home and Automobile Insurance Company	(93,886)	(125,180)
Income tax effects and adjustments	454,690	586,716
GAAP net income	$2,528,582	$9,871,027

(C) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps by the companies comprising the Insurance Group represented 989,483 shares, or approximately 19% of that company's total outstanding shares at the end of both 1974 and 1973. The carrying value was comprised of the following:

	December 31, 1974	1973
Cost, represented by:		
Underlying net asset values at dates of acquisition	$ 9,115,779	$ 9,115,779
Excess cost, net of amortization of $1,279,853, 1974 and $795,673, 1973	2,421,642	2,905,822
	11,537,421	12,021,601
Equity in post-acquisition undistributed earnings	2,833,559	1,695,673
	$14,370,980	$13,717,274

The excess cost over underlying net assets is being amortized over eight years from the beginning of 1972. Amortization charged against earnings of the Insurance Group was $484,180 in 1974 and $480,000 in 1973.

The National Association of Insurance Commissioners assigned per share valuation of $5.25 at December 31, 1974 and $7.25 at December 31, 1973 to the stock of Blue Chip Stamps which is publicly traded in the over-the-counter market. Accordingly, on these bases, the insurance subsidiaries reported in their Convention statements filed with the various state insurance departments an aggregate "market value" of $5,194,784 at December 31, 1974 and $7,171,502 at

NOTES TO FINANCIAL STATEMENTS, *Continued*

December 31, 1973, for their holdings of Blue Chip Stamps. The company does not believe that the statutory valuation is indicative of the fair market value of the substantial block of Blue Chip shares represented by the Berkshire Hathaway holdings of which these are a part.

See also note 4 to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries.

(D) Stockholders' Equity

The following additional common stock was issued during the two years ended December 31, 1974:

National Indemnity Company, $10 par value common stock:

March 1973 – 150,000 shares of $11,250,000

Surplus is restricted for dividend purposes by the insurance departments of the states in which the companies do business.

(E) Federal Income Taxes

Federal income tax expense (credit) is made up of the following:

	1974	1973
Totals:		
(Credit) charge applicable to operating earnings	$(2,184,761)	$2,346,719
Charge applicable to equity in earnings of Blue Chip Stamps	99,200	116,000
(Credit) charge applicable to realized investment losses	(567,678)	401,699
	$(2,653,239)	$2,864,418
Current tax expense (credits) relating to:		
Earnings (net operating loss) of insurance underwriting operations	$(1,839,393)	$2,363,435
Dividends received from Blue Chip Stamps	17,200	16,000
Realized investment gains (losses)	(567,678)	401,699
Total current	(2,389,871)	2,781,134

	1974	1973
Deferred tax expense (credit) relating to:		
Equity in undistributed earnings of Blue Chip Stamps	82,000	100,000
Accreted discount on bonds	75,632	170,000
Credit for tax effect of reduction in deferred acquisition costs	(421,000)	(186,716)
Total deferred	(263,368)	83,284
Total income tax expense (credit)	$(2,653,239)	$2,864,418

Total net income (loss) after taking into account realized investment losses, but before income taxes, was ($124,657) for 1974 and $12,735,445 for 1973. Income tax expense (credit) of approximately ($60,000) for 1974 and $6,113,000 for 1973 would result if computed by applying the statutory U. S. Federal income tax rate of 48% to income (loss) before taxes. A reconciliation of the differences are as follows:

	1974	1973
Tax expense at statutory rate	$ (60,000)	$ 6,113,000
Increase (reduction) in income taxes resulting from:		
Tax-exempt interest	(2,082,000)	(2,304,000)
85% dividends received credit relating to:		
Dividends received from unaffiliated companies	(1,065,000)	(542,000)
Equity in earnings of Blue Chip Stamps	(561,000)	(655,000)
Amortization of excess of cost over net assets of subsidiary and investee (not deductible for tax purposes)	277,000	290,000
Tax benefit to affiliate	620,000	–
Capital gains tax rate differential	343,000	(237,000)
Miscellaneous	(125,239)	199,418
	$(2,653,239)	$ 2,864,418

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
206 WEST STATE STREET, SUITE 700
ROCKFORD, ILLINOIS 61101

The Board of Directors
The Illinois National Bank
& Trust Co. of Rockford:

