BERKSHIRE HATHAWAY INC.

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1984
ANNUAL REPORT TO THE STOCKHOLDERS

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BERKSHIRE HATHAWAY INC.

1984 ANNUAL REPORT

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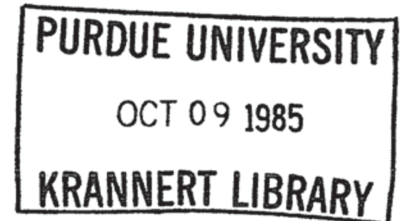

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 1984 was $152.6 million, or $133 per share. This sounds pretty good but actually it's mediocre. Economic gains must be evaluated by comparison with the capital that produces them. Our twenty-year compounded annual gain in book value has been 22.1% (from $19.46 in 1964 to $1108.77 in 1984), but our gain in 1984 was only 13.6%.

As we discussed last year, the gain in per-share intrinsic business value is the economic measurement that really counts. But calculations of intrinsic business value are subjective. In our case, book value serves as a useful, although somewhat understated, proxy. In my judgment, intrinsic business value and book value increased during 1984 at about the same rate.

Using my academic voice, I have told you in the past of the drag that a mushrooming capital base exerts upon rates of return. Unfortunately, my academic voice is now giving way to a reportorial voice. Our historical 22% rate is just that — history. To earn even 15% annually over the next decade (assuming we continue to follow our present dividend policy, about which more will be said later in this letter) we would need profits aggregating about $3.9 billion. Accomplishing this will require a few big ideas — small ones just won't do. Charlie Munger, my partner in general management, and I do not have any such ideas at present, but our experience has been that they pop up occasionally. (How's that for a strategic plan?)

Sources of Reported Earnings

The table on the following page shows the sources of Berkshire's reported earnings. Berkshire's net ownership interest in many of the constituent businesses changed at midyear 1983 when the Blue Chip merger took place. Because of these changes, the first two columns of the table provide the best measure of underlying business performance.

All of the significant gains and losses attributable to unusual sales of assets by any of the business entities are aggregated with securities transactions on the line near the bottom of the table, and are not included in operating earnings. (We regard any annual figure for realized capital gains or losses as meaningless, but we regard the aggregate realized and unrealized capital gains over a period of years as very important.) Furthermore, amortization of Goodwill is not charged against the specific businesses but, for reasons outlined in the Appendix to my letter in the 1983 annual report, is set forth as a separate item.

(000s omitted)

	Earnings Before Income Taxes				Net Earnings After Tax	
	Total		Berkshire Share		Berkshire Share	
	1984	1983	1984	1983	1984	1983
Operating Earnings:						
Insurance Group:						
Underwriting	$ (48,060)	$ (33,872)	$ (48,060)	$ (33,872)	$ (25,955)	$ (18,400)
Net Investment Income	68,903	43,810	68,903	43,810	62,059	39,114
Buffalo News	27,328	19,352	27,328	16,547	13,317	8,832
Nebraska Furniture Mart[1]	14,511	3,812	11,609	3,049	5,917	1,521
See's Candies	26,644	27,411	26,644	24,526	13,380	12,212
Associated Retail Stores	(1,072)	697	(1,072)	697	(579)	355
Blue Chip Stamps[2]	(1,843)	(1,422)	(1,843)	(1,876)	(899)	(353)
Mutual Savings and Loan	1,456	(798)	1,166	(467)	3,151	1,917
Precision Steel	4,092	3,241	3,278	2,102	1,696	1,136
Textiles	418	(100)	418	(100)	226	(63)
Wesco Financial	9,777	7,493	7,831	4,844	4,828	3,448
Amortization of Goodwill	(1,434)	(532)	(1,434)	(563)	(1,434)	(563)
Interest on Debt	(14,734)	(15,104)	(14,097)	(13,844)	(7,452)	(7,346)
Shareholder-Designated Contributions	(3,179)	(3,066)	(3,179)	(3,066)	(1,716)	(1,656)
Other	4,932	10,121	4,529	9,623	3,476	8,490
Operating Earnings	87,739	61,043	82,021	51,410	70,015	48,644
Special GEICO Distribution	—	19,575	—	19,575	—	18,224
Special Gen. Foods Distribution	8,111	—	7,896	—	7,294	—
Sales of securities and unusual sales of assets	104,699	67,260	101,376	65,089	71,587	45,298
Total Earnings — all entities	$200,549	$147,878	$191,293	$136,074	$148,896	$112,166

[1] *1983 figures are those for October through December.*

[2] *1984 and 1983 are not comparable; major assets were transferred in the mid-year 1983 merger of Blue Chip Stamps.*

Sharp-eyed shareholders will notice that the amount of the special GEICO distribution and its location in the table have been changed from the presentation of last year. Though they reclassify and reduce "accounting" earnings, the changes are entirely of form, not of substance. The story behind the changes, however, is interesting.

As reported last year: (1) in mid-1983 GEICO made a tender offer to buy its own shares; (2) at the same time, we agreed by written contract to sell GEICO an amount of its shares that would be proportionately related to the aggregate number of shares GEICO repurchased via the tender from all other shareholders; (3) at completion of the tender, we delivered 350,000 shares to GEICO, received $21 million cash, and were left owning exactly the same percentage of GEICO that we owned before the tender; (4) GEICO's transaction with us amounted to a proportionate redemption, an opinion rendered us, without qualification, by a leading law firm; (5) the Tax Code logically regards such proportionate redemptions as substantially equivalent to dividends and, therefore, the $21 million we received was taxed at only the 6.9% inter-corporate dividend rate; (6) importantly, that $21 million was far less than the previously-undistributed earnings that had inured to our ownership in GEICO and, thus, from the standpoint of economic substance, was in our view equivalent to a dividend.

Because it was material and unusual, we highlighted the GEICO distribution last year to you, both in the applicable quarterly report and in this section of the annual report. Additionally, we emphasized the transaction to our auditors, Peat, Marwick, Mitchell & Co. Both the Omaha office of Peat Marwick and the reviewing Chicago partner, without objection, concurred with our dividend presentation.

In 1984, we had a virtually identical transaction with General Foods. The only difference was that General Foods repurchased its stock over a period of time in the open market, whereas GEICO had made a "one-shot" tender offer. In the General Foods case we sold to the company, on each day that it repurchased shares, a quantity of shares that left our ownership percentage precisely unchanged. Again our transaction was pursuant to a written contract executed before repurchases began. And again the money we received was far less than the retained earnings that had inured to our ownership interest since our purchase. Overall we received $21,843,601 in cash from General Foods, and our ownership remained at exactly 8.75%.

At this point the New York office of Peat Marwick came into the picture. Late in 1984 it indicated that it disagreed with the conclusions of the firm's Omaha office and Chicago reviewing partner. The New York view was that the GEICO and General Foods transactions should be treated as sales of stock by Berkshire rather than as the receipt of dividends. Under this accounting approach, a portion of the cost of our investment in the stock of each company would be charged against the redemption payment and any gain would be shown as a capital gain, not as dividend income. This is an accounting approach only, having no bearing on taxes: Peat Marwick agrees that the transactions were dividends for IRS purposes.

We disagree with the New York position from both the viewpoint of economic substance and proper accounting. But, to avoid a qualified auditor's opinion, we have adopted herein Peat Marwick's 1984 view and restated 1983 accordingly. None of this, however, has any effect on intrinsic business value: our ownership interests in GEICO and General Foods, our cash, our taxes, and the market value and tax basis of our holdings all remain the same.

This year we have again entered into a contract with General Foods whereby we will sell them shares concurrently with open market purchases that they make. The arrangement provides that our ownership interest will remain unchanged at all times. By keeping it so, we will insure ourselves dividend treatment for tax purposes. In our view also, the economic substance of this transaction again is the creation of dividend income. However, we will account for the redemptions as sales of stock rather than dividend income unless accounting rules are adopted that speak directly to this point. We will continue to prominently identify any such special transactions in our reports to you.

While we enjoy a low tax charge on these proportionate redemptions, and have participated in several of them, we view such repurchases as at least equally favorable for shareholders who do not sell. When companies with outstanding businesses and comfortable financial positions find their shares selling far below intrinsic value in the marketplace, no alternative action can benefit shareholders as surely as repurchases.

(Our endorsement of repurchases is limited to those dictated by price/value relationships and does not extend to the "greenmail" repurchase — a practice we find odious and repugnant. In these transactions, two parties achieve their personal ends by exploitation of an innocent and unconsulted third party. The players are: (1) the "shareholder" extortionist who, even before the ink on his stock certificate dries, delivers his "your-money-or-your-life" message to managers; (2) the corporate insiders who quickly seek peace at any price — as long as the price is paid by someone else; and (3) the shareholders whose money is used by (2) to make (1) go away. As the dust settles, the mugging, transient shareholder gives his speech on "free enterprise", the muggee management gives its speech on "the best interests of the company", and the innocent shareholder standing by mutely funds the payoff.)

The companies in which we have our largest investments have all engaged in significant stock repurchases at times when wide discrepancies existed between price and value. As shareholders, we find this encouraging and rewarding for two important reasons — one that is obvious, and one that is subtle and not always understood. The obvious point involves basic arithmetic: major repurchases at prices well below per-share intrinsic business value immediately increase, in a highly significant way, that value. When companies purchase their own stock, they often find it easy to get $2 of present value for $1. Corporate acquisition programs almost never do as well and, in a discouragingly large number of cases, fail to get anything close to $1 of value for each $1 expended.

The other benefit of repurchases is less subject to precise measurement but can be fully as important over time. By making repurchases when a company's market value is well below its business value, management clearly demonstrates that it is given to actions that enhance the wealth of shareholders, rather than to actions that expand management's domain but that do nothing for (or even harm) shareholders. Seeing this, shareholders and potential shareholders increase their estimates of future returns from the business. This upward revision, in turn, produces market prices more in line with intrinsic business value. These prices are entirely rational. Investors should pay more for a business that is lodged in the hands of a manager with demonstrated pro-shareholder leanings than for one in the hands of a self-interested manager marching to a different drummer. (To make the point extreme, how much would you pay to be a minority shareholder of a company controlled by Robert Vesco?)

The key word is "demonstrated". A manager who consistently turns his back on repurchases, when these clearly are in the interests of owners, reveals more than he knows of his motivations. No matter how often or how eloquently he mouths some public relations-inspired phrase such as "maximizing shareholder wealth" (this season's favorite), the market correctly discounts assets lodged with him. His heart is not listening to his mouth — and, after a while, neither will the market.

We have prospered in a very major way — as have other shareholders — by the large share repurchases of GEICO, Washington Post, and General Foods, our three largest holdings. (Exxon, in which we have our fourth largest holding, has also wisely and aggressively repurchased shares but, in this case, we have only recently established our position.) In each of these companies, shareholders have had their interests in outstanding businesses materially enhanced by repurchases made at bargain prices. We feel very comfortable owning interests in businesses such as these that offer excellent economics combined with shareholder-conscious managements.

The following table shows our 1984 yearend net holdings in marketable equities. All numbers exclude the interests attributable to minority shareholders of Wesco and Nebraska Furniture Mart.

No. of Shares		*Cost*	*Market*
		(000s omitted)	
690,975	Affiliated Publications, Inc.	$ 3,516	$ 32,908
740,400	American Broadcasting Companies, Inc.	44,416	46,738
3,895,710	Exxon Corporation	173,401	175,307
4,047,191	General Foods Corporation	149,870	226,137
6,850,000	GEICO Corporation	45,713	397,300
2,379,200	Handy & Harman	27,318	38,662
818,872	Interpublic Group of Companies, Inc.	2,570	28,149
555,949	Northwest Industries	26,581	27,242
2,553,488	Time, Inc.	89,327	109,162
1,868,600	The Washington Post Company	10,628	149,955
		$573,340	$1,231,560
	All Other Common Stockholdings	11,634	37,326
	Total Common Stocks	$584,974	$1,268,886

It's been over ten years since it has been as difficult as now to find equity investments that meet both our qualitative standards and our quantitative standards of value versus price. We try to avoid compromise of these standards, although we find doing nothing the most difficult task of all. (One English statesman attributed his country's greatness in the nineteenth century to a policy of "masterly inactivity". This is a strategy that is far easier for historians to commend than for participants to follow.)

In addition to the figures supplied at the beginning of this section, information regarding the businesses we own appears in Management's Discussion on pages 42-47. An amplified discussion of Wesco's businesses appears in Charlie Munger's report on pages 50-59. You will find particularly interesting his comments about conditions in the thrift industry. Our other major controlled businesses are Nebraska Furniture Mart, See's, Buffalo Evening News, and the Insurance Group, to which we will give some special attention here.

Nebraska Furniture Mart

Last year I introduced you to Mrs. B (Rose Blumkin) and her family. I told you they were terrific, and I understated the case. After another year of observing their remarkable talents and character, I can honestly say that I never have seen a managerial group that either functions or behaves better than the Blumkin family.

Mrs. B, Chairman of the Board, is now 91, and recently was quoted in the local newspaper as saying, "I come home to eat and sleep, and that's about it. I can't wait until it gets daylight so I can get back to the business". Mrs. B is at the store seven days a week, from opening to close, and probably makes more decisions in a day than most CEOs do in a year (better ones, too).

In May Mrs. B was granted an Honorary Doctorate in Commercial Science by New York University. (She's a "fast track" student: not one day in her life was spent in a school room prior to her receipt of the doctorate.) Previous recipients of honorary degrees in business from NYU include Clifton Garvin, Jr., CEO of Exxon Corp.; Walter Wriston, then CEO of Citicorp; Frank Cary, then CEO of IBM; Tom Murphy, then CEO of General Motors; and, most recently, Paul Volcker. (*They* are in good company.)

The Blumkin blood did not run thin. Louie, Mrs. B's son, and his three boys, Ron, Irv, and Steve, all contribute in full measure to NFM's amazing success. The younger generation has attended the best business school of them all — that conducted by Mrs. B and Louie — and their training is evident in their performance.

Last year NFM's net sales increased by $14.3 million, bringing the total to $115 million, all from the one store in Omaha. That is by far the largest volume produced by a single home furnishings store in the United States. In fact, the gain in sales last year was itself greater than the annual volume of many good-sized successful stores. The business achieves this success because it deserves this success. A few figures will tell you why.

In its fiscal 1984 10-K, the largest independent specialty retailer of home furnishings in the country, Levitz Furniture, described its prices as "generally lower than the prices charged by conventional furniture stores in its trading area". Levitz, in that year, operated at a gross margin of 44.4% (that is, on average, customers paid it $100 for merchandise that had cost it $55.60 to buy). The gross margin at NFM is not much more than half of that. NFM's low mark-ups are possible because of its exceptional efficiency: operating expenses (payroll, occupancy, advertising, etc.) are about 16.5% of sales versus 35.6% at Levitz.

None of this is in criticism of Levitz, which has a well-managed operation. But the NFM operation is simply extraordinary (and, remember, it all comes from a $500 investment by Mrs. B in 1937). By unparalleled efficiency and astute volume purchasing, NFM is able to earn excellent returns on capital while saving its customers at least $30 million annually from what, on average, it would cost them to buy the same merchandise at stores maintaining typical mark-ups. Such savings enable NFM to constantly widen its geographical reach and thus to enjoy growth well beyond the natural growth of the Omaha market.

I have been asked by a number of people just what secrets the Blumkins bring to their business. These are not very esoteric. All members of the family: (1) apply themselves with an enthusiasm and energy that would make Ben Franklin and Horatio Alger look like dropouts; (2) define with extraordinary realism their area of special competence and act decisively on all matters within it; (3) ignore even the most enticing propositions falling outside of that area of special competence; and, (4) unfailingly behave in a high-grade manner with everyone they deal with. (Mrs. B boils it down to "sell cheap and tell the truth".)