We have examined the consolidated balance sheets of The Illinois National Bank & Trust Co. of Rockford and subsidiary as of December 31, 1974 and 1973, and the related consolidated statements of income, changes in stockholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of The Illinois National Bank & Trust Co. of Rockford and subsidiary at December 31, 1974 and 1973, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

January 17, 1975

Berkshire Hathaway Inc.
BANK SUBSIDIARY
The Illinois National Bank & Trust Co. of Rockford

Financial Statements
1974 and 1973

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	Years ended December 31, 1974	1973
ASSETS		
Cash and due from banks	$ 21,543,577	$ 26,683,653
Investment securities (note 2):		
United States Government obligations	565,107	804,781
United States Government agencies	10,050,113	10,550,049
Obligations of states and political subdivisions	45,857,638	47,712,563
Other securities	3,845,970	3,358,350
Federal funds sold	5,000,000	—
Loans (note 3)	70,853,542	66,022,357
Bank premises and equipment (note 4)	1,008,749	1,116,504
Accrued interest receivable	1,812,021	1,549,003
Other assets	1,044,645	607,074
	$161,581,362	$158,404,334
LIABILITIES RESERVE FOR LOAN LOSSES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Demand deposits	$ 53,177,813	$ 55,716,465
Time deposits	85,519,225	81,450,028
Total deposits	138,697,038	137,166,493
Accrued taxes and other liabilities (note 5)	1,005,234	835,154
Total liabilities	139,702,272	138,001,647
Reserve for loan losses (note 6)	1,251,163	1,163,658
Stockholders' equity:		
Common stock of $20 par value. Authorized and issued 250,000 shares	5,000,000	5,000,000
Surplus	5,000,000	5,000,000
Undivided profits	9,626,927	8,238,029
Reserve for contingencies	1,001,000	1,001,000
Total stockholders' equity	20,627,927	19,239,029
	$161,581,362	$158,404,334

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

	Years ended December 31, 1974	1973
Operating income:		
Interest and fees on loans	$ 6,607,862	$ 5,316,152
Income on Federal funds sold	361,452	236,853
Interest and dividends on:		
United States Government obligations	42,986	47,904
United States Government agencies	898,579	584,272
Obligations of states and political subdivisions	2,797,632	2,795,721
Other securities	284,283	342,642
Total interest income	10,992,794	9,323,544
Trust fees	434,201	450,529
Service charges on deposit accounts	139,060	129,500
Other	559,578	499,862
Total operating income	12,125,633	10,403,435
Operating expenses:		
Interest on deposits	4,954,302	4,295,303
Interest on borrowed money	14,106	55,303
Total interest	4,968,408	4,350,606
Salaries	1,551,511	1,503,374
Employee benefits (note 7)	246,573	262,878
Occupancy, net (note 4)	257,229	417,739
Furniture and equipment (note 4)	248,078	252,709
Provision for loan losses (note 6)	19,300	16,100
Other	592,443	766,862
Total operating expenses	7,883,542	7,570,268
Income before income taxes, securities gains and extraordinary item	4,242,091	2,833,167
Applicable income taxes, net (note 5)	220,256	61,136
Income before securities gains and extraordinary item	4,021,835	2,772,031
Securities gains, net of related taxes of $7,001 in 1974 and $33,939 in 1973 (note 5)	168,022	33,477
Income before extraordinary item	4,189,857	2,805,508
Gain on sale of real estate, net of related taxes of $19,305	—	42,717
Net income	$ 4,189,857	$ 2,848,225

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common stock	Surplus	Undivided profits	Reserve for contingencies
Balance December 31, 1972	$5,000,000	$5,000,000	$ 7,796,349	$1,001,000
Net income	–	–	2,848,225	–
Cash dividends	–	–	(2,300,000)	–
Transfer to reserve for loan losses, net of tax of $4,440 (note 6)	–	–	(106,545)	–
Balance December 31, 1973	5,000,000	5,000,000	8,238,029	1,001,000
Net income	–	–	4,189,857	–
Cash dividends	–	–	(2,750,000)	–
Transfer to reserve for loan losses, net of tax of $51,122 (note 6)	–	–	(50,959)	–
Balance December 31, 1974	$5,000,000	$5,000,000	$ 9,626,927	$1,001,000

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Years ended December 31, 1974	1973
Funds provided:		
Increase in:		
Stockholders' equity:		
Net income	$ 4,189,857	$ 2,848,225
Cash dividends	(2,750,000)	(2,300,000)
Other, net	(50,959)	(106,545)
Net change in stockholders' equity	1,388,898	441,680
Deposits	1,530,545	4,478,197
Other, net	545,570	454,209
Decrease in investment securities	2,106,915	6,130,441
Total	$ 5,571,928	$ 11,504,527
Funds used:		
Increase in loans	9,872,360	6,919,649
Additions to bank premises and equipment	44,891	53,592
Increase in accrued interest receivable	263,018	76,500
Other, net	531,735	(117,392)
	10,712,004	6,932,349
Increase (decrease) in cash and due from banks	(5,140,076)	4,572,178
Total	$ 5,571,928	$ 11,504,527

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

Notes to Consolidated Financial Statements
December 31, 1974 and 1973

(1) **Significant Accounting Policies**

The accounting policies of The Illinois National Bank & Trust Co. of Rockford (a 97.7% owned subsidiary of Berkshire Hathaway Inc.) and its wholly-owned subsidiary, Brown Building Corporation, conform to generally accepted accounting principles and to general practice within the banking industry. The following is a description of the more significant accounting policies:

Consolidation

The consolidated financial statements include those of the Bank and its wholly-owned subsidiary. All significant intercompany transactions are eliminated in consolidation. Certain 1973 amounts have been reclassified to conform with 1974 presentation.

Investment Securities

Investment securities are stated at cost, adjusted for amortization of premium. Accretion of discount is not reflected in the accompanying statements and would not be material. Gains or losses on sales of investment securities are recognized only upon realization and are shown separately in the statements of income.

Installment Loans

Installment loans are generally made on a discount basis. Unearned discount is taken into income over the terms of the respective loans using a method that approximates straight-line.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation based on the estimated useful life of each asset. Depreciation is computed on the straight-line method for building and automobiles, and on an accelerated method for improvements, equipment, and drive-in and parking facilities.

Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are charged against operations as incurred.

Federal Income Taxes

Taxable income is determined using the cash basis of accounting whereas the accrual method of accounting is used in preparation of financial statements. Deferred taxes are provided in recognition of timing differences.

Provision for and Reserve for Loan Losses

The provision for loan losses is based on past loan loss experience. Pursuant to regulations of the Comptroller of the Currency, the Bank adopted in 1969 the five-year historical moving average method to determine the minimum annual provision for loan losses charged to operating expense.

(2) **Investment Securities**

A summary of investments by major classifications is as follows:

	December 31, 1974 (In Thousands) Par value	Book value	Market value	December 31, 1973 (In Thousands) Par value	Book value	Market value
U. S. Government—direct	$ 565	$ 565	$ 567	$ 815	$ 805	$ 818
U. S. Government—agencies	10,050	10,050	10,066	10,550	10,550	10,599
State and local municipalities	46,474	45,858	43,778	48,136	47,713	52,057
Other	4,312	3,846	3,550	3,715	3,358	3,453
	$61,401	$60,319	$57,961	$63,216	$62,426	$66,927

The market value decline in investment securities is considered to be a temporary condition in view of the fact that management presently intends to hold the securities to maturity or until they can otherwise be disposed of without significant loss.

Investment securities with a book value of $7,575,779 and $9,530,567 at December 31, 1974 and 1973, respectively, were pledged to secure public deposits and for other purposes.

(3) **Loans**

A summary of the major classifications of loans at December 31, 1974 and 1973 is as follows:

	1974	1973
Commercial loans	$35,706,525	$30,150,101
Consumer credit loans (less unearned discount of $2,722,089 in 1974 and $2,786,609 in 1973)	15,042,339	16,206,182
Floor plan loans	6,211,502	5,312,806
Real estate loans	13,893,176	14,353,268
	$70,853,542	$66,022,357

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(4) **Bank Premises and Equipment**

Bank premises and equipment are recorded at cost less accumulated depreciation of $1,919,822 and $1,777,091 at December 31, 1974 and 1973, respectively. Depreciation expense totaled $146,576 for 1974 and $188,552 for 1973.

(5) **Income Taxes**

Accrued taxes and other liabilities and the reserve for loan losses in the accompanying balance sheets include deferred taxes of $542,869 and $305,952 at December 31, 1974 and 1973, respectively. Such deferred taxes result from timing differences arising from reporting taxable income on the cash basis. The Bank and its subsidiary join in the filing of a consolidated Federal income tax return with the parent company, Berkshire Hathaway Inc. The tax benefit of deductions by the parent has been passed to the Bank, as shown in the following schedules.