Our evaluation of the integrity of Mrs. B and her family was demonstrated when we purchased 90% of the business: NFM had never had an audit and we did not request one; we did not take an inventory nor verify the receivables; we did not check property titles. We gave Mrs. B a check for $55 million and she gave us her word. That made for an even exchange.

You and I are fortunate to be in partnership with the Blumkin family.

See's Candy Shops, Inc.

Below is our usual recap of See's performance since the time of purchase by Blue Chip Stamps:

52-53 Week Year Ended About December 31	Sales Revenues	Operating Profits After Taxes	Number of Pounds of Candy Sold	Number of Stores Open at Year End
1984	$135,946,000	$13,380,000	24,759,000	214
1983 (53 weeks)	133,531,000	13,699,000	24,651,000	207
1982	123,662,000	11,875,000	24,216,000	202
1981	112,578,000	10,779,000	24,052,000	199
1980	97,715,000	7,547,000	24,065,000	191
1979	87,314,000	6,330,000	23,985,000	188
1978	73,653,000	6,178,000	22,407,000	182
1977	62,886,000	6,154,000	20,921,000	179
1976 (53 weeks)	56,333,000	5,569,000	20,553,000	173
1975	50,492,000	5,132,000	19,134,000	172
1974	41,248,000	3,021,000	17,883,000	170
1973	35,050,000	1,940,000	17,813,000	169
1972	31,337,000	2,083,000	16,954,000	167

This performance has not been produced by a generally rising tide. To the contrary, many well-known participants in the boxed-chocolate industry either have lost money in this same period or have been marginally profitable. To our knowledge, only one good-sized competitor has achieved high profitability. The success of See's reflects the combination of an exceptional product and an exceptional manager, Chuck Huggins.

During 1984 we increased prices considerably less than has been our practice in recent years: per-pound realization was $5.49, up only 1.4% from 1983. Fortunately, we made good progress on cost control, an area that has caused us problems in recent years. Per-pound costs — other than those for raw materials, a segment of expense largely outside of our control — increased by only 2.2% last year.

Our cost-control problem has been exacerbated by the problem of modestly declining volume (measured by pounds, not dollars) on a same-store basis. Total pounds sold through shops in recent years has been maintained at a roughly constant level only by the net addition of a few shops annually. This more-shops-to-get-the-same-volume situation naturally puts heavy pressure on per-pound selling costs.

In 1984, same-store volume declined 1.1%. Total shop volume, however, grew 0.6% because of an increase in stores. (Both percentages are adjusted to compensate for a 53-week fiscal year in 1983.)

See's business tends to get a bit more seasonal each year. In the four weeks prior to Christmas, we do 40% of the year's volume and earn about 75% of the year's profits. We also earn significant sums in the Easter and Valentine's Day periods, but pretty much tread water the rest of the year. In recent years, shop volume at Christmas has grown in relative importance, and so have quantity orders and mail orders. The increased concentration of business in the Christmas period produces a multitude of managerial problems, all of which have been handled by Chuck and his associates with exceptional skill and grace.

Their solutions have in no way involved compromises in either quality of service or quality of product. Most of our larger competitors could not say the same. Though faced with somewhat less extreme peaks and valleys in demand than we, they add preservatives or freeze the finished product in order to smooth the production cycle and thereby lower unit costs. We reject such techniques, opting, in effect, for production headaches rather than product modification.

Our mall stores face a host of new food and snack vendors that provide particularly strong competition at non-holiday periods. We need new products to fight back and during 1984 we introduced six candy bars that, overall, met with a good reception. Further product introductions are planned.

In 1985 we will intensify our efforts to keep per-pound cost increases below the rate of inflation. Continued success in these efforts, however, will require gains in same-store poundage. Prices in 1985 should average 6% - 7% above those of 1984. Assuming no change in same-store volume, profits should show a moderate gain.

Buffalo Evening News

Profits at the News in 1984 were considerably greater than we expected. As at See's, excellent progress was made in controlling costs. Excluding hours worked in the newsroom, total hours worked decreased by about 2.8%. With this productivity improvement, overall costs increased only 4.9%. This performance by Stan Lipsey and his management team was one of the best in the industry.

However, we now face an acceleration in costs. In mid-1984 we entered into new multi-year union contracts that provided for a large "catch-up" wage increase. This catch-up is entirely appropriate: the cooperative spirit of our unions during the unprofitable 1977-1982 period was an important factor in our success in remaining cost competitive with The Courier-Express. Had we not kept costs down, the outcome of that struggle might well have been different.

Because our new union contracts took effect at varying dates, little of the catch-up increase was reflected in our 1984 costs. But the increase will be almost totally effective in 1985 and, therefore, our unit labor costs will rise this year at a rate considerably greater than that of the industry. We expect to mitigate this increase by continued small gains in productivity, but we cannot avoid significantly higher wage costs this year. Newsprint price trends also are less favorable now than they were in 1984. Primarily because of these two factors, we expect at least a minor contraction in margins at the News.

Working in our favor at the News are two factors of major economic importance:

(1) Our circulation is concentrated to an unusual degree in the area of maximum utility to our advertisers. "Regional" newspapers with wide-ranging circulation, on the other hand, have a significant portion of their circulation in areas that are of negligible utility to most advertisers. A subscriber several hundred miles away is not much of a prospect for the puppy you are offering to sell via a classified ad — nor for the grocer with stores only in the metropolitan area. "Wasted" circulation — as the advertisers call it — hurts profitability: expenses of a newspaper are determined largely by gross circulation while advertising revenues (usually 70% - 80% of total revenues) are responsive only to useful circulation;

(2) Our penetration of the Buffalo retail market is exceptional; advertisers can reach almost all of their potential customers using only the News.

Last year I told you about this unusual reader acceptance: among the 100 largest newspapers in the country, we were then number one, daily, and number three, Sunday, in penetration. The most recent figures show us number one in penetration on weekdays and number two on Sunday. (Even so, the number of households in Buffalo has declined, so our current weekday circulation is down slightly; on Sundays it is unchanged.)

I told you also that one of the major reasons for this unusual acceptance by readers was the unusual quantity of news that we delivered to them: a greater percentage of our paper is devoted to news than is the case at any other dominant paper in our size range. In 1984 our "news hole" ratio was 50.9% (versus 50.4% in 1983), a level far above the typical 35% - 40%. We will continue to maintain this ratio in the 50% area. Also, though we last year reduced total hours worked in other departments, we maintained the level of employment in the newsroom and, again, will continue to do so. Newsroom costs advanced 9.1% in 1984, a rise far exceeding our overall cost increase of 4.9%.

Our news hole policy costs us significant extra money for newsprint. As a result, our news costs (newsprint for the news hole plus payroll and expenses of the newsroom) as a percentage of revenue run higher than those of most dominant papers of our size. There is adequate room, however, for our paper or any other dominant paper to sustain these costs: the difference between "high" and "low" news costs at papers of comparable size runs perhaps three percentage points while pre-tax profit margins are often ten times that amount.

The economics of a dominant newspaper are excellent, among the very best in the business world. Owners, naturally, would like to believe that their wonderful profitability is achieved only because they unfailingly turn out a wonderful product. That comfortable theory wilts before an uncomfortable fact. While first-class newspapers make excellent profits, the profits of third-rate papers are as good or better — as long as either class of paper is dominant within its community. Of course, product quality may have been crucial to the paper in achieving dominance. We believe this was the case at the News, in very large part because of people such as Alfred Kirchhofer who preceded us.

Once dominant, the newspaper itself, not the marketplace, determines just how good or how bad the paper will be. Good or bad, it will prosper. That is not true of most businesses: inferior quality generally produces inferior economics. But even a poor newspaper is a bargain to most citizens simply because of its "bulletin board" value. Other things being equal, a poor product will not achieve quite the level of readership achieved by a first-class product. A poor product, however, will still remain essential to most citizens, and what commands their attention will command the attention of advertisers.

Since high standards are not imposed by the marketplace, management must impose its own. Our commitment to an above-average expenditure for news represents an important quantitative standard. We have confidence that Stan Lipsey and Murray Light will continue to apply the far-more-important qualitative standards. Charlie and I believe that newspapers are very special institutions in society. We are proud of the News, and intend an even greater pride to be justified in the years ahead.

Insurance Operations

Shown below is an updated version of our usual table listing two key figures for the insurance industry:

	Yearly Change in Premiums Written (%)	*Combined Ratio after Policy-holder Dividends*
1972	10.2	96.2
1973	8.0	99.2
1974	6.2	105.4
1975	11.0	107.9
1976	21.9	102.4
1977	19.8	97.2
1978	12.8	97.5
1979	10.3	100.6
1980	6.0	103.1
1981	3.9	106.0
1982	4.4	109.7
1983 (Revised)	4.5	111.9
1984 (Estimated)	8.1	117.7

Source: Best's *Aggregates and Averages*

Best's data reflect the experience of practically the entire industry, including stock, mutual, and reciprocal companies. The combined ratio represents total insurance costs (losses incurred plus expenses) compared to revenue from premiums; a ratio below 100 indicates an underwriting profit, and one above 100 indicates a loss.

For a number of years, we have told you that an annual increase by the industry of about 10% per year in premiums written is necessary for the combined ratio to remain roughly unchanged. We assumed in making that assertion that expenses as a percentage of premium volume would stay relatively stable and that losses would grow at about 10% annually because of the combined influence of unit volume increases, inflation, and judicial rulings that expand what is covered by the insurance policy.

Our opinion is proving dismayingly accurate: a premium increase of 10% per year since 1979 would have produced an aggregate increase through 1984 of 61% and a combined ratio in 1984 almost identical to the 100.6 of 1979. Instead, the industry had only a 30% increase in premiums and a 1984 combined ratio of 117.7. Today, we continue to believe that the key index to the trend of underwriting profitability is the year-to-year percentage change in industry premium volume.

It now appears that premium volume in 1985 will grow well over 10%. Therefore, assuming that catastrophes are at a "normal" level, we would expect the combined ratio to begin easing downward toward the end of the year. However, under our industrywide loss assumptions (i.e., increases of 10% annually), five years of 15%-per-year increases in premiums would be required to get the combined ratio back to 100. This would mean a doubling of industry volume by 1989, an outcome that seems highly unlikely to us. Instead, we expect several years of premium gains somewhat above the 10% level, followed by highly-competitive pricing that generally will produce combined ratios in the 108-113 range.

Our own combined ratio in 1984 was a humbling 134. (Here, as throughout this report, we exclude structured settlements and the assumption of loss reserves in reporting this ratio. Much additional detail, including the effect of discontinued operations on the ratio, appears on pages 42-43). This is the third year in a row that our underwriting performance has been far poorer than that of the industry. We expect an improvement in the combined ratio in 1985, and also expect our improvement to be substantially greater than that of the industry. Mike Goldberg has corrected many of the mistakes I made before he took over insurance operations. Moreover, our business is concentrated in lines that have experienced poorer-than-average results during the past several years, and that circumstance has begun to subdue many of our competitors and even eliminate some. With the competition shaken, we were able during the last half of 1984 to raise prices significantly in certain important lines with little loss of business.

For some years I have told you that there could be a day coming when our premier financial strength would make a real difference in the competitive position of our insurance operation. That day may have arrived. We are almost without question the strongest property/casualty insurance operation in the country, with a capital position far superior to that of well-known companies of much greater size.

Equally important, our corporate policy is to retain that superiority. The buyer of insurance receives only a promise in exchange for his cash. The value of that promise should be appraised against the possibility of adversity, not prosperity. At a minimum, the promise should appear able to withstand a prolonged combination of depressed financial markets and exceptionally unfavorable underwriting results. Our insurance subsidiaries are both willing and able to keep their promises in any such environment — and not too many other companies clearly are.

Our financial strength is a particular asset in the business of structured settlements and loss reserve assumptions that we reported on last year. The claimant in a structured settlement and the insurance company that has reinsured loss reserves need to be completely confident that payments will be forthcoming for decades to come. Very few companies in the property/casualty field can meet this test of unquestioned long-term strength. (In fact, only a handful of companies exists with which we will reinsure our own liabilities.)

We have grown in these new lines of business: funds that we hold to offset assumed liabilities grew from $16.2 million to $30.6 million during the year. We expect growth to continue and perhaps to greatly accelerate. To support this projected growth we have added substantially to the capital of Columbia Insurance Company, our reinsurance unit specializing in structured settlements and loss-reserve assumptions. While these businesses are very competitive, returns should be satisfactory.

At GEICO the news, as usual, is mostly good. That company achieved excellent unit growth in its primary insurance business during 1984, and the performance of its investment portfolio continued to be extraordinary. Though underwriting results deteriorated late in the year, they still remain far better than those of the industry. Our ownership in GEICO at yearend amounted to 36% and thus our interest in their direct property/casualty volume of $885 million amounted to $320 million, or well over double our own premium volume.

I have reported to you in the past few years that the performance of GEICO's stock has considerably exceeded that company's business performance, brilliant as the latter has been. In those years, the carrying value of our GEICO investment on our balance sheet grew at a rate greater than the growth in GEICO's intrinsic business value. I warned you that overperformance by the stock relative to the performance of the business obviously could not occur every year, and that in some years the stock must underperform the business. In 1984 that occurred and the carrying value of our interest in GEICO changed hardly at all, while the intrinsic business value of that interest increased substantially. Since 27% of Berkshire's net worth at the beginning of 1984 was represented by GEICO, its static market value had a significant impact upon our rate of gain for the year. We are not at all unhappy with such a result: we would far rather have the business value of GEICO increase by X during the year, while market value decreases, than have the intrinsic value increase by only ½ X with market value soaring. In GEICO's case, as in all of our investments, we look to business performance, not market performance. If we are correct in expectations regarding the business, the market eventually will follow along.

You, as shareholders of Berkshire, have benefited in enormous measure from the talents of GEICO's Jack Byrne, Bill Snyder, and Lou Simpson. In its core business — low-cost auto and homeowners insurance — GEICO has a major, sustainable competitive advantage. That is a rare asset in business generally, and it's almost non-existent in the field of financial services. (GEICO, itself, illustrates this point: despite the company's excellent management, superior profitability has eluded GEICO in all endeavors other than its core business.) In a large industry, a competitive advantage such as GEICO's provides the potential for unusual economic rewards, and Jack and Bill continue to exhibit great skill in realizing that potential.

Most of the funds generated by GEICO's core insurance operation are made available to Lou for investment. Lou has the rare combination of temperamental and intellectual characteristics that produce outstanding long-term investment performance. Operating with below-average risk, he has generated returns that have been by far the best in the insurance industry. I applaud and appreciate the efforts and talents of these three outstanding managers.

Errors in Loss Reserving

Any shareholder in a company with important interests in the property/casualty insurance business should have some understanding of the weaknesses inherent in the reporting of current earnings in that industry. Phil Graham, when publisher of the Washington Post, described the daily newspaper as "a first rough draft of history". Unfortunately, the financial statements of a property/casualty insurer provide, at best, only a first rough draft of earnings and financial condition.

The determination of costs is the main problem. Most of an insurer's costs result from losses on claims, and many of the losses that should be charged against the current year's revenue are exceptionally difficult to estimate. Sometimes the extent of these losses, or even their existence, is not known for decades.

The loss expense charged in a property/casualty company's current income statement represents: (1) losses that occurred and were paid during the year; (2) estimates for losses that occurred and were reported to the insurer during the year, but which have yet to be settled; (3) estimates of ultimate dollar costs for losses that occurred during the year but of which the insurer is unaware (termed "IBNR": incurred but not reported); and (4) the net effect of revisions this year of similar estimates for (2) and (3) made in past years.

Such revisions may be long delayed, but eventually any estimate of losses that causes the income for year X to be misstated must be corrected, whether it is in year X + 1, or X + 10. This, perforce, means that earnings in the year of correction also are misstated. For example, assume a claimant was injured by one of our insureds in 1979 and we thought a settlement was likely to be made for $10,000. That year we would have charged $10,000 to our earnings statement for the estimated cost of the loss and, correspondingly, set up a liability reserve on the balance sheet for that amount. If we settled the claim in 1984 for $100,000, we would charge earnings with a loss cost of $90,000 in 1984, although that cost was truly an expense of 1979. And if that piece of business was our only activity in 1979, we would have badly misled ourselves as to costs, and you as to earnings.

The necessarily-extensive use of estimates in assembling the figures that appear in such deceptively precise form in the income statement of property/casualty companies means that some error must seep in, no matter how proper the intentions of management. In an attempt to minimize error, most insurers use various statistical techniques to adjust the thousands of individual loss evaluations (called case reserves) that comprise the raw data for estimation of aggregate liabilities. The extra reserves created by these adjustments are variously labeled "bulk", "development", or "supplemental" reserves. The goal of the adjustments should be a loss-reserve total that has a 50-50 chance of being proved either slightly too high or slightly too low when all losses that occurred prior to the date of the financial statement are ultimately paid.

At Berkshire, we have added what we thought were appropriate supplemental reserves but in recent years they have not been adequate. It is important that you understand the magnitude of the errors that have been involved in our reserving. You can thus see for yourselves just how imprecise the process is, and also judge whether we may have some systemic bias that should make you wary of our current and future figures.

The following table shows the results from insurance underwriting as we have reported them to you in recent years, and also gives you calculations a year later on an "if-we-knew-then-what-we-think-we-know-now" basis. I say "what we think we know now" because the adjusted figures still include a great many estimates for losses that occurred in the earlier years. However, many claims from the earlier years have been settled so that our one-year-later estimate contains less guess work than our earlier estimate:

Year	*Underwriting Results as Reported to You*	*Corrected Figures After One Year's Experience*
1980	$ 6,738,000	$14,887,000
1981	1,478,000	(1,118,000)
1982	(21,462,000)	(25,066,000)
1983	(33,192,000)	(50,974,000)
1984	(45,413,000)	?

Our structured settlement and loss-reserve assumption businesses are not included in this table. Important additional information on loss reserve experience appears on pages 43-45.

To help you understand this table, here is an explanation of the most recent figures: 1984's reported pre-tax underwriting loss of $45.4 million consists of $27.6 million we estimate that we lost on 1984's business, *plus* the increased loss of $17.8 million reflected in the corrected figure for 1983.

As you can see from reviewing the table, my errors in reporting to you have been substantial and recently have always presented a better underwriting picture than was truly the case. This is a source of particular chagrin to me because: (1) I like for you to be able to count on what I say; (2) our insurance managers and I undoubtedly acted with less urgency than we would have had we understood the full extent of our losses; and (3) we paid income taxes calculated on overstated earnings and thereby gave the government money that we didn't need to. (These overpayments eventually correct themselves, but the delay is long and we don't receive interest on the amounts we overpaid.)

Because our business is weighted toward casualty and reinsurance lines, we have more problems in estimating loss costs than companies that specialize in property insurance. (When a building that you have insured burns down, you get a much faster fix on your costs than you do when an employer you have insured finds out that one of his retirees has contracted a disease attributable to work he did decades earlier.) But I still find our errors embarrassing. In our direct business, we have far underestimated the mushrooming tendency of juries and courts to make the "deep pocket" pay, regardless of the factual situation and the past precedents for establishment of liability. We also have underestimated the contagious effect that publicity regarding giant awards has on juries. In the reinsurance area, where we have had our worst experience in underreserving, our customer insurance companies have made the same mistakes. Since we set reserves based on information they supply us, their mistakes have become our mistakes.

I heard a story recently that is applicable to our insurance accounting problems: a man was traveling abroad when he received a call from his sister informing him that their father had died unexpectedly. It was physically impossible for the brother to get back home for the funeral, but he told his sister to take care of the funeral arrangements and to send the bill to him. After returning home he received a bill for several thousand dollars, which he promptly paid. The following month another bill came along for $15, and he paid that too. Another month followed, with a similar bill. When, in the next month, a third bill for $15 was presented, he called his sister to ask what was going on. "Oh", she said. "I forgot to tell you. We buried Dad in a rented suit."

If you've been in the insurance business in recent years — particularly the reinsurance business — this story hurts. We have tried to include all of our "rented suit" liabilities in our current financial statement, but our record of past error should make us humble, and you suspicious. I will continue to report to you the errors, plus or minus, that surface each year.

Not all reserving errors in the industry have been of the innocent-but-dumb variety. With underwriting results as bad as they have been in recent years — and with managements having as much discretion as they do in the presentation of financial statements — some unattractive aspects of human nature have manifested themselves. Companies that would be out of business if they realistically appraised their loss costs have, in some cases, simply preferred to take an extraordinarily optimistic view about these yet-to-be-paid sums. Others have engaged in various transactions to hide true current loss costs.

Both of these approaches can "work" for a considerable time: external auditors cannot effectively police the financial statements of property/casualty insurers. If liabilities of an insurer, correctly stated, would exceed assets, it falls to the insurer to volunteer this morbid information. In other words, the corpse is supposed to file the death certificate. Under this "honor system" of mortality, the corpse sometimes gives itself the benefit of the doubt.

In most businesses, of course, insolvent companies run out of cash. Insurance is different: you can be broke but flush. Since cash comes in at the inception of an insurance policy and losses are paid much later, insolvent insurers don't run out of cash until long after they have run out of net worth. In fact, these "walking dead" often redouble their efforts to write business, accepting almost any price or risk, simply to keep the cash flowing in. With an attitude like that of an embezzler who has gambled away his purloined funds, these companies hope that somehow they can get lucky on the next batch of business and thereby cover up earlier shortfalls. Even if they don't get lucky, the penalty to managers is usually no greater for a $100 million shortfall than one of $10 million; in the meantime, while the losses mount, the managers keep their jobs and perquisites.

The loss-reserving errors of other property/casualty companies are of more than academic interest to Berkshire. Not only does Berkshire suffer from sell-at-any-price competition by the "walking dead", but we also suffer when their insolvency is finally acknowledged. Through various state guarantee funds that levy assessments, Berkshire ends up paying a portion of the insolvent insurers' asset deficiencies, swollen as they usually are by the delayed detection that results from wrong reporting. There is even some potential for cascading trouble. The insolvency of a few large insurers and the assessments by state guarantee funds that would follow could imperil weak-but-previously-solvent insurers. Such dangers can be mitigated if state regulators become better at prompt identification and termination of insolvent insurers, but progress on that front has been slow.

Washington Public Power Supply System

From October, 1983 through June, 1984 Berkshire's insurance subsidiaries continuously purchased large quantities of bonds of Projects 1, 2, and 3 of Washington Public Power Supply System ("WPPSS"). This is the same entity that, on July 1, 1983, defaulted on $2.2 billion of bonds issued to finance partial construction of the now-abandoned Projects 4 and 5. While there are material differences in the obligors, promises, and properties underlying the two categories of bonds, the problems of Projects 4 and 5 have cast a major cloud over Projects 1, 2, and 3, and might possibly cause serious problems for the latter issues. In addition, there have been a multitude of problems related directly to Projects 1, 2, and 3 that could weaken or destroy an otherwise strong credit position arising from guarantees by Bonneville Power Administration.

Despite these important negatives, Charlie and I judged the risks *at the time we purchased the bonds and at the prices Berkshire paid* (much lower than present prices) to be considerably more than compensated for by prospects of profit.

As you know, we buy marketable stocks for our insurance companies based upon the criteria we would apply in the purchase of an entire business. This business-valuation approach is not widespread among professional money managers and is scorned by many academics. Nevertheless, it has served its followers well (to which the academics seem to say, "Well, it may be all right in practice, but it will never work in theory.") Simply put, we feel that if we can buy small pieces of businesses with satisfactory underlying economics at a fraction of the per-share value of the entire business, something good is likely to happen to us — particularly if we own a group of such securities.

We extend this business-valuation approach even to bond purchases such as WPPSS. We compare the $139 million cost of our yearend investment in WPPSS to a similar $139 million investment in an operating business. In the case of WPPSS, the "business" contractually earns $22.7 million after tax (via the interest paid on the bonds), and those earnings are available to us currently in cash. We are unable to buy operating businesses with economics close to these. Only a relatively few businesses earn the 16.3% after tax on unleveraged capital that our WPPSS investment does and those businesses, when available for purchase, sell at large premiums to that capital. In the average negotiated business transaction, unleveraged corporate earnings of $22.7 million after-tax (equivalent to about $45 million pre-tax) might command a price of $250 - $300 million (or sometimes far more). For a business we understand well and strongly like, we will gladly pay that much. But it is double the price we paid to realize the same earnings from WPPSS bonds.

However, in the case of WPPSS, there is what we view to be a very slight risk that the "business" could be worth *nothing* within a year or two. There also is the risk that interest payments might be interrupted for a considerable period of time. Furthermore, the most that the "business" could be worth is about the $205 million face value of the bonds that we own, an amount only 48% higher than the price we paid.

This ceiling on upside potential is an important minus. It should be realized, however, that the great majority of operating businesses have a limited upside potential also unless more capital is continuously invested in them. That is so because most businesses are unable to significantly improve their average returns on equity — even under inflationary conditions, though these were once thought to automatically raise returns.

(Let's push our bond-as-a-business example one notch further: if you elect to "retain" the annual earnings of a 12% bond by using the proceeds from coupons to buy more bonds, earnings of that bond "business" will grow at a rate comparable to that of most operating businesses that similarly reinvest all earnings. In the first instance, a 30-year, zero-coupon, 12% bond purchased today for $10 million will be worth $300 million in 2015. In the second, a $10 million business that regularly earns 12% on equity and retains all earnings to grow, will also end up with $300 million of capital in 2015. Both the business and the bond will earn over $32 million in the final year.)

Our approach to bond investment — treating it as an unusual sort of "business" with special advantages and disadvantages — may strike you as a bit quirky. However, we believe that many staggering errors by investors could have been avoided if they had viewed bond investment with a businessman's perspective. For example, in 1946, 20-year AAA tax-exempt bonds traded at slightly below a 1% yield. In effect, the buyer of those bonds at that time bought a "business" that earned about 1% on "book value" (and that, moreover, could never earn a dime more than 1% on book), and paid 100 cents on the dollar for that abominable business.

If an investor had been business-minded enough to think in those terms — and that was the precise reality of the bargain struck — he would have laughed at the proposition and walked away. For, at the same time, businesses with excellent future prospects could have been bought at, or close to, book value while earning 10%, 12%, or 15% after tax on book. Probably no business in America changed hands in 1946 at book value that the buyer believed lacked the ability to earn more than 1% on book. But investors with bond-buying habits eagerly made economic commitments throughout the year on just that basis. Similar, although less extreme, conditions prevailed for the next two decades as bond investors happily signed up for twenty or thirty years on terms outrageously inadequate by business standards. (In what I think is by far the best book on investing ever written — "The Intelligent Investor", by Ben Graham — the last section of the last chapter begins with, "Investment is most intelligent when it is most businesslike." This section is called "A Final Word", and it is appropriately titled.)

We will emphasize again that there is unquestionably some risk in the WPPSS commitment. It is also the sort of risk that is difficult to evaluate. Were Charlie and I to deal with 50 similar evaluations over a lifetime, we would expect our judgment to prove reasonably satisfactory. But we do not get the chance to make 50 or even 5 such decisions in a single year. Even though our long-term results may turn out fine, in any given year we run a risk that we will look extraordinarily foolish. (That's why all of these sentences say "Charlie and I", or "we".)

Most managers have very little incentive to make the intelligent-but-with-some-chance-of-looking-like-an-idiot decision. Their personal gain/loss ratio is all too obvious: if an unconventional decision works out well, they get a pat on the back and, if it works out poorly, they get a pink slip. (Failing conventionally is the route to go; as a group, lemmings may have a rotten image, but no individual lemming has ever received bad press.)

Our equation is different. With 47% of Berkshire's stock, Charlie and I don't worry about being fired, and we receive our rewards as owners, not managers. Thus we behave with Berkshire's money as we would with our own. That frequently leads us to unconventional behavior both in investments and general business management.

We remain unconventional in the degree to which we concentrate the investments of our insurance companies, including those in WPPSS bonds. This concentration makes sense only because our insurance business is conducted from a position of exceptional financial strength. For almost all other insurers, a comparable degree of concentration (or anything close to it) would be totally inappropriate. Their capital positions are not strong enough to withstand a big error, no matter how attractive an investment opportunity might appear when analyzed on the basis of probabilities.

With our financial strength we can own large blocks of a few securities that we have thought hard about and bought at attractive prices. (Billy Rose described the problem of over-diversification: "If you have a harem of forty women, you never get to know any of them very well.") Over time our policy of concentration should produce superior results, though these will be tempered by our large size. When this policy produces a really bad year, *as it must*, at least you will know that our money was committed on the same basis as yours.

We made the major part of our WPPSS investment at different prices and under somewhat different factual circumstances than exist at present. If we decide to change our position, we will not inform shareholders until long after the change has been completed. (We may be buying or selling as you read this.) The buying and selling of securities is a competitive business, and even a modest amount of added competition on either side can cost us a great deal of money. Our WPPSS purchases illustrate this principle. From October, 1983 through June, 1984, we attempted to buy almost all the bonds that we could of Projects 1, 2, and 3. Yet we purchased less than 3% of the bonds outstanding. Had we faced even a few additional well-heeled investors, stimulated to buy because they knew we were, we could have ended up with a materially smaller amount of bonds, purchased at a materially higher price. (A couple of coat-tail riders easily could have cost us $5 million.) For this reason, we will not comment about our activities in securities — neither to the press, nor shareholders, nor to anyone else — unless legally required to do so.

One final observation regarding our WPPSS purchases: we dislike the purchase of most long-term bonds under most circumstances and have bought very few in recent years. That's because bonds are as sound as a dollar — and we view the long-term outlook for dollars as dismal. We believe substantial inflation lies ahead, although we have no idea what the average rate will turn out to be. Furthermore, we think there is a small, but not insignificant, chance of runaway inflation.

Such a possibility may seem absurd, considering the rate to which inflation has dropped. But we believe that present fiscal policy — featuring a huge deficit — is both extremely dangerous and difficult to reverse. (So far, most politicians in both parties have followed Charlie Brown's advice: "No problem is so big that it can't be run away from.") Without a reversal, high rates of inflation may be delayed (perhaps for a long time), but will not be avoided. If high rates materialize, they bring with them the potential for a runaway upward spiral.

While there is not much to choose between bonds and stocks (as a class) when annual inflation is in the 5%-10% range, runaway inflation is a different story. In that circumstance, a diversified stock portfolio would almost surely suffer an enormous loss in real value. But bonds already outstanding would suffer far more. Thus, we think an all-bond portfolio carries a small but unacceptable "wipe-out" risk, and we require *any* purchase of long-term bonds to clear a special hurdle. Only when bond purchases appear decidedly superior to other business opportunities will we engage in them. Those occasions are likely to be few and far between.

Dividend Policy

Dividend policy is often reported to shareholders, but seldom explained. A company will say something like, "Our goal is to pay out 40% to 50% of earnings and to increase dividends at a rate at least equal to the rise in the CPI". And that's it — no analysis will be supplied as to why that particular policy is best for the owners of the business. Yet, allocation of capital is crucial to business and investment management. Because it is, we believe managers and owners should think hard about the circumstances under which earnings should be retained and under which they should be distributed.

The first point to understand is that all earnings are not created equal. In many businesses — particularly those that have high asset/profit ratios — inflation causes some or all of the reported earnings to become ersatz. The ersatz portion — let's call these earnings "restricted" — cannot, if the business is to retain its economic position, be distributed as dividends. Were these earnings to be paid out, the business would lose ground in one or more of the following areas: its ability to maintain its unit volume of sales, its long-term competitive position, its financial strength. No matter how conservative its payout ratio, a company that consistently distributes restricted earnings is destined for oblivion unless equity capital is otherwise infused.