Taxes applicable to net income were as follows:

	1974	*1973*
Tax provision applicable to income before securities gains and extraordinary item	$759,929	$ 61,136
Tax provision applicable to securities gains	88,380	33,939
Tax provision applicable to gain on sale of real estate	–	19,305
	848,309	114,380
Less tax benefit from parent corporation applicable to:		
Income before securities gains	539,673	–
Securities gains	81,379	–
	621,052	–
Applicable income taxes, net	$227,257	$114,380

The components of consolidated income tax expense are as follows:

	1974	*1973*
Taxes currently payable:		
Federal	$486,701	$ 20,364
Less tax benefit from parent applicable to:		
Taxes currently payable	486,701	–
Recovery of prior taxes paid through net operating loss carryback	134,351	–
Total benefit from parent	621,052	–
	(134,351)	20,364
State	124,691	92,268
Total currently payable (receivable)	(9,660)	112,632
Deferred income taxes:		
Federal	222,635	(38,208)
State	14,282	39,956
	236,917	1,748
Applicable income taxes, net	$227,257	$114,380

The sources of timing differences resulting in deferred income taxes and the tax effect of each were as follows:

	1974	*1973*
Net increase in accrued income taken on cash basis on tax return and on accrual basis for books	$156,825	$101,402
Net (increase) decrease in accrued expenses taken on cash basis on tax return and accrual basis for books	28,970	(104,094)
Loan loss deduction on tax return in excess of the amount charged to operating expenses	51,122	4,440
	$236,917	$ 1,748

Total tax expense amounted to $227,257 (an effective rate of 5.1%) in 1974, and $114,380 (an effective rate of 4.0%) in 1973, a total less than $2,120,215 and $1,368,778 for 1974 and 1973, respectively, computed by applying the United States Federal income tax rate of 48% to income before tax. The reasons for these differences are as follows:

	1974		*1973*	
	Amount	*Percent of pretax income*	*Amount*	*Percent of pretax income*
Tax expense at statutory rate	$2,120,215	48.0%	$1,368,778	48.0%
Increase (reduction) in taxes resulting from:				
Tax-exempt interest	(1,342,863)	(30.4)	(1,341,946)	(47.1)
State income taxes, net of Federal income tax benefits	72,266	1.6	68,756	2.4
Tax benefit from parent	(621,052)	(14.1)	–	–
Other—net	(1,309)	–	18,792	.7
Actual tax expense	$ 227,257	5.1%	$ 114,380	4.0%

Berkshire Hathaway Inc.
BANK SUBSIDIARY
The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(6) **Reserve for Loan Losses**

The following schedule summarizes the changes in the reserve for loan losses for the years ended December 31, 1974 and 1973:

	1974	*1973*
Balance at beginning of year	$1,163,658	$1,024,601
Recoveries on loans previously charged off	7,299	29,143
Provisions charged to:		
Operating expenses	19,300	16,100
Undivided profits	50,959	106,545
Deferred income taxes	51,122	4,440
	1,292,338	1,180,829
Less loans charged off	41,175	17,171
Balance at end of year	$1,251,163	$1,163,658

The portion of the reserve which was available to absorb possible loan losses was $719,919 at December 31, 1974 and $734,495 at December 31, 1973.

The components of the reserve for loan losses as of December 31, 1974 and 1973 are as follows:

	1974	*1973*
Valuation (available for charging off loan losses)	$ 719,919	$ 734,495
Contingency (undivided profits)	313,742	262,783
Deferred taxes	217,502	166,380
	$1,251,163	$1,163,658

(7) **Pension and Profit-Sharing Plan**

The Bank has a noncontributory pension plan and a profit-sharing plan for all officers and employees with two full years of service. The total expense was $128,247 for 1974 and $144,559 for 1973.

Based upon the most recent actuarial report available (as of January 1, 1974), the pension fund assets exceeded the actuarial computed value of vested benefits; and there was no unfunded past service cost liability.

LINES OF BUSINESS

Sources of Revenues:

Revenues reflected in the consolidated financial statements include those from (1) premiums earnings and investment income of the Insurance Group, plus (2) sales revenues from the textile business of the parent company and its Canadian subsidiary plus a minor amount of investment income of the parent company. The following table summarizes for the past five years the total revenues derived from these two categories for the past five years, in thousands of dollars:

	1970	1971	1972	1973	1974
Insurance	$42,249	$66,050	$66,556	$60,526	$ 68,776
Textile	24,629	26,092	27,772	33,479	32,706
	$66,878	$92,142	$94,328	$94,005	$101,482

Sources of Net Income:

The unconsolidated bank subsidiary and the investment in Blue Chip Stamps represent additional significant sources of income for the Company. Sources of total net income for the past five years, on a pre-tax basis with total tax effects to the Company and its consolidated subsidiaries reflected as a separate item, were as follows for the past five years:

(Thousands of Dollars)

	1970	1971	1972	1973	1974
Insurance	$2,639	$6,372	$10,701	$10,249	$ 892
Textile	104	233	1,697	2,837	2,660
Unconsolidated bank subsidiary	2,973	2,192	2,700	2,782	4,093
Blue Chip Stamps	–	68	142	1,124	1,164
Interest and corporate administrative expenses	(581)	(648)	(770)	(1,966)	(2,324)
Realized investment gain (loss)	(301)	1,028	1,359	1,331	(1,908)
Extraordinary item	282	–	–	–	–
Total pre-tax income	5,116	9,245	15,829	16,357	4,577
Less: Total income taxes (credit)	551	1,559	3,703	3,497	(2,466)
Net Earnings	$4,565	$7,686	$12,126	$12,860	$7,043

Berkshire Hathaway Inc.

FIVE YEAR SUMMARY OF OPERATIONS

	1970	1971	1972	1973	1974
	(Dollars in thousands, except per share amounts)				
Insurance premiums earned	$39,172	$60,867	$59,627	$52,929	$60,574
Net sales of textile products	24,569	26,011	27,742	33,411	32,592
Interest and dividend income	2,942	5,043	6,648	7,378	8,030
Insurance underwriting gain (loss)	(331)	1,409	4,284	3,319	(6,892)
Gross profit from sales of textile products	2,349	2,566	4,087	5,105	5,163
Interest expense	581	595	584	1,605	1,718
Income taxes (credit) applicable to insurance underwriting and textile operations	387	1,245	3,241	2,979	(2,010)
Net earnings from insurance underwriting and textile operations	1,675	4,712	8,387	8,141	3,239
Equity in net earnings of bank subsidiary	2,973	2,192	2,700	2,782	4,093
Equity in net earnings of Blue Chip Stamps	–	63	111	1,008	1,052
Earnings before realized investment gains (losses) and extraordinary items	4,648	6,967	11,198	11,931	8,383
Realized investment gains (losses) net of income taxes	(301)	719	928	929	(1,340)
Net earnings	4,565	7,686	12,126	12,860	7,043
Average shares outstanding	979,715	979,569	979,569	979,569	979,569
Per share:					
Earnings before realized investment gains (losses) and extraordinary items	4.74	7.11	11.43	12.18	8.56
Net earnings	4.66	7.85	12.38	13.13	7.19

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Insurance Premiums Earned and Insurance Underwriting Gain (Loss)

The following table sets forth the net premiums written and earned by the Insurance Group in each of the past three years:

Operational Area		1972	1973	1974
		(Thousands of Dollars)		
Specialized Auto, General Liability and Other(1)	Written	$35,354	$28,617	$36,738
	Earned	37,950	29,969	34,436
Reinsurance(2)	Written	11,436	10,184	12,204
	Earned	11,699	11,996	12,938
Urban Auto(3)	Written	6,874	6,571	6,613
	Earned	7,092	6,120	7,902
Home State Companies(4)	Written	4,286	5,000	5,442
	Earned	2,886	4,844	5,298
Totals	Written	$57,950	$50,372	$60,997
	Earned	$59,627	$52,929	$60,574

(1) National Indemnity Company and National Fire & Marine Insurance Company less the Reinsurance Department of National Indemnity.

(2) Reinsurance Department of National Indemnity.

(3) Home and Automobile Insurance Company.

(4) Corporations organized in the jurisdictions of Nebraska, Minnesota, Texas and Iowa underwriting standard and preferred classes of fire and casualty insurance in those states.