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Restricted earnings are seldom valueless to owners, but they often must be discounted heavily. In effect, they are conscripted by the business, no matter how poor its economic potential. (This retention-no-matter-how-unattractive-the-return situation was communicated unwittingly in a marvelously ironic way by Consolidated Edison a decade ago. At the time, a punitive regulatory policy was a major factor causing the company's stock to sell as low as one-fourth of book value; i.e., every time a dollar of earnings was retained for reinvestment in the business, that dollar was transformed into only 25¢ of market value. But, despite this gold-into-lead process, most earnings were reinvested in the business rather than paid to owners. Meanwhile, at construction and maintenance sites throughout New York, signs proudly proclaimed the corporate slogan, "Dig We Must".)

Restricted earnings need not concern us further in this dividend discussion. Let's turn to the much-more-valued unrestricted variety. These earnings may, with equal feasibility, be retained or distributed. In our opinion, management should choose whichever course makes greater sense for the owners of the business.

This principle is not universally accepted. For a number of reasons managers like to withhold unrestricted, readily distributable earnings from shareholders — to expand the corporate empire over which the managers rule, to operate from a position of exceptional financial comfort, etc. But we believe there is only one valid reason for retention. Unrestricted earnings should be retained only when there is a reasonable prospect — backed preferably by historical evidence or, when appropriate, by a thoughtful analysis of the future — that *for every dollar retained by the corporation, at least one dollar of market value will be created for owners*. This will happen only if the capital retained produces incremental earnings equal to, or above, those generally available to investors.

To illustrate, let's assume that an investor owns a risk-free 10% perpetual bond with one very unusual feature. Each year the investor can elect either to take his 10% coupon in cash, or to reinvest the coupon in more 10% bonds with identical terms; i.e., a perpetual life and coupons offering the same cash-or-reinvest option. If, in any given year, the prevailing interest rate on long-term, risk-free bonds is 5%, it would be foolish for the investor to take his coupon in cash since the 10% bonds he could instead choose would be worth considerably more than 100¢ on the dollar. Under these circumstances, the investor wanting to get his hands on cash should take his coupon in additional bonds and then immediately sell them. By doing that, he would realize more cash than if he had taken his coupon directly in cash. Assuming all bonds were held by rational investors, no one would opt for cash in an era of 5% interest rates, not even those bondholders needing cash for living purposes.

If, however, interest rates were 15%, no rational investor would want his money invested for him at 10%. Instead, the investor would choose to take his coupon in cash, even if his personal cash needs were nil. The opposite course — reinvestment of the coupon — would give an investor additional bonds with market value far less than the cash he could have elected. If he should want 10% bonds, he can simply take the cash received and buy them in the market, where they will be available at a large discount.

An analysis similar to that made by our hypothetical bondholder is appropriate for owners in thinking about whether a company's unrestricted earnings should be retained or paid out. Of course, the analysis is much more difficult and subject to error because the rate earned on reinvested earnings is not a contractual figure, as in our bond case, but rather a fluctuating figure. Owners must guess as to what the rate will average over the intermediate future. However, once an informed guess is made, the rest of the analysis is simple: you should wish your earnings to be reinvested if they can be expected to earn high returns, and you should wish them paid to you if low returns are the likely outcome of reinvestment.

Many corporate managers reason very much along these lines in determining whether subsidiaries should distribute earnings to their parent company. At that level, the managers have no trouble thinking like intelligent owners. But payout decisions at the parent company level often are a different story. Here managers frequently have trouble putting themselves in the shoes of their shareholder-owners.

With this schizoid approach, the CEO of a multi-divisional company will instruct Subsidiary A, whose earnings on incremental capital may be expected to average 5%, to distribute all available earnings in order that they may be invested in Subsidiary B, whose earnings on incremental capital are expected to be 15%. The CEO's business school oath will allow no lesser behavior. But if his own long-term record with incremental capital is 5% — and market rates are 10% — he is likely to impose a dividend policy on shareholders of the parent company that merely follows some historical or industry-wide payout pattern. Furthermore, he will expect managers of subsidiaries to give him a full account as to why it makes sense for earnings to be retained in their operations rather than distributed to the parent-owner. But seldom will he supply *his* owners with a similar analysis pertaining to the whole company.

In judging whether managers should retain earnings, shareholders should not simply compare total incremental earnings in recent years to total incremental capital because that relationship may be distorted by what is going on in a core business. During an inflationary period, companies with a core business characterized by extraordinary economics can use small amounts of incremental capital in that business at very high rates of return (as was discussed in last year's section on Goodwill). But, unless they are experiencing tremendous unit growth, outstanding businesses by definition generate large amounts of excess cash. If a company sinks most of this money in other businesses that earn low returns, the company's overall return on retained capital may nevertheless appear excellent because of the extraordinary returns being earned by the portion of earnings incrementally invested in the core business. The situation is analagous to a Pro-Am golf event: even if all of the amateurs are hopeless duffers, the team's best-ball score will be respectable because of the dominating skills of the professional.

Many corporations that consistently show good returns both on equity and on overall incremental capital have, indeed, employed a large portion of their retained earnings on an economically unattractive, even disastrous, basis. Their marvelous core businesses, however, whose earnings grow year after year, camouflage repeated failures in capital allocation elsewhere (usually involving high-priced acquisitions of businesses that have inherently mediocre economics). The managers at fault periodically report on the lessons they have learned from the latest disappointment. They then usually seek out future lessons. (Failure seems to go to their heads.)

In such cases, shareholders would be far better off if earnings were retained only to expand the high-return business, with the balance paid in dividends or used to repurchase stock (an action that increases the owners' interest in the exceptional business while sparing them participation in sub-par businesses). Managers of high-return businesses who consistently employ much of the cash thrown off by those businesses in other ventures with low returns should be held to account for those allocation decisions, regardless of how profitable the overall enterprise is.

Nothing in this discussion is intended to argue for dividends that bounce around from quarter to quarter with each wiggle in earnings or in investment opportunities. Shareholders of public corporations understandably prefer that dividends be consistent and predictable. Payments, therefore, should reflect long-term expectations for both earnings and returns on incremental capital. Since the long-term corporate outlook changes only infrequently, dividend patterns should change no more often. But over time distributable earnings that have been withheld by managers should earn their keep. If earnings have been unwisely retained, it is likely that managers, too, have been unwisely retained.

Let's now turn to Berkshire Hathaway and examine how these dividend principles apply to it. Historically, Berkshire has earned well over market rates on retained earnings, thereby creating over one dollar of market value for every dollar retained. Under such circumstances, *any* distribution would have been contrary to the financial interest of shareholders, large or small.

In fact, significant distributions in the early years might have been disastrous, as a review of our starting position will show you. Charlie and I then controlled and managed three companies, Berkshire Hathaway Inc., Diversified Retailing Company, Inc., and Blue Chip Stamps (all now merged into our present operation). Blue Chip paid only a small dividend, Berkshire and DRC paid nothing. If, instead, the companies had paid out their entire earnings, we almost certainly would have no earnings at all now — and perhaps no capital as well. The three companies each originally made their money from a single business: (1) textiles at Berkshire; (2) department stores at Diversified; and (3) trading stamps at Blue Chip. These cornerstone businesses (carefully chosen, it should be noted, by your Chairman and Vice Chairman) have, respectively, (1) survived but earned almost nothing, (2) shriveled in size while incurring large losses, and (3) shrunk in sales volume to about 5% its size at the time of our entry. (Who says "you can't lose 'em all"?) Only by committing available funds to much better businesses were we able to overcome these origins. (It's been like overcoming a misspent youth.) Clearly, diversification has served us well.

We expect to continue to diversify while also supporting the growth of current operations — though, as we've pointed out, our returns from these efforts will surely be below our historical returns. But as long as prospective returns are above the rate required to produce a dollar of market value per dollar retained, we will continue to retain all earnings. Should our estimate of future returns fall below that point, we will distribute all unrestricted earnings that we believe can not be effectively used. In making that judgment, we will look at both our historical record and our prospects. Because our year-to-year results are inherently volatile, we believe a five-year rolling average to be appropriate for judging the historical record.

Our present plan is to use our retained earnings to further build the capital of our insurance companies. Most of our competitors are in weakened financial condition and reluctant to expand substantially. Yet large premium-volume gains for the industry are imminent, amounting probably to well over $15 billion in 1985 versus less than $5 billion in 1983. These circumstances could produce major amounts of profitable business for us. Of course, this result is no sure thing, but prospects for it are far better than they have been for many years.

Miscellaneous

This is the spot where each year I run my small "business wanted" ad. In 1984 John Loomis, one of our particularly knowledgeable and alert shareholders, came up with a company that met all of our tests. We immediately pursued this idea, and only a chance complication prevented a deal. Since our ad is pulling, we will repeat it in precisely last year's form:

We prefer:

(1) large purchases (at least $5 million of after-tax earnings),
(2) demonstrated consistent earning power (future projections are of little interest to us, nor are "turn-around" situations),
(3) businesses earning good returns on equity while employing little or no debt,
(4) management in place (we can't supply it),
(5) simple businesses (if there's lots of technology, we won't understand it),
(6) an offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer — customarily within five minutes — as to whether we're interested. We prefer to buy for cash, but will consider issuance of stock when we receive as much in intrinsic business value as we give. We invite potential sellers to check us out by contacting people with whom we have done business in the past. For the right business — and the right people — we can provide a good home.

* * *

A record 97.2% of all eligible shares participated in Berkshire's 1984 shareholder-designated contributions program. Total contributions made through this program were $3,179,000, and 1,519 charities were recipients. Our proxy material for the annual meeting will allow you to cast an advisory vote expressing your views about this program — whether you think we should continue it and, if so, at what per-share level. (You may be interested to learn that we were unable to find a precedent for an advisory vote in which management seeks the opinions of shareholders about owner-related corporate policies. Managers who put their trust in capitalism seem in no hurry to put their trust in capitalists.)

We urge new shareholders to read the description of our shareholder-designated contributions program that appears on pages 60 and 61. If you wish to participate in future programs, we strongly urge that you immediately make sure that your shares are registered in the name of the actual owner, not in "street" name or nominee name. Shares not so registered on September 30, 1985 will be ineligible for the 1985 program.

* * *

Our annual meeting will be on May 21, 1985 in Omaha, and I hope that you attend. Many annual meetings are a waste of time, both for shareholders and for management. Sometimes that is true because management is reluctant to open up on matters of business substance. More often a non-productive session is the fault of shareholder participants who are more concerned about their own moment on stage than they are about the affairs of the corporation. What should be a forum for business discussion becomes a forum for theatrics, spleen-venting and advocacy of issues. (The deal is irresistible: for the price of one share you get to tell a captive audience your ideas as to how the world should be run.) Under such circumstances, the quality of the meeting often deteriorates from year to year as the antics of those interested in themselves discourage attendance by those interested in the business.

Berkshire's meetings are a different story. The number of shareholders attending grows a bit each year and we have yet to experience a silly question or an ego-inspired commentary. Instead, we get a wide variety of thoughtful questions about the business. Because the annual meeting is the time and place for these, Charlie and I are happy to answer them all, no matter how long it takes. (We cannot, however, respond to written or phoned questions at other times of the year; one-person-at-a-time reporting is a poor use of management time in a company with 3000 shareholders.) The only business matters that are off limits at the annual meeting are those about which candor might cost our company real money. Our activities in securities would be the main example.

We always have bragged a bit on these pages about the quality of our shareholder-partners. Come to the annual meeting and you will see why. Out-of-towners should schedule a stop at Nebraska Furniture Mart. If you make some purchases, you'll save far more than enough to pay for your trip, and you'll enjoy the experience.

Warren E. Buffett
Chairman of the Board

February 25, 1985

Subsequent Event: On March 18, a week after copy for this report went to the typographer but shortly before production, we agreed to purchase three million shares of Capital Cities Communications, Inc. at $172.50 per share. Our purchase is contingent upon the acquisition of American Broadcasting Companies, Inc. by Capital Cities, and will close when that transaction closes. At the earliest, that will be very late in 1985. Our admiration for the management of Capital Cities, led by Tom Murphy and Dan Burke, has been expressed several times in previous annual reports. Quite simply, they are tops in both ability and integrity. We will have more to say about this investment in next year's report.

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BERKSHIRE HATHAWAY INC.
BUSINESS ACTIVITIES OF THE COMPANY AND ITS SUBSIDIARIES
December 29, 1984

The activities of the Parent company, which was incorporated in Massachusetts in 1889 and reincorporated in Delaware in 1973, were originally centered in New England and for several decades consisted of the manufacture and sale of woven textile products.

In 1967, after discontinuance from time to time of certain of the Company's unprofitable textile manufacturing activities, the Company acquired two entities that were engaged in the property and casualty insurance business. Thereafter, the insurance operations were expanded, the textile operations were shrunk further, and controlling interests in several other businesses were acquired.

At the end of 1978, Berkshire merged into it Diversified Retailing Company, Inc. and thereby succeeded to ownership of that company's apparel retailing business as well as its property/casualty insurance business. An important combined holding of the two parties to this merger was a majority ownership interest (about 58% of the common stock) of Blue Chip Stamps, a Los Angeles based company operating a conventional trading stamp business. Blue Chip also owned interests in other unrelated businesses. In mid 1983, Berkshire acquired, by merger of Blue Chip, the then outstanding minority interest in Blue Chip. Also in 1983, after the Blue Chip merger, Berkshire purchased controlling interest in Nebraska Furniture Mart, Inc., a major home furnishings retailing operation.

Berkshire's present diverse activities are now principally conducted through wholly-owned or substantially-wholly-owned subsidiaries. Four major business activities so conducted are:

(a) Underwriting of property and casualty insurance
(b) Candy production and sale at retail
(c) Newspaper publishing
(d) Retailing of home furnishings

These major business activities of Berkshire are described below and on the following page.

(a) Underwriting of Property and Casualty Insurance. Several Berkshire subsidiaries, collectively referred to in this report as the "Insurance Group", provide insurance coverages with respect to property and casualty insurance risks both on a direct and reinsurance basis. ("Reinsurance" agreements relate to assumption by one insurance company of obligations originally undertaken by another insurance company.) National Indemnity Company and National Fire and Marine Insurance Company, companion carriers with a common staff and sharing a home office in Omaha, Nebraska are principal insurance subsidiaries of the Company. Those companies together, and to some degree through their own subsidiary insurance companies (e.g., National Indemnity Company of Florida and National Indemnity Company of Minnesota), specialize primarily in the underwriting on a direct basis of non-standard commercial motor vehicle (e.g., long haul trucks) and general liability insurance.

Standard multiple line property and casualty insurance is presently underwritten by "Home-state" subsidiaries formed for that purpose in Colorado, Kansas and Nebraska. Other Berkshire subsidiaries have specialized in the underwriting of workers' compensation coverages. Such operations were discontinued in 1984 by two Berkshire subsidiaries. Cypress Insurance Company, Pasadena, California is a Berkshire subsidiary that continues to specialize in this line of insurance.

The Insurance Group's reinsurance operations are conducted by National Indemnity and Columbia Insurance Company. These operations include conventional risk-sharing arrangements with unrelated insurance companies as well as assumption of liabilities of such other companies with respect to periodic payment ("structured settlement") obligations and loss portfolio obligations. Significantly extended settlement periods are a feature of both of the latter type of obligations, so that the above average financial strength of the Berkshire subsidiaries is believed to work to their advantage in competing for these types of reinsurance agreements.

Significant amounts of investment income are generated by Berkshire's insurance business, both from capital funds committed to the operations and from policyholders' funds derived from unearned premiums and loss reserves.

Approximately 560 employees were engaged in the conduct of Berkshire's insurance businesses at December 31, 1984.