Premium volume, both written and earned, in National Indemnity's most significant line of insurance, i.e., substandard private passenger automobile and commercial automobile coverages, is subject to significant fluctuation from year to year. This is a highly competitive area, as is the area of general liability also underwritten by National Indemnity. General liability premiums written by National Indemnity declined from the preceding year by approximately $1 million in both 1973 and 1974. This decline in 1974 was offset by increased writings of workmen's compensation coverages. Private passenger and commercial auto underwritings declined by approximately $7 million from 1972 to 1973; this loss in volume was substantially recovered in 1974.

Combined loss and expense ratios (which are the sum of the ratio of losses and loss expenses incurred to premiums earned plus the ratio of underwriting expenses to premiums written) have been as follows for the Insurance Group for the past five years.

	NET PREMIUMS		RATIOS		
	Written	Earned	Losses and Loss Adj. Exp./ Earned Prem.	Underwriting Expenses/ Written Prem.	Combined Loss and Expenses Ratio
	(In thousands)				
1970	$45,086	$39,172	68.6%	31.7	100.3
1971	66,455	60,867	67.0	30.1	97.1
1972	57,950	59,627	62.0	29.7	91.7
1973	50,372	52,929	62.0	32.5	94.5
1974	60,997	60,574	77.8	32.0	109.8

The combined loss and expense ratio is the traditional measure of underwriting results of property and casualty companies. In any year when that ratio exceeds 100, it generally indicates that unprofitable business has been underwritten.

The total underwriting gain or loss for the Insurance Group for the past three years is shown in the following table:

	1972		1973		1974	
	(Thousands of Dollars)					
	Statutory	GAAP	Statutory	GAAP	Statutory	GAAP
Specialized auto, general liability and other	$5,530	$4,329	$4,623	$4,409	$(2,119)	$(1,939)
Reinsurance	614	561	715	353	(1,470)	(2,068)
Urban Auto	86	62	(834)	(878)	(1,761)	(2,183)
Home state companies	(798)	(667)	(801)	(565)	(702)	(702)
	$5,432	$4,285	$3,703	$3,319	$(6,052)	$(6,892)

The only difference between the Statutory and GAAP underwriting results is the change in amount of premium acquisition costs (underwriting expenses, i.e., commissions, etc.) which is deferred under GAAP. In each of the above years, the amount of such costs deferred at year-end decreased from the preceding year-end. The decrease of $840,000 in deferred acquisition costs in 1974 was generally in recognition of unfavorable underwriting results expected from certain portions of the in-force book of business, plus, in the case of Home and Auto, where no costs were deferred at December 31, 1974, a recognition of substantially reduced premium volume without yet having achieved commensurate reduction in operating expenses.

The premium rates at which the Insurance Group wrote its business in 1974 proved inadequate. Premium rate increases lagged the rate of inflation in both 1973 and 1974, and, while the industry in general and the Berkshire Insurance Group in particular escaped the expected consequences in 1973, they suffered quite badly in 1974.

In addition to the negative influence on the Insurance Group of inadequate rates to cover inflating claim costs, the reinsurance operations in 1974 sustained what management considers to have been an above average number of catastrophe loss occurrences related to the April tornadoes in the country. In contrast, management believes that its catastrophe loss occurrences in 1973 were below average in number.

The "Urban Auto" business referred to above, conducted by Home and Automobile Insurance Company ("Home and Auto") differs from that of National Indemnity and National Fire & Marine principally in that rates and other aspects of Home and Auto's business are based almost entirely upon the loss experienced in the limited urban area in which it operates. These operations were limited to the Chicago area until 1973 when a similar operation was begun in the Miami area. Premium volume from this Florida operation was only nominal in 1973, but approximated $1,700,000, or 25% of Home and Auto's 1974 net written premiums. This proved unprofitable, a statutory underwriting loss of approximately $1,600,000 was sustained in 1974 on this Florida business, and underwriting in Florida by Home and Auto was terminated in 1974. Losses incurred there are still in process of settlement. Home and Auto's underwriting loss in 1973 was attributable to its Cook County, Illinois business which had historically been profitable. Premium rate increases were effected for the Chicago area writings in the fourth quarter of 1974. This resulted in somewhat lower premium writings in this traditional area of Home and Auto's business in 1974, and it is expected that a significantly lower level of premiums will be written in all of 1975.

Net Sales and Gross Profit from Sales of Textile Products

Efforts to optimize product sales mix have been continuously underway during the last five years in the textile operations. These efforts tend to be most rewarding when demand for all products is strong as it was in 1972, 1973 and during the first three quarters of 1974. The lack of availability of certain desired raw materials was a minor deterrent to these efforts in early 1974. The shortages were, we believe, attributable to distortions existing in the economy generally and have not persisted. In late 1974 demand for our products fell to depressed levels; the major impact of this will be reflected in lower sales and gross profits in 1975.

1973 compared to 1972: Total sales of textile products in 1973 increased over 1972 by approximately 20% measured in dollars, and 14% measured in yards. The increase in unit sales was achieved in a profitable area and this, combined with inflation, caused stated gross profits in 1973 to increase by 25% over 1972. See Note 7 to the consolidated financial statements which discloses the effect on 1973 earnings of the change in that year to the LIFO basis of determining cost of inventories.

1974 compared to 1973: In 1974, unit sales of textile products declined approximately 14% from 1973; but improved product mix and higher selling prices influenced in large part by inflation allowed dollar sales and gross profits to remain almost level with 1973.

Interest and Dividend Income

Interest and dividend income is earned almost entirely by the Insurance Group. The continuing increase in this category of income is the result of increased investments. Interest and dividend income is related to average investments for the past five years in the following table, which excludes the investment in and dividends received from Blue Chip Stamps, which is accounted for by the equity method.

	Average Investments at cost	*Interest and Dividend Income*	*Average Per Cent Earned*
	(Amounts in Thousands)		
1970	51,422	2,942	5.72
1971	79,117	5,043	6.37
1972	103,217	6,648	6.44
1973	117,516	7,378	6.28
1974	131,347	8,030	6.11

The average per cent earned declined in 1973 and 1974 as a result of the increase in the average investments in preferred and common stocks relative to the average investment in bonds; the income yield on the bonds tends to exceed that on the stocks. Investments for the past five years are categorized in the following table, at the average of their carrying values at the beginning and end of each year:

	Bonds, Treasury bills and other short-term obligations	*Preferred and common stocks*	*Total*
		(In Thousands of Dollars)	
1970	41,722	9,700	51,422
1971	68,906	10,211	79,117
1972	87,175	16,042	103,217
1973	81,311	36,205	117,516
1974	78,557	52,790	131,347

Interest Expense

The significant increase in interest expense in 1973, as compared to 1972, is attributable to the increase in indebtedness outstanding as a result of issuance in March of 1973 of $20,000,000 8% Senior Notes due 1993. Part of the proceeds of that financing was used to repay $9,000,000 of bank notes which were outstanding in 1972, with respect to which the effective interest rate had been less than 7%.

Income Taxes (Credit) Applicable to Insurance Underwriting and Textile Operations

Each year there is a significant difference between pre-tax income reported in the financial statements, and income subject to tax. The difference arises principally from certain dividends received credits and

from the fact that a considerable portion of income of the Insurance Group is produced by tax exempt bonds. For 1974, these items exceeded the pre-tax earnings from insurance underwriting and manufacturing operations and all other items of taxable income so that a "net operating loss", as defined by the Internal Revenue Code, was reported for tax purposes. Berkshire Hathaway Inc. and its includible subsidiaries join in the filing of a consolidated Federal income tax return, and the 1974 consolidated net operating loss can be carried back to recover income taxes paid by members of the group for 1971 and 1972. Consequently, an income tax credit to earnings for 1974 appears in the summary of earnings, compared to an income tax expense for preceding years.

Equity in Net Earnings of Bank Subsidiary

Berkshire's equity in net earnings of the Illinois National Bank and Trust Co. of Rockford, a 98% owned subsidiary of Berkshire, increased to $4,093,000 in 1974, an increase of $1,311,000, or 47%, over the $2,782,000 recorded for 1973. The bank incurred no current Federal income tax expense for 1974, benefiting, as a member of the group for which Berkshire files a consolidated Federal income tax return, from the net operating losses sustained by other members of the group. Increases in the banks pre-tax earnings thus virtually became increases in its net earnings.