(b) The Candy Business. See's Candy Shops, Incorporated became wholly-owned by Berkshire in 1983 through the merger of Blue Chip Stamps. See's produces boxed chocolates and other confectionery products of high quality in two large kitchen facilities in California. See's is believed to be one of the largest candy manufacturers distributing at retail through its own chain of stores. It now has 214 retail shops in thirteen western and midwestern states including Hawaii. Five full-time quantity order centers are in operation; seventeen additional such centers were in temporary operation to serve peak seasonal requirements in the fourth quarter of 1984.

A significant degree of seasonality exists in this business. About 50% of each year's unit sales volume is generated during the last two months of the year, when quantity sales at reduced prices to businesses and other organizations augment the extremely high December shop volume. At Christmas, the number of See's employees peaks at about three times the full-time base of approximately 1,500.

(c) The Newspaper Business. This business is operated by the Buffalo Evening News, Inc. The assets of the entity were purchased by Blue Chip Stamps in April, 1977. It then published in Buffalo, New York an evening and Saturday edition of its newspaper. In October, 1977 it introduced a Sunday edition, whereupon it became a defendant in quite costly and prolonged litigation brought by its principal competitor. The competitor ceased publication in September, 1982, whereupon the News began publishing a morning edition. Later in September, 1982, the litigation was dismissed with prejudice pursuant to a stipulation of the parties. The Buffalo News is now the only daily newspaper serving the entire Buffalo metropolitan area. In February, 1985, it ranked 25th among the nations daily newspapers in daily circulation.

The Buffalo Evening News, Inc. became wholly-owned in 1983 through the merger of Blue Chip Stamps.

The News employs about 1,000 persons on a full-time basis.

(d) Retailing of Home Furnishings. This business is conducted by Nebraska Furniture Mart, Inc., 90% ownership of which was acquired by Berkshire on September 30, 1983. Its store in Omaha, Nebraska is believed by Berkshire management to be the largest single furniture retail store in the United States. It has sizeable warehousing facilities near its retail outlet permitting it to serve a trade area within a radius of about 300 miles from Omaha. Local consumer preference studies indicate Nebraska Furniture Mart to be the leading retailer of its products in its marketing area. The business is operated by members of the family from whom Berkshire purchased its interest therein, and who retain a minority ownership interest. As stated, Berkshire's ownership interest in the business is 90%, but as a result of options outstanding to key managers of the operation, Berkshire's interest in the earnings of the business is 80%. An important feature of the business is its ability to control its costs and realize highly satisfactory earnings while offering significant value to its customers.

Nebraska Furniture Mart employs about 500 persons.

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* * *

BERKSHIRE HATHAWAY INC.
BUSINESS ACTIVITIES OF THE COMPANY AND ITS SUBSIDIARIES *(Continued)*

Associated Retail Stores, Inc. with headquarters and warehouse in Long Island City, New York is a wholly-owned subsidiary of Berkshire. Associated operates a chain of about 90 retail apparel stores located in New York City, Chicago, Philadelphia and at various other locations in midwest and northeast states. It employs approximately 1,000 persons on a full-time basis. Blue Chip Stamps, with about 140 employees at December 31, 1984 is also wholly-owned by Berkshire. It operates a west coast trading stamp business from its Los Angeles headquarters.

* * *

Wesco Financial Corporation, 80.1% beneficially owned by Berkshire, owns and receives income with respect to a downtown business block in Pasadena, California with improvements including a nine-story office building, commercial store buildings and a multi-story parking garage. Wholly-owned subsidiaries of Wesco include Mutual Savings and Loan Association, Pasadena, California, a state chartered savings and loan company with 80 employees, and Precision Steel Warehouse Inc., Franklin Park, Illinois and Charlotte, North Carolina. Precision operates a metals service center business and employs about 265 persons.

* * *

Berkshire continues to operate a textile weaving mill in New Bedford, Massachusetts, in which approximately 450 persons are employed. Berkshire is also directly engaged in the manufacture and sale of branded ("K & W") chemical products used in the automotive after-market. This business employs 35 persons and operates from Los Angeles, California and Bloomington, Indiana.

* * *

Investment activities and decisions and all other capital allocation decisions are made for Berkshire and its subsidiaries by Warren E. Buffett in consultation with Charles T. Munger, Chairman and Vice Chairman, respectively, of Berkshire's Board of Directors. Operating decisions, by contrast, are made by the managers of Berkshire's operating units.

Berkshire's executive offices are in Omaha, Nebraska.

Peat, Marwick, Mitchell & Co.
Certified Public Accountants
Kiewit Plaza Building
Thirty-Sixth and Farnam Street
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 29, 1984 and December 31, 1983 and the related consolidated statements of earnings and changes in financial position for each of the years in the three-year period ended December 29, 1984. Our examinations were 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. We did not examine the consolidated financial statements of Blue Chip Stamps and Wesco Financial Corporation for the year ended January 1, 1983, which statements reflect total revenues constituting 49 percent of the related consolidated totals. These financial statements were examined by other auditors whose reports thereon have been furnished to us and our opinion expressed herein, insofar as it relates to Blue Chip Stamps and Wesco Financial Corporation prior to January 1, 1983, is based solely upon the reports of the other auditors.

In our opinion, based upon our examinations and the reports of other auditors, the aforementioned consolidated financial statements present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries at December 29, 1984 and December 31, 1983 and the results of their operations and the changes in their financial position for each of the years in the three-year period ended December 29, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

March 13, 1985, except as to
note 21 which is as of
March 18, 1985

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	Dec. 29, 1984	Dec. 31, 1983*
ASSETS		
Cash	$ 3,682	$ 6,161
Investments, other than investments in affiliates:		
Fixed maturities, principally bonds (market value: Dec. 29, 1984 — $317,734; Dec. 31, 1983 — $204,801)	303,928	208,245
Marketable equity securities (Notes 3, 4 and 5)	1,235,903	1,232,150
Invested cash, represented by various short-term investments at adjusted cost which approximates market	170,039	75,343
Total investments, other than affiliates	1,709,870	1,515,738
Investment in Mutual Savings and Loan Association (Note 6)	32,927	27,004
Accounts receivable from customers, agents and others (Note 7)	88,489	72,813
Inventories (Note 8)	41,332	37,516
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (Note 9)	67,919	69,749
Goodwill of acquired businesses	77,269	79,327
Other assets	13,715	29,235
	$2,035,203	$1,837,543
LIABILITIES AND STOCKHOLDERS' EQUITY		
Losses and loss adjustment expenses	$ 243,298	$ 212,706
Unearned premiums	49,099	55,783
Liability for unredeemed trading stamps	58,957	60,669
Accounts payable, accruals and other liabilities	73,346	58,094
Current income taxes	11,432	8,511
Deferred income taxes (Note 10)	177,907	175,613
Term debt and other borrowings (Notes 11 and 12)	127,104	128,984
Minority shareholders' interests	22,299	17,990
	763,442	718,350
Stockholders' equity (Notes 12, 13 and 14):		
Common stock of $5 par value. Authorized 1,500,000 shares; issued 1,375,183 shares, including shares held in treasury	6,876	6,876
Capital in excess of par value	157,377	157,377
Unrealized appreciation of marketable equity securities, net of provision for deemed applicable income taxes	486,953	483,280
Retained earnings	661,493	512,598
	1,312,699	1,160,131
Less common stock in treasury, at cost (228,274 shares)	40,938	40,938
Total stockholders' equity	1,271,761	1,119,193
Commitments (Note 15), Subsequent event (Note 21)		
	$2,035,203	$1,837,543

Certain 1983 items are reclassified to conform to 1984 presentation.

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
CONSOLIDATED STATEMENTS OF EARNINGS
(dollars in thousands except per share amounts)

	Fiscal Year Ended Saturday nearest December 31,		
	1984	*1983**	*1982*
Income items:			
Insurance premiums earned	$ 140,242	$ 152,480	$152,945
Sales and service revenues	500,219	381,674	306,564
Interest and dividend income	84,161	64,903	58,003
Equity in earnings excluding realized investment gain of Mutual Savings and Loan Association	4,557	3,669	3,960
	729,179	602,726	521,472
Cost and expense items:			
Insurance losses and loss adjustment expenses	141,550	134,109	121,996
Cost of products and services sold	296,770	214,362	177,508
Insurance underwriting expenses	46,752	52,243	52,508
Selling, general and administrative expenses	138,875	122,023	110,021
Interest and financing costs	14,734	15,104	14,995
	638,681	537,841	477,028
Earnings from operations including minority interest in consolidated subsidiaries, before applicable income taxes and before realized investment gain	90,498	64,885	44,444
Income taxes applicable to above (Note 16)	16,420	8,904	2,524
	74,078	55,981	41,920
Minority interest applicable to above	3,877	7,337	10,423
Earnings before realized investment gain	70,201	48,644	31,497
Realized investment gain, net (Note 17)	78,694	63,522	14,877
Net earnings	$ 148,895	$ 112,166	$ 46,374
Average shares outstanding	1,146,909	1,066,709	986,509
Per share:			
Earnings before realized investment gain	$ 61.21	$ 45.60	$ 31.93
Net earnings	129.82	105.15	47.01

**1983 is restated — See Note 1(b)*

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
(dollars in thousands)

	Fiscal Year Ended Saturday nearest December 31,		
	1984	*1983**	*1982*
Funds provided:			
From operations:			
Net earnings	$148,895	$112,166	$ 46,374
Minority interest in earnings	5,131	8,801	20,609
Earnings including minority interest	154,026	120,967	66,983
Charges or credits not requiring (not providing) funds:			
Equity in undistributed earnings of unconsolidated subsidiaries	(5,299)	(3,046)	(534)
Depreciation and amortization of property, plant and equipment, including leaseholds	8,764	7,953	7,092
Decrease (increase) in accounts receivable	(15,676)	57,972	(58,756)
Decrease (increase) in inventories	(3,816)	(3,871)	3,063
Increase in unpaid losses and loss adjustment expenses	30,592	19,229	2,507
Decrease in unearned premiums	(6,684)	(2,631)	(3,855)
Increase (decrease) in liability for unredeemed trading stamps	(1,712)	429	(4,022)
Increase in liability for income taxes applicable to earnings	6,276	4,934	7,620
Increase (decrease) in accounts payable, accruals and other liabilities	15,252	(999)	(3,892)
Other	2,744	(7,401)	(7,906)
	30,441	72,569	(58,683)
Funds provided from operations	184,467	193,536	8,300
Proceeds from issuance of debt, net of expense	42	—	41,900
Change in Wesco's savings account maintained at Mutual	14,624	(7)	(12,204)
Issuance of common stock in Blue Chip merger	—	154,665	—
Decrease in cash	2,480	1,913	—
	$201,613	$350,107	$ 37,996
Funds used:			
Purchase of minority shareholders' interest in net tangible assets of Blue Chip Stamps	$ —	$108,987	$ —
Purchase of majority interest in net tangible assets of Nebraska Furniture Mart, Inc.	—	35,045	—
Goodwill — excess of purchase cost over value of net tangible assets acquired	—	66,682	—
Net assets of acquired businesses	—	210,714	—
Additions to property, plant and equipment, net	7,069	6,210	9,229
Repayment of debt	1,922	40,963	2,245
Dividends paid to minority stockholders	822	890	1,210
Cost of net purchases (sales) of investments:			
Bonds and other fixed maturity securities	95,683	18,611	(16,748)
Marketable equity securities	1,142	68,999	49,663
Short-term investments	94,696	3,720	(7,865)
Unconsolidated subsidiaries	279	—	—
Net purchase of investments	191,800	91,330	25,050
Increase in cash	—	—	262
	$201,613	$350,107	$ 37,996

**1983 is restated — See Note 1(b)*

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 29, 1984
(dollars in thousands except per share amounts)

(1) Significant Accounting Policies and Practices

(a) Basis of Consolidation

The accompanying Consolidated Financial Statements include the accounts of Berkshire Hathaway Inc. (the "Company" or "Berkshire") consolidated with accounts of all of its subsidiaries except Mutual Savings and Loan Association ("Mutual") and a wholly-owned subsidiary of Mutual, and except certain other subsidiaries in which the Company's aggregate investment is minor. The Company at December 29, 1984 owned, beneficially, 80.1% of Mutual and Mutual's subsidiary. It accounts for this investment pursuant to the equity method of accounting.

Consolidated financial position and results reflect those of companies engaged in a number of diverse businesses. See Note 20.

(b) Restatement of 1983 Consolidated Statement of Earnings

In 1983, Berkshire subsidiaries received $21,000 from GEICO Corporation in an unusual transaction. The transaction was structured as a redemption by GEICO of shares of its common stock held by Berkshire subsidiaries. Simultaneously with the repurchase from Berkshire subsidiaries, GEICO repurchased additional shares of its own stock tendered to it by other GEICO shareholders. Pursuant to contractual arrangements between GEICO and Berkshire subsidiaries, the number (350,000) of GEICO shares redeemed from Berkshire subsidiaries was determined by the number of shares repurchased by GEICO from its other shareholders so that the percentage ownership (aggregating approximately 33.6%) by Berkshire subsidiaries of GEICO's total outstanding shares was unchanged by the redemption. The proceeds distributed by GEICO to Berkshire subsidiaries in the form of redemption of GEICO shares were, economically to Berkshire subsidiaries, substantially equivalent to dividend income. In prior reports, Berkshire applied the substance-over-form principle in accounting for the proceeds received as dividend income. 1983 reported income was not reduced for the original cost of the redeemed shares, but rather Berkshire's original cost of its investment in GEICO was deemed unchanged.

Berkshire's independent accountants subsequently advised the Company that its substance-over-form view does not provide, in the accountants' judgment, a proper basis under generally accepted accounting principles to account for the proceeds as dividend income. Berkshire's 1983 Consolidated Statement of Earnings is accordingly restated to reflect the GEICO share redemption proceeds, after reduction by cost of shares redeemed, as a realized investment gain. The effect of the change is to reduce 1983 net earnings from those previously reported by $1,327 ($1.25 per share).

The carrying value in Berkshire's Consolidated Balance Sheet of Berkshire's investment in GEICO is market value of the shares. Accordingly, there is no change in total stockholders' equity at December 31, 1983 from that previously reported.

(c) Accounting Period

Accounts of Berkshire and certain of its subsidiaries are maintained on the basis of a 52-53 week fiscal year ending with respect to December 31. For 1983, the accounting period for See's candy business consisted of 53 weeks. The calendar year is the annual accounting period of the insurance subsidiaries, the newspaper subsidiary, the home funishings subsidiary and certain other of the consolidated companies.

(d) Investments in Securities, Other Than Affiliates

Investments in obligations with fixed dates of maturity — bonds and redeemable preferred stocks — and in short-term investments are stated at cost, adjusted where appropriate for accretion of discount or amortization of premium.

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
December 29, 1984
(dollars in thousands)

(1) Significant Accounting Policies and Practices (Continued)

Investments in marketable equity securities held by members of the Insurance Group are carried at market value. Investments in marketable equity securities held by Berkshire and by consolidated subsidiaries which are not members of the Insurance Group are carried at the lower of aggregate cost or market.

(e) Inventories

Inventories are stated at cost, determined principally under the first-in, first-out ("FIFO"), or average cost method, but in part under the last-in, first-out ("LIFO") method.

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

These items of property (including significant betterments and renewals) are carried at cost, depreciated principally on a straight line basis over their useful lives estimated at the date of acquisition. Maintenance, repairs and renewals of a minor nature are generally charged to operations as incurred.

(g) Goodwill and Negative Goodwill of Acquired Businesses

The difference between purchase cost and the fair value of the net assets of acquired businesses is amortized on a straight line basis over forty years.

(h) Premium Acquisition Costs

For financial reporting purposes, premium acquisition costs such as commissions, premium taxes and a portion of certain other underwriting costs are deferred, subject to ultimate recoverability generally estimated on a company by company basis without regard to anticipated investment income; such deferred costs are charged against financial statement income in subsequent periods when the related premiums are earned. For statutory insurance accounting and income tax reporting purposes, premium acquisition costs are charged against income when incurred.

(j) Losses and Loss Adjustment Expenses

The Insurance Group provides for losses and loss adjustment expenses for unsettled cases based on estimates of ultimate liability with respect to reported cases, plus estimates of aggregate liability with respect to incurred but not reported losses. Estimates of liability relating to assumed reinsurance are based on loss reports received from the primary insurers. The liability provision is reduced for amounts recoverable on account of reinsurance ceded; these reductions amounted to $10,531 and $10,115 at December 31, 1984 and 1983, respectively.

An aggregate liability amounting to $15,944 and $8,182 at December 31, 1984 and December 31, 1983, respectively, was additionally established at present value on a contract-by-contract basis with respect to periodic payment obligations ("Structured Settlements") assumed by members of the Insurance Group. The range of interest rates used to discount those liabilities, for financial reporting purposes, ranged from 9½% to 15%, with a weighted average of approximately 12%. The specific rate applicable to a given contract is dependent upon market rates at the inception date of the contract. For statutory insurance accounting and tax reporting purposes, these liabilities were discounted at a rate of 7% as prescribed by regulatory authority.

Additionally at December 31, 1984 and December 31, 1983, an aggregate liability amounting to $14,712 and $8,055, respectively, was established with respect to portfolio reinsurance obligations assumed by Columbia Insurance Company, a member of the Berkshire Insurance Group.

Incurred losses and loss adjustment expenses in the accompanying Consolidated Statements of Earnings are net of recoveries of salvage and subrogation collected or in process of collection in accordance with statutory accounting requirements for insurance companies.

(1) Significant Accounting Policies and Practices (Continued)

Any additional amounts that may be recoverable as salvage or on account of subrogation, relating principally to automobile physical damage coverages, are not recognized as they are considered immaterial in the aggregate.

(k) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the terms of the policies. Unearned premiums are computed on a monthly or daily pro rata basis and are stated after deduction of premiums for reinsurance placed with reinsurers in the amount of $1,780 and $1,647 at December 31, 1984 and 1983, respectively.

Dividends to policyholders, primarily relating to workers compensation coverages, are reflected in the accompanying Consolidated Statements of Earnings as a deduction from earned premiums. This reduction amounted to $3,110 for 1984, $4,955 for 1983, and $3,262 for 1982.

(m) Stamp Service Accounting

Trading stamp revenues and related redemption costs of Blue Chip Stamps, a consolidated subsidiary engaged in the promotional services business, are recognized upon issuance of the trading stamps. A liability for unredeemed trading stamps is maintained based on estimates of the future cost of redemption merchandise and service; the estimates are periodically revised to take into account the effect of changing facts and circumstances including, among other factors, the probable effects of Blue Chip's declining volume of stamp issuance.

(n) Income Taxes

Income taxes reflected in the Consolidated Financial Statements represent those of the Company and those of its subsidiaries that are consolidated for financial reporting purposes. Mutual is a non-consolidated subsidiary for financial reporting, but it is included in Berkshire's consolidated U.S. Federal income tax return.

Certain items of income and deductions which are recognized in the financial statements in time periods that differ from those in which they are recognized in the income tax returns filed for the companies give rise to recognition in the financial statements of deferred or prepaid income taxes.

(2) Corporate Changes in 1983

During 1983, Blue Chip Stamps ("Blue Chip") was merged with and into the Company. For several years prior to the merger, Berkshire owned approximately 59.6% of Blue Chip's outstanding shares. In the merger, Berkshire issued shares of its common stock and provided for payment of cash in lieu of issuance of fractional shares for the 40.4% of Blue Chip's outstanding shares not already owned by Berkshire. The Company accounted for the transaction as a purchase of the minority interest in Blue Chip's net assets.

In the merger, subsidiaries of the merged Blue Chip became subsidiaries of Berkshire, directly or benefically, to the same extent as previously owned by the merged Blue Chip. Thus, See's Candy Shops, Incorporated and the Buffalo Evening News became wholly-owned by Berkshire, and Wesco Financial Corporation and wholly-owned subsidiaries of Wesco became 80.1% beneficially owned by Berkshire.

On September 30, 1983, Berkshire purchased for cash the majority of the outstanding capital stock of Nebraska Furniture Mart, Inc., a corporation engaged in the business of retailing of home funishings. Results of operation of the business from the date of purchase are reflected in the accompanying Consolidated Statements of Earnings.

(3) Investments in Marketable Equity Securities

Aggregate data with respect to the consolidated investment in marketable equity securities is shown below as of the dates for which consolidated balance sheets are presented herein. See Note 1(d) as to methods applied to determine carrying value of these securities.

	December 29, 1984			
	Cost	*Unrealized Gain*	*Market*	*Carrying Value*
Common stock of:				
Exxon Corporation	$150,370	$ 1,586	$ 151,956	$ 151,959
GEICO Corporation	45,713	351,587	397,300	397,300
General Foods Corporation	153,964	78,914	232,878	221,189
The Washington Post Company	10,628	139,327	149,955	149,955
All Others	201,168	114,670	315,838	315,500
	$561,843	$686,084	$1,247,927	$1,235,903

	December 31, 1983			
	Cost	*Unrealized Gain*	*Market*	*Carrying Value*
Common stock of:				
GEICO Corporation	$ 45,713	$352,443	$ 398,156	$ 398,156
General Foods Corporation	168,273	67,215	235,488	197,543
R. J. Reynolds Industries, Inc.	260,210	71,620	331,830	302,140
The Washington Post Company	10,628	126,247	136,875	136,875
All Others	75,877	124,973	200,850	197,436
	$560,701	$742,498	$1,303,199	$1,232,150

The $686,084 net excess of aggregate market value over aggregate cost of marketable equity securities at December 29, 1984 represented unrealized gains of $686,522 less an unrealized loss of $438.

(4) Investment in GEICO Corporation, and special share redemption in 1983

Subsidiaries of Berkshire, at both December 29, 1984 and at December 31, 1983, owned 6,850,000 shares of common stock of GEICO Corporation. The shares possessed approximately 36½% of the voting rights of all GEICO shares outstanding at December 29, 1984, but Berkshire holds the shares subject to an Order of the Superintendent of Insurance of the District of Columbia, the corporate domicile of GEICO, which prohibits Berkshire from exercising such rights. The Order provides that Berkshire must maintain an independent proxy arrangement for voting of these shares and prohibits Berkshire from seeking or causing to change the independent proxy. Also, under the Order, no officer or director of Berkshire or of any affiliate or subsidiary of Berkshire is permitted to serve as a director of GEICO. As a result of the Order, which divests Berkshire of its voting rights with respect to its GEICO holdings, Berkshire does not use the equity method of accounting for its investment in GEICO.

Dividends declared by GEICO and received by Berkshire subsidiaries with respect to their investments in GEICO shares amounted to $6,028 in 1984, $5,121 in 1983, and $4,032 in 1982. Additionally in the prior year (1983) Berkshire subsidiaries received $21,000 from GEICO in redemption of a portion of their shareholdings of GEICO. That transaction was structured so as to result in no decrease in Berkshire's percentage ownership of GEICO. In Berkshire's restated 1983 Consolidated Statement of Earnings — see Note 1(b) hereinbefore — the redemption proceeds are included in realized investment gain after reduction for cost of the shares redeemed and for applicable income taxes. The redemption of the GEICO shares contributed $18,224 ($17.08 per share) to Berkshire's restated net earnings for 1983.

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(5) Investment in General Foods Corporation, and special share redemptions in 1984

Subsidiaries of Berkshire at December 29, 1984 owned 4,167,830 shares of common stock of General Foods Corporation. At the end of 1983, Berkshire and its consolidated subsidiaries owned 4,583,700 such shares. At both dates, the holdings represented approximately 8.75% of all General Foods outstanding shares.

In addition to receipt of proceeds representing regular quarterly cash dividends declared and paid by General Foods with respect to these shareholdings, in 1984 Berkshire subsidiaries received $21,844 share redemption proceeds from General Foods. The share redemptions were structured so as to result in no change in Berkshire's percentage ownership of General Foods, since the number of shares redeemed from the Berkshire subsidiaries were determined by the number of shares redeemed from time to time during the year by General Foods from other of its shareholders. The share redemption proceeds are included in realized investment gain in the accompanying 1984 Consolidated Statement of Earnings after reduction for the cost of the shares redeemed, for applicable income taxes and for the interest of minority shareholders of Wesco. The redemption of the General Foods shares contributed $7,294 ($6.36 per share) to Berkshire's net earnings for 1984.

Dividends declared and paid by General Foods and received by Berkshire companies with respect to their investments in General Foods shares amounted to $10,923 in 1984, $9,428 in 1983, and $5,673 in 1982. These figures are stated on a pre-tax basis and are reflected in the accompanying Consolidated Statements of Earnings in the income item captioned "Interest and dividend income".

(6) Investment in Mutual Savings and Loan Association

Berkshire's carrying value of its investment in Mutual represents the original cost of the investment adjusted for amortization of negative goodwill that arose at the various dates of acquisition. The equity in underlying net assets of Mutual, measured at book value at the dates of acquisition, exceeded the amounts then paid for acquired interest. The unamortized excess (negative goodwill) was $16,934 at the end of 1984 ($17,558 at the end of 1983).

Summarized financial information of Mutual is as follows:

Balance Sheet Data	December 31 1984	December 31 1983
Assets		
Cash and marketable securities	$188,851	$143,461
Loans receivable, net	95,120	106,831
Other assets	11,071	15,944
	$295,042	$266,236
Liabilities and Shareholders' Equity		
Savings accounts*	$227,585	$203,284
Other liabilities	5,906	7,547
Total liabilities	233,491	210,831
Shareholders' equity, substantially restricted	61,551	55,405
	$295,042	$266,236

**Included in Mutual's liability for savings accounts is $403 at December 31, 1984 and $15,025 at December 31, 1983, representing an account maintained for Wesco Financial Corporation, a consolidated subsidiary of Berkshire that is Mutual's parent company.*

Earnings Statement Data	1984	1983	1982
Total revenues	$26,887	$22,741	$23,360
Net income	$ 6,844	$ 3,047	$ 910

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(7) Receivables

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

	Dec. 29, 1984	Dec. 31, 1983
Trade accounts receivable, net of allowances for doubtful accounts	$ 47,647	$ 42,390
Agents' balances and premiums in course of collection	19,935	20,856
Reinsurance recoverable on loss payments	522	324
Investment income due and accrued	18,342	9,014
Amounts due from sales of securities	2,043	229
Total receivables	$ 88,489	$ 72,813

(8) Inventories

Inventories of the various consolidated businesses at the end of the current and prior year were as follows:

	Dec. 29, 1984	Dec. 31, 1983
Candy business	$ 7,110	$ 5,724
Retailing of home furnishings	9,728	7,964
Retailing of apparel	5,249	5,850
Steel service business	7,690	6,893
Textile business	5,144	5,424
Other	6,411	5,661
	$41,332	$37,516

The carrying amounts for inventories determined under the LIFO method were approximately $7,731 and $7,078 less than their aggregate replacement cost at year-end 1984 and 1983 respectively.

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

The composition of property, plant and equipment, on a consolidated basis, at the end of the past two years is shown below:

	Dec. 29, 1984	Dec. 31, 1983
Land	$ 7,486	$ 7,486
Buildings	39,418	37,758
Machinery and equipment	60,821	61,236
Furniture, fixtures and leasehold improvements	32,040	30,720
	139,765	137,200
Less accumulated depreciation and amortization	71,846	67,451
	$ 67,919	$ 69,749

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(10) Deferred Income Taxes

The liability for deferred income taxes shown in the Consolidated Balance Sheets includes $186,198 at December 29, 1984, and $188,071 at December 31, 1983 which amounts are deemed applicable to unrealized appreciation of marketable equity securities carried at market value. That liability is reduced by net prepaid taxes arising from timing differences. Such differences arise because certain items of income and deductions are recognized for financial reporting purposes in time periods different from those in which they are recognized for income tax reporting purposes. A summary follows of prepaid/deferred taxes arising from timing differences.

Item Giving Rise To Prepaid/Deferred Taxes	*Prepaid (Deferred) Taxes At*	
	Dec. 29, 1984	*Dec. 31, 1983*
Trading stamp liability	$15,839	$17,519
Structured settlements and portfolio reinsurance	(5,471)	(2,267)
Deferred premium acquisition costs	(3,423)	(4,295)
Depreciation of property, plant & equipment	(1,622)	(1,160)
State income and franchise taxes	1,008	1,060
Unearned carrying charges	950	805
All other	1,010	796
	$ 8,291	$12,458

(11) Revolving Credit and Term Loan Agreements

In February, 1984, Berkshire entered into Revolving Credit and Term Loan Agreements with banks. The revolving credit period under the Agreements extends to January 31, 1987. During this period, the banks will make loans to Berkshire, at Berkshire's request, aggregating up to $175,000 outstanding. For borrowings during the revolving credit period, Berkshire will pay interest at not more than the respective bank's prime rate. For unused portions of the commitments, Berkshire will quarterly pay fees at the per annum rate of ¼ of 1%. Any borrowings outstanding under the Agreements at January 31, 1987 will be repayable in sixteen equal quarterly installments commencing April 30, 1987. Berkshire may borrow specified amounts within the aggregate limits of the Agreements for a specified term of up to one year at interest rates which may be less than the prime rate but fixed for the specified term. Subject to the expiration of the term periods with respect to any such borrowings, Berkshire may at any time, without penalty, terminate the Agreements upon repayment of borrowings thereunder.

The Agreements provide for optional termination by either bank of its commitment and require repayment of borrowings thereunder in twelve equal quarterly installments if Warren E. Buffett ceases to act as chairman and the chief executive officer of the Company or if total borrowings of the Company and its consolidated subsidiaries exceed a formula amount, generally 35% of Capitalization as defined.

There were no outstanding borrowings under these agreements at December 29, 1984.

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(12) Term Debt Payable and Other Borrowings

Consolidated term debt and other borrowings were as follows:

	Dec. 29, 1984	*Dec. 31, 1983*
Berkshire:		
8% Senior Notes maturing through March 1, 1993 at $1,143 annually	$ 13,142	$ 14,285
9¼% Senior Notes maturing March 1, 1985 to March 1, 1993 at $777 annually	7,000	7,000
12¾% debentures maturing from August 1, 1991 through August 1, 2005 at $4,004 annually	60,000	60,000
8% debentures due 1985, with 1% additional participating interest	6,600	6,600
Other notes, debentures and capitalized lease obligations maturing through 1992 in varying annual installments, with interest at rates varying from 7½% to 17½%	1,324	1,560
	88,066	89,445
Consolidated Subsidiaries:		
10⅛% notes maturing in June, 1991	25,000	25,000
9¼% note, secured by land, bulding and assignment of leases, due in monthly installments through March, 2007	5,098	5,166
Notes and capitalized lease obligations maturing through 2006 in varying installments, with interest at rates varying from 6% to 15%	8,940	9,373
Total consolidated term debt	$127,104	$128,984

Berkshire's Senior Note Agreements include limiting terms relating to sales of assets, mergers and consolidations, and allow the noteholders to demand prepayment at par within 60 days of notice that, during the lifetime of Warren E. Buffett, his ownership of stock of the Company, together with that of certain family affiliates, has decreased to less than 15% of the Company's outstanding capital stock. Among the covenants of Berkshire's various borrowing agreements, the Senior Note Agreements include the most limiting of provisions restricting retained earnings. Thereunder, retained earnings of approximately $233,000 as of December 29, 1984 were free of restriction, the balance is restricted.