Income of the bank before income taxes and before securities transactions increased $1,409,000, or 49.7%, over 1973. The sources of this change were as follows (dollars in thousands):

	1974	*1973*	*Change Amount*	*Change %*
Interest income	$10,993	$9,324	$1,669	17.9
Interest expense	4,969	4,351	618	14.2
Net interest earnings	6,024	4,973	1,051	21.1
Non-interest income	1,133	1,080	53	4.9
	7,157	6,053	1,104	18.2
Non-interest expenses	2,915	3,220	(305)	(9.5)
Income before taxes and before securities transactions	$ 4,242	$2,833	$1,409	49.7

Loan demand continued strong throughout the year and was accompanied by record high interest rates. Accordingly, interest income increased as a result of increased volume of earning assets and a higher yield thereon. Increased reliance on interest bearing time deposits as a source of funds and an increased average rate paid thereon caused the rise in interest expense.

Non-interest expense items declined in total primarily as the result of a change instituted by local taxing authorities in assessing to Berkshire, as a shareholder of the bank, certain capital stock taxes previously assessed to the bank. While bank earnings increased as a result of this action by the taxing authorities, the net effect of this change was of no benefit to Berkshire, since taxes not heretofore paid by Berkshire amounting to approximately $260,000 appear as part of Berkshire's 1974 selling and administrative expenses.

Equity in Net Earnings of Blue Chip Stamps

Berkshire's equity in net earnings of Blue Chip Stamps as computed by the equity method for each of the past three years has been as follows:

	1972	*1973*	*1974*
		(Amounts in Thousands)	
Equity in net earnings	$458	$1,605	$1,548
Applicable income taxes	(31)	(116)	(112)
Amortization of excess of cost over equity in net assets	(316)	(481)	(384)
Net equity in earnings	$111	$1,008	$1,052

The number of shares of Blue Chip Stamps owned by Berkshire has increased in each of the past three years. Average shares owned in 1972, 1973 and 1974 were, respectively, 464,527, 934,000, and 1,144,670. Stated on the basis of per-average-share-owned, the above table is as follows:

	1972	1973	1974
Equity in net earnings	$0.99	$1.72	$1.35
Applicable income taxes	(.07)	(.12)	(.10)
Amortization of excess of cost over equity in net assets	(.68)	(.52)	(.33)
Net equity in earnings	$0.24	$1.08	$0.92

Realized Investment Gains (Losses)

Realized investment losses in 1974 aggregated $1,908,000 with a tax carryback credit of $568,000 reducing the after-tax realized investment loss to $1,340,000. In 1973 and 1972 realized investment gains before taxes were, respectively, $1,332,000 and $1,359,000; after taxes, $929,000 and $928,000. Realization of investment gains or losses is determined by prevailing investment strategy as applied under changing economic conditions.

Unrealized market value decreases in investments in preferred and common stocks of unaffiliated companies amounted to $4,356,000 in 1974 and $13,741,000 in 1973, contrasted with a nominal $272,000 increase in 1972. In the absence of operating or investment reasons compelling liquidation, we consider it inappropriate to reflect in income the results of temporary fluctuations in market value of investments; consequently, unrealized investment losses or gains do not appear in the summary of earnings.

During the first ten weeks of 1975, the company realized investment losses of approximately $1,500,000, net of applicable tax credit. Also during the first ten weeks of 1975 management noted a recovery exceeding $10,000,000 in market value of its preferred and common stock portfolio. Neither the lasting effect, total timing nor extent of this recovery in market values can be predicted, but management believes that over the long term, no significant net loss to the company will result from its continued holding or sale of the securities which constituted its portfolio at December 31, 1974.

Berkshire Hathaway Inc.

DIRECTORS AND EXECUTIVE OFFICERS

WARREN E. BUFFETT, *Director and Chairman of the Board*
Chief Executive Officer of the Company

KENNETH V. CHACE, *Director*
President of the Company and Chief Operating Officer of the Textile Operations of the Company

MALCOLM G. CHACE, JR., *Director*
Retired, Former Chairman of the Board of Directors

J. VERNE MCKENZIE, *Director*
Vice President, Secretary and Treasurer of the Company

COMMON STOCK PRICES

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market. The high and low bid prices for the stock in each quarter of 1973 and 1974 is set forth in the following table:

	High	Low
1973 1st Quarter	93	80
2nd Quarter	87	85
3rd Quarter	88	83
4th Quarter	87	71
1974 1st Quarter	76	72
2nd Quarter	76	64
3rd Quarter	64	49
4th Quarter	49	40

The Company has not paid a dividend in the past two years.

BERKSHIRE HATHAWAY INC.

Executive Offices — 97 Cove Street, New Bedford, Massachusetts 02744