Principal payments on term debt outstanding at December 29, 1984 are required during the succeeding five years as follows:

1985	$9,288
1986	2,853
1987	2,749
1988	2,818
1989	2,508

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(13) Stockholders' Equity Accounts

Changes in Stockholders' Equity accounts during the most recent three years were as follows:

	Net Unrealized Appreciation	*Retained Earnings*	*Treasury Stock*
Balance at January 2, 1982	$196,475	$354,058	$40,658
Increase during 1982 in unrealized appreciation included in carrying value of marketable equity securities	224,509		
Change during 1982 in deemed applicable income taxes	(62,863)		
Net earnings 1982		46,374	
Balance at January 1, 1983	358,121	400,432	40,658
Increase during 1983* in unrealized appreciation included in carrying value of marketable equity securities	174,058		
Change during 1983* in deemed applicable income taxes	(48,899)		
Net earnings 1983*		112,166	
Value of 500 treasury shares acquired in Blue Chip merger			280
Balance at December 31, 1983*	483,280	512,598	40,938
Increase during 1984 in unrealized appreciation included in carrying value of marketable equity securities	2,612		
Change during 1984 in deemed applicable income taxes	1,061		
Net earnings 1984		148,895	
Balance at December 29, 1984	$486,953	$661,493	$40,938

**1983 is restated — see Note 1(b).*

On July 28, 1983, Berkshire increased by $805 its issued common stock when it exchanged 160,900 shares of its $5 par value shares for the 40.4% in Blue Chip's net assets that it did not already own. Additionally in recording this transaction $153,860 was credited to capital in excess of par value.

(14) Dividend Restrictions — Insurance Subsidiaries

Payments of dividends by Insurance Group members are restricted by insurance statutes and regulations, to the extent that not more than approximately $131,000 could be paid to the Company in 1985 by insurance subsidiaries of the Company, without prior regulatory approvals.

(15) Lease Commitments

Berkshire and subsidiaries of Berkshire have significant commitments outstanding with respect to real estate occupied under agreements classified as operating leases, minimum rentals under which were as follows at December 29, 1984:

Year	*Total*
1985	$ 8,891
1986	7,538
1987	6,401
1988	5,715
1989	4,276
Thereafter	12,820

Total rental expense, including equipment rentals, charged to consolidated earnings was $12,332 for 1984, $12,477 for 1983, and $12,809 for 1982; such figures include contingent real estate rentals in excess of stated minimums amounting to $3,186 for 1984, $3,412 for 1983, and $3,265 for 1982.

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(16) Income Taxes

The Consolidated Statements of Earnings reflect charges for income taxes applicable to operating earnings and to realized investment gain as shown below.

Applicable to	*Applicable income taxes*		
	1984	*1983*	*1982*
Operating earnings	$ 16,420	$ 8,904	$ 2,524
Realized investment gain of consolidated companies	31,221	21,849	13,734
Realized investment loss — Mutual Savings	—	—	(80)
	$ 47,641	$ 30,753	$16,178
These taxes are comprised of:			
Federal	$ 39,128	$ 26,728	$11,854
State	8,455	3,920	4,293
Foreign	58	105	31
	$ 47,641	$ 30,753	$16,178

Charges for income taxes are reconciled in the table which follows to hypothetical amounts computed at the Federal statutory rate.

	1984	*1983*	*1982*
Net earnings including minority interest, before applicable income taxes	$203,031	$151,720	$83,161
Hypothetical amounts applicable to above computed at the Federal statutory rate (46%)	$ 93,394	$ 69,791	$38,254
Decreases, resulting from:			
Tax-exempt interest income	(10,992)	(4,310)	(3,722)
85% dividends received deduction relating to dividend income reported herein	(16,408)	(17,714)	(13,873)
Rate differentials relating to realized investment gains	(21,209)	(19,391)	(5,384)
State income taxes, less Federal income tax benefit	4,636	2,117	2,619
Net other differences	(1,780)	260	(1,716)
Total income taxes	$ 47,641	$ 30,753	$16,178

Total income taxes for 1984 included approximately $43,268 current expense plus net prepaid/deferred taxes of $4,373. For 1982 and 1983, the net change in prepaid/deferred taxes for financial reporting purposes was insubstantial, so that total income taxes for those years as shown above essentially represent current income tax expense.

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(17) Realized Investment Gain

A summary of net realized investment gain for each of the past three years is presented in the following table:

	1984	1983*	1982
Special share redemption proceeds received from General Foods Corporation in 1984 and GEICO Corporation in 1983, less cost of shares redeemed — See Notes 4 and 5	$ 8,111	$19,575	$ —
Pre-tax net gain realized on sales of securities by consolidated companies	101,692	67,260	41,143
Applicable income taxes	(31,221)	(21,849)	(13,734)
Applicable minority interest	(2,035)	(1,464)	(11,454)
	76,547	63,522	15,955
Equity in net realized gain (loss) of Mutual Savings and Loan Association, an unconsolidated subsidiary	2,147	—	(1,078)
Realized investment gain, net	$ 78,694	$63,522	$14,877

**1983 is restated — see Note 1(b).*

In February 1982, Mutual Savings and Loan Association sustained a loss of $2,426 on the sale of GNMA backed real estate mortgage certificates. The Company's equity in such loss (net of applicable minority interests and income taxes) was approximately $1,078.

The cost of securities sold is usually determined on a first-in, first-out basis; occasionally, when specific identification of securities sold results in lower applicable income tax, identified cost is used.

(18) Pension Plans

Employees of Berkshire and its consolidated subsidiaries who meet certain eligibility requirements are covered under either employer-sponsored or union-sponsored pension plans. Total pension expense charged to consolidated earnings was $2,455 for 1984, $2,362 for 1983, and $2,636 for 1982, which includes, as to certain of the plans, amortization of prior service costs over a 30-year period. Berkshire and its subsidiaries generally fund pension costs as accrued.

The latest actuarial evaluations of employer-sponsored defined benefit plans of the Company and its consolidated subsidiaries were last performed as of various dates from January 1, 1983 to June 1, 1984. The actuarial present values determined for accumulated benefits, using interest assumptions ranging from 6% to 10%, segregated as between overfunded and underfunded plans, together with assets available for benefits as of that date, are presented in the following table.

	Overfunded plans	*Underfunded plans*
Actuarial present value of accumulated benefits:		
Vested	$26,844	$5,533
Not vested	1,380	379
Total	$28,224	$5,912
Assets available for benefits	$38,883	$3,681

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(19) Quarterly Data

A summary of earnings by quarter for the past two years is presented in the following table. This information is unaudited. Information for the third quarter of 1983 is restated from that previously presented, reflecting a changed accounting treatment of GEICO share redemption proceeds received in that period. See Note 1(b). Information for the second and third quarter of 1984 is restated from that previously published, reflecting a changed accounting treatment of General Foods share redemption proceeds received during those periods. See below.

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter[a]
1984				
Income items	$164,580	$179,208	$160,509	$224,882
Earnings before realized investment gain	13,001	14,648	13,870	28,682
Realized investment gain	21,446	21,670	17,654	17,924
Net earnings	$ 34,447	$ 36,318	$ 31,524	$ 46,606
Per average outstanding share:				
Earnings before realized investment gain	$ 11.34	$ 12.77	$ 12.09	$ 25.01
Net earnings	30.03	31.67	27.49	40.63
1983				
Income items	$130,875	$138,039	$123,326	$210,486
Earnings before realized investment gain	9,254	8,554	8,334	22,502
Realized investment gain	10,120	20,938	29,550	2,914
Net earnings	$ 19,374	$ 29,492	$ 37,884	$ 25,416
Per average outstanding share:				
Earnings before realized investment gain	$ 9.38	$ 8.67	$ 7.26	$ 19.62
Net earnings	19.64	29.90	33.03	22.16

[a] *Candy business revenues and earnings are significantly higher in the fourth quarter of the year compared to earlier quarters. More than half of See's Candies annual sales are normally recorded in the fourth quarter. Newspaper revenues and earnings also peak in the fourth quarter of the year.*

In the second and third quarters of 1984, Berkshire subsidiaries received $8,892 and $7,299, respectively, representing proceeds from redemption by General Foods Corporation of its shares owned by Berkshire subsidiaries. The proceeds were received pursuant to contractual arrangements whereby the redemptions kept unchanged the Berkshire subsidiaries' ownership percentages of total General Foods outstanding shares. The proceeds distributed by General Foods to Berkshire subsidiaries in the form of redemption of General Foods shares were, economically to Berkshire subsidiaries, substantially equivalent to dividend income. In its 1984 second and third quarter financial reports previously published, Berkshire applied the substance-over-form principle in accounting for the proceeds received as dividend income. Income previously reported for 1984 interim periods was not reduced for the cost of the redeemed shares. Berkshire's independent accountants subsequently advised the Company that its substance-over-form view does not provide, in the accountants' judgment, a proper basis under generally accepted accounting principles to account for the proceeds as dividend income. Earnings data for the second and third quarters of 1984 are accordingly restated in the above summary to reflect the General Foods share redemption proceeds, after reduction for cost of shares redeemed, as realized investment gain. The effect of the change is to reduce earnings from amounts previously reported for the second quarter by $5,376 ($4.69 per share), and for the third quarter by $4,099 ($3.58 per share). The related changes to previously published interim balance sheets are insignificant.

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(20) Business Segment Data

The tables below reflect data for each of the three most recent fiscal years, broken down as to business segments.

Revenues

	1984	1983	1982
Insurance	$209,523	$196,729	$194,736
Candy	136,053	133,616	123,770
Newspaper	101,639	90,161	63,630
Retailing of home furnishings	118,176	28,910	—
Steel service center	55,305	46,266	37,483
Retailing of apparel	41,966	41,997	42,609
Textiles	32,444	26,611	21,755
Revenues not identified with segments	34,073	38,436	37,489
	$729,179	$602,726	$521,472

Operating Profit Before Taxes

	1984	1983	1982
Insurance	$ 20,843	$ 9,938	$ 20,062
Candy	25,669	26,697	23,440
Newspaper	26,729	19,039	(1,244)
Retailing of home furnishings	14,044	3,642	—
Steel service center	4,092	3,241	703
Retailing of apparel	(1,072)	697	914
Textiles	418	(100)	(1,545)
Pre-tax operating profits not identified with segments	19,230	21,173	19,227
Corporate expenses	(1,543)	(1,272)	(1,227)
Shareholder designated contributions	(3,178)	(3,066)	(891)
Interest expense	(14,734)	(15,104)	(14,995)
	$ 90,498	$ 64,885	$ 44,444

Amounts are stated before deduction of any applicable minority interest. Charges or credits for depreciation and amortization of tangible and intangible assets have been taken into account. See below. Realized investment gains are not reflected.

Capital Expenditures

	1984	1983	1982
Insurance	$ 441	$ 282	$ 342
Candy	3,727	2,406	2,711
Newspaper	734	788	2,931
Retailing of home furnishings	623	—	—
Steel service center	409	159	315
Retailing of apparel	612	1,269	2,588
Textiles	320	470	720
Other	720	972	358
	$ 7,586	$ 6,346	$ 9,965

Excludes expenditures which were part of business acquisitions.

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(20) Business Segment Data (continued)

Depreciation and Amortization of Tangible Assets

	1984	*1983*	*1982*
Insurance	$ 492	$ 550	$ 651
Candy	2,386	2,264	2,087
Newspaper	2,592	2,557	2,354
Retailing of home furnishings	922	228	—
Steel service center	633	633	614
Retailing of apparel	457	400	248
Textiles	662	689	610
Other	620	632	528
	$ 8,764	$ 7,953	$ 7,092

Amortization of Intangible Assets

	1984	*1983*	*1982*
Candy	$ 975	$ 714	$ 444
Newspaper	599	314	29
Retailing of home furnishings	467	128	—
Mutual	(624)	(624)	(624)
Other	17	—	—
	$ 1,434	$ 532	$ (151)

Identifiable Assets At Year-End

	1984	*1983*	*1982*
Identified with segments:			
Insurance	$1,615,274	$1,322,160	$1,059,670
Candy — tangible assets	28,631	27,791	28,757
— goodwill	34,497	35,472	12,802
Newspaper — tangible assets	37,653	37,292	37,703
— goodwill	22,907	23,506	930
Retailing of home furnishings			
— tangible assets	40,560	35,165	—
— goodwill	19,807	20,274	—
Steel service center	18,182	17,672	15,337
Retailing of apparel	13,186	13,435	16,002
Textiles	16,085	14,789	12,878
Other	9,487	10,575	90,261
	1,856,269	1,558,131	1,274,340
Not identified with segments:			
Investment in unconsolidated subsidiaries	33,235	27,216	24,065
Corporate cash and marketable securities of parent and non-insurance subsidiaries	145,699	252,196	234,879
	$2,035,203	$1,837,543	$1,533,284

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(20) Business Segment Data (continued)

Revenues of the Insurance Segment

	1984	*1983*	*1982*
Premiums written	$133,558	$149,849	$149,091
Premiums earned:			
Specialized auto and general liability	64,003	68,148	69,026
Workers' Compensation*	22,665	18,849	15,951
Reinsurance	16,066	26,889	27,408
Home State multiple lines	32,598	35,328	37,552
Structured settlements and portfolio reinsurance	4,910	3,266	3,008
Total premiums earned	140,242	152,480	152,945
Investment income	69,281	44,249	41,791
	$209,523	$196,729	$194,736

**Workers' Compensation coverage written by the Home State Companies, as part of their multiple line business, is not disaggregated from their total earned premiums.*

Insurance Segment Operating Profit Before Taxes

	1984	*1983*	*1982*
Underwriting gain (loss):			
Specialized auto and general liability	$(16,049)	$(14,880)	$(12,647)
Workers' Compensation	(12,560)	(1,091)	2,658
Reinsurance	(12,703)	(8,387)	(7,524)
Home State multiple lines	(4,101)	(8,834)	(3,949)
Subtotal — conventional insurance operations	(45,413)	(33,192)	(21,462)
Structured settlements and portfolio reinsurance transactions	(2,647)	(680)	(96)
Total underwriting (loss)	(48,060)	(33,872)	(21,558)
Net investment income	68,903	43,810	41,620
	$ 20,843	$ 9,938	$ 20,062

Portfolio reinsurance obligations were first assumed near the end of 1983 and no gain or loss from such transactions was recorded until 1984.

(21) Subsequent Event

On March 18, 1985, Berkshire agreed to purchase from Capital Cities Communications, Inc. ("Capital Cities") three million shares of that company's common stock at a per-share price of $172.50, if and when Capital Cities purchases American Broadcasting Companies, Inc. ("ABC"). Capital Cities and ABC have publicly announced a plan whereby the latter would be acquired by the former upon their obtaining the necessary shareholder and regulatory approvals. Capital Cities' acquisition of ABC, if consummated pursuant to this plan, and Berkshire's purchase of the Capital Cities shares, would most likely not occur until after the end of the third calendar quarter of 1985. Berkshire's contingent purchase commitment amounts to $517,500, and Berkshire's investment in Capital Cities stock if made pursuant to this proposal would represent immediately after the transaction about 18% of Capital Cities' outstanding shares. Capital Cities is a publicly owned corporation that is presently extensively engaged in radio and television broadcasting, in publishing and in the operation of cable television systems.

BERKSHIRE HATHAWAY INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Results of Operations

Berkshire's operations are diverse. For purposes of this discussion, results are disaggregated to permit separate discussion of the more significant sources. Extensive data with respect to the various Berkshire operations appears in Note 20 (the "Segment Note") to the Consolidated Financial Statements appearing elsewhere herein. This discussion should be read in conjunction with that data.

In the Segment Note, the operating profit before taxes of the various Berkshire businesses is detailed. The impact of income taxes is somewhat uneven as to the various line items. Consolidated *after-tax* earnings for the past three years are summarized by principal source in the following table:

Source	*Net After-Tax Earnings (Loss) 000s Omitted*		
	1984	*1983*	*1982*
Insurance underwriting	$ (25,955)	$ (18,400)	$ (11,345)
Candy business	12,406	11,498	6,470
Newspaper business	12,717	8,518	(255)
Retailing of home furnishings	5,451	1,352	—
Interest and dividend income	71,017	53,341*	43,789
Interest and financing costs	(7,452)	(7,346)	(6,951)
Other operating items, net	2,017	(319)	(211)
Earnings before realized investment gain	70,201	48,644*	31,497
Realized investment gain, net	78,694	63,522*	14,877
Net earnings	$148,895	$112,166*	$ 46,374

**1983 is restated — see Note 1(b)*

Insurance underwriting

A summary of the combined underwriting results of the several property/casualty insurance company members of the Insurance Group is presented below, on the basis of generally accepted accounting principles ("GAAP"), for the past three years, with dollars in thousands:

	1984		*1983*		*1982*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Premiums written	$133,558	XX	$149,849	XX	$149,091	XX
Premiums earned	140,242	100.0	152,480	100.0	152,945	100.0
Losses and loss expenses	141,550	100.9	134,109	87.9	121,996	79.8
Underwriting expenses	46,752	33.4	52,243	34.3	52,507	34.3
	188,302	134.3	186,352	122.2	174,503	114.1
Underwriting loss — pre-tax	(48,060)		(33,872)		(21,558)	
Applicable income tax credit	22,105		15,472		10,213	
After-tax loss	$ (25,955)		$ (18,400)		$ (11,345)	

The percentage figure shown in the above table representing the ratio of total losses and expenses to premiums earned (hereafter, the "loss and expense ratio") is comparable but not identical to the "combined ratio" that is computed for companies in the industry based on data assembled for statutory reporting purposes. Of course, GAAP underwriting results are profitable to the extent that the loss and expense ratio is less than 100% and unprofitable to the extent that the ratio exceeds 100%.

Disaggregated Insurance Group comparative data is shown in the last two tables of the Segment Note. The last of such tables indicates that significant underwriting losses were recorded in each of the past three years for each subsegment of Berkshire's insurance business.

The dollars of underwriting loss recorded for reinsurance activities with respect to structured settlements and loss portfolio assumptions were $2,647,000 — 1984, $680,000 — 1983 and $96,000 — 1982. These reinsurance activities, data for which is reflected in the table first above, had a negligible effect on the loss and expense ratio of the Group for each of the past three years.

Berkshire's insurance operations, excluding reinsurance activity with respect to structured settlements and loss portfolio assumptions, have not expanded in the past three years. Rather, certain unprofitable operations, which appeared to lack potential for necessary improvement, were discontinued. The discontinued operations were not sold, but their activities were wound-down. Additional losses were incurred in the winding-down process in which the income stream was cut off but expenses continued in support of the process. Underwriting losses of the operations that were discontinued at the end of each respective year amounted to $10.1 million for 1984, $13.1 million for 1983 and $2.4 million for 1982. These losses, because they compare to relatively low levels of premiums earned by the operations, had an adverse effect on the loss and expense ratios shown above for the Group. The data for discontinued operations increased that ratio for 1984 by 4.9 percentage points, for 1983 by 6.4 points and for 1982 by 1.2 points.

Obvious from the above is that underwriting losses of Berkshire's continuing conventional underwriting operations have been sizeable — amounting to $35.3 million in 1984, $20.1 million in 1983 and $19 million in 1982. For several years, price competition has been intense in the property/casualty insurance business. As the duration of time extended during which inadequate pricing practices were the rule, their adverse effect on industry profits became more pervasive and underwriting losses increased. Some improvement in industry pricing appeared in the last half of 1984. However, the forward-pricing nature of the insurance business results in delays between the date that higher prices are initiated and the date they are reflected in the underwriting results. And, the need for higher prices was of such magnitude that there is virtually no way that the industry can record an underwriting profit in the near future.

As to Berkshire's continuing insurance operations, it is management's view that the worst of their underwriting losses are in the past but that an underwriting loss will be recorded for 1985. It is also highly likely that losses will be recorded in 1985 with respect to Berkshire's discontinued insurance operations, but their extent will be determined by their loss reserve developments.

Loss Reserve Developments

Significant adverse loss development was recorded by Berkshire's Insurance Group in 1984. The term "loss development" refers to changes in estimates of total losses incurred with respect to loss occurrences in years prior to the current year. Figures relating to the specialized reinsurance arrangements — periodic payments and portfolio reinsurance — are excluded in the data presented below because their inclusion would not be informative. Summaries of loss and loss expense data for the conventional insurance and reinsurance operations for the past three years are shown in the following table.

Loss Reserve Developments (Continued)

	000s Omitted		
	1984	*1983*	*1982*
Unpaid losses and loss expense at beginning of year	$196,468	$189,911	$190,970
Incurred losses recorded:			
Current year occurrences	116,441	126,634	115,775
All prior years' occurrences	17,770	3,604	2,596
	134,211	130,238	118,371
Payments with respect to:			
Current year occurrences	40,820	52,240	46,496
All prior years' occurrences	77,216	71,441	72,934
	118,036	123,681	119,430
Unpaid losses and loss expense at end of year	$212,643	$196,468	$189,911

Loss development is represented by the figures for incurred losses captioned "All prior years' occurrences". They represent charges against the given year's results that, based on information that came to light in that given year with respect to prior years' loss occurrences, should have been charged to prior years' results. Loss development recorded in a given year is an indication of the estimation error that resulted when the prior year-end liability for unpaid losses was established. They are only an indicator of the degree of that error, because even though one additional year's hindsight is employed in making the revised estimate, additional information may still become available and events may subsequently occur that influence the actual loss amounts ultimately incurred with respect to the prior years' occurrences. It literally takes years to determine the precise amount of estimation error that existed in an original estimate, and when the ultimate determination is made, the information, because it is stale, may tend to be less than useful. One-year developments, as presented above, have the advantage of revealing the effect on reported income of any given year of the estimation error recognized in that year.

The estimation error recognized in 1984 for Berkshire's Insurance Group was $17,770,000 which is 12.7% of premiums earned in 1984. It is of such magnitude that further explanation follows. More than 50% of the total, or $9.7 million, was recorded for Berkshire's reinsurance operations. As to reinsured business, the reinsurers (the Berkshire Insurance Group members, in this case), in establishing their estimates of unpaid amounts, must rely upon the estimates of the ceding insurers (the "Cedents") that are themselves directly liable. In fairness to Berkshire's Cedents, it must be pointed out that many of the cases with respect to which Berkshire's reinsurance operations recorded 1984 adverse loss development were in long-tail lines (auto liability, general liability, medical malpractice), where the Cedents themselves did not have available one year earlier the information that would have permitted them to then make more accurate estimates. This adverse development recorded in Berkshire's reinsurance operations relates to loss occurrences in years in which Berkshire's reinsurance volume was considerably higher than for 1984. The effect of the latter is a slightly negative influence on the determination of the Insurance Group's 1984 loss and expense ratio. For that computation, the numerator (losses plus expenses incurred) includes the adverse loss development relating to prior years, while the denominator (premiums earned) does not, of course, include any of the higher prior year premium income.

Most of the remainder of Berkshire's 1984 adverse loss development was in another long-tail line, workers' compensation. That line produced adverse development to Berkshire of $6.2 million, of which $1.8 million represents that of operations that were discontinued by Berkshire at the end of 1984. Adverse development recorded in 1984 by Cypress Insurance Company amounted to $4.2 million. Underreserving was not a previously revealed characteristic at that operation, which had produced results in each of several prior years that were considered by Berkshire's management as quite satisfactory. The extent of Cypress' 1984 adverse development was an unhappy surprise. It is unfortunately yet too early to tell whether the underestimation of Cypress's 1983 yearend reserves that were revealed in 1984 resulted from applying inadequate estimation methods, or whether the errors resulted from events of an unpredictable nature that precluded more accurate estimation.

Loss Reserve Developments (Continued)

Acceptance of business at inadequate prices tends to accompany underestimation of unpaid losses. If a company underestimates its costs, it is more likely to underprice its product. If an insurance company underestimates its unpaid losses, it will also pay income taxes on amounts that weren't really income. For several reasons, Berkshire's management is genuinely concerned about the underestimation of its 1983 yearend loss reserves that was revealed in 1984.

Candy Business

A summary of results to Berkshire from the candy business for the past three years is as follows:

	000s omitted			
	Profit before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings*
1984	$25,670	$13,264	$ —	$12,406
1983	26,697	13,712	1,487	11,498
1982	23,440	12,178	4,792	6,470

This business became wholly-owned by Berkshire in 1983 as a result of the merger of Blue Chip Stamps. Prior to that merger it was for some time approximately 60% beneficially owned by Berkshire. The elimination, effective for the last half of 1983 and thereafter, of the minority interest in See's business had a pronounced effect on Berkshire's earnings for 1983 versus 1982, as indicated above, and a somewhat lesser effect on the comparisons between 1984 and 1983.

Unit volume (pounds of candy sold) has been relatively static in the past three years, actually declining somewhat on a store-for-store basis. Increased selling prices in 1983 overcame increased costs in 1983, each as compared to the prior year. However, in 1984, the nominal increases in selling price were somewhat less than increases in cost so that profit before taxes in 1984 declined slightly from 1983.

Newspaper Business

Berkshire's results from operation of the Buffalo News for the past three years is as follows:

	000s omitted			
	Profit (loss) before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings (loss)*
1984	$26,728	$14,011	$ —	$12,717
1983	19,039	9,000	1,521	8,518
1982	(1,244)	(765)	(224)	(255)

The News was 59.6% beneficially owned by Berkshire in earlier years and until the mid-1983 merger of Blue Chip Stamps. It is now 100% owned by Berkshire.

A dramatic turnaround to profitability of the Buffalo News resulted in 1983 after the 1982 cessation of publication of the competing Buffalo Courier-Express. Both advertising and circulation revenues of the News increased significantly in 1983, as unit volume and prices both increased. Also of benefit in 1983 was an unanticipated decline in newsprint prices.

Advertising and circulation revenues both increased in 1984 from 1983 levels. Total revenues in 1984 increased about 12% over 1983 amounts. A lesser rate of increase in costs in 1984 permitted the News' profit before taxes to increase as shown above. Only nominal state income taxes were incurred in 1983 as a result of applicable net operating loss carryovers. Income of the News in 1984 was fully subject to both state and federal income taxes.

Retailing of Home Furnishings

Berkshire purchased its controlling interest in this business on September 30, 1983. Therefore, the below table compares data for the full 1984 year to that for only the last three months of 1983.

	000s omitted			
	Profit before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings*
1984	$14,044	$7,064	$1,529	$5,451
1983 (3 months) ...	3,642	1,909	381	1,352

The rewarding results of this business for 1984 compare favorably to Berkshire management's expectations.

Interest and Dividend Income

This income is largely earned by the Insurance Group. Wesco and certain other consolidated subsidiaries and, from time to time, Berkshire also retain investments in income producing securities issued by non-affiliates.

A summary of this category of income for the past three years follows:

	000s omitted			
	Profit before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings*
1984	$84,161	$11,802	$1,342	$71,017
1983 (Restated*)	64,903	8,018	3,544	53,341
1982	58,003	8,906	5,308	43,789

*See Note 1(b)

A portion of this income is received with respect to tax-exempt obligations, and a significant portion represents dividend income of which only 15% is taxable at the full Federal corporate rate. Total interest and dividend income has increased as the amount of investments has increased. Tax-exempt interest income increased significantly from $8,091,000 in 1982 to $9,677,000 in 1983, and to $23,896,000 in 1984. That increase resulted from an increased investment in Washington Public Power Supply System bonds.

Realized Investment Gain

This component of Berkshire's net earnings for 1984 and 1983 (as restated) includes proceeds received from investees in transactions that kept unchanged Berkshire's proportionate ownership interest in the investees. The net gain in the transactions ($7,294,000 for 1984 and $18,224,000 for 1983) was determined for current financial reporting purposes after deducting from the proceeds the cost of the redeemed shares. Berkshire's management believes that a more appropriate financial presentation would result if the proceeds were reflected as dividend-equivalent special distributions, following the substance-over-form principle. Berkshire's management does not consider that Berkshire "sold" any part of its ownership interest in GEICO in 1983 nor of its ownership interest in General Foods in 1984, and it views the redemption proceeds it received from those entities in the same light as it views dividend income. Accounting otherwise for the transactions, as is reflected in the accompanying consolidated financial statements, in management's view obscures the underlying economic reality of the transactions.

Realized Investment Gain (Continued)

This part of the discussion in recent years included a recitation to the effect that a significant component of Berkshire's net earnings has historically resulted from realized gains recorded when appreciated securities were sold, that management's decision to sell any of Berkshire's investments is based on a number of factors, but the impact of the decision on reported earnings is not a consideration, and that the amount of earnings that Berkshire may derive from realized investment gains, if any, tends to fluctuate significantly from period to period. That recitation was and still is totally appropriate, irrespective of the accounting treatment afforded to proportionate redemption proceeds.

Liquidity and Capital Resources

Berkshire's consolidated balance sheet at December 29, 1984 reflects continuing significant liquidity. In management's opinion, the fiduciary nature of obligations to policyholders of Berkshire's insurance subsidiaries, to savers of Blue Chip's trading stamps and its other obligations requires maintenance of high liquidity; management expects to continue to meet this requirement with a significant margin of safety. Maintenance of liquidity considerably above industry norms is intended to permit Berkshire's insurance subsidiaries to perform their underwriting function without a view towards cash flow. It also permits quick response to business acquisition opportunities, such as occurred in 1983 when control of the Nebraska Furniture Mart became available.

Berkshire's businesses are not capital-intensive; i.e., they do not require significant investment or reinvestment in property, plant and equipment. Generally, management tends to avoid deployment of assets in businesses of such a nature. On the contrary, Berkshire desires to own companies engaged in businesses that produce positive cash flow. It retains funds and obtains credit with a view towards acquiring more such operations or expanding existing operations into areas where above-average capital strength creates competitive advantage to them.

Berkshire's total equity capital has more than doubled over the past three years, from approximately $519 million at the end of 1981 to over $1.2 billion at the end of 1984, the net increase amounting to $752 million. About $155 million of the increase resulted from Berkshire's issuance of shares of its common stock to acquire the outstanding minority interest of Blue Chip Stamps. Realized and unrealized securities gains during the three years represent approximately $447 million of the increase and reinvested operating earnings in the three years were about $150 million. Debt is used by Berkshire in relatively modest amounts, and management does not expect Berkshire to rely upon a high degree of leverage in its financing at any time in the foreseeable future. Management is averse to reliance on any significant amount of short-term debt. Berkshire has outstanding $60 million 12¾% debentures issued in a public offering in 1980, repayable in the years 1991 through 2005. Berkshire put into place on February 22, 1984, $175 million Revolving Credit and Term Loan Agreements with banks. It is thus in position to acquire significant business interests should an opportunity arise to do so.

Inflation

Berkshire's management does not believe that, to date, inflation has seriously affected Berkshire's businesses. Generally, Berkshire receives current revenues in any year which have substantially the same purchasing power as the dollars which represent its current costs. Very few of Berkshire's costs are stated in dollars which are other than current dollars.

Very large changes in the rate of inflation that were not anticipated could seriously impact Berkshire's insurance business, particularly since premium rates are established well in advance of incurrence of the related costs. Management believes that to date, however, underwriting results have not been impacted materially by inflation or changes in inflation rates.

BERKSHIRE HATHAWAY INC.
PARENT COMPANY ONLY — SUMMARIZED FINANCIAL STATEMENTS
(dollars in thousands)

These summarized financial statements should be read in conjunction with the Consolidated Financial Statements of Berkshire Hathaway Inc. and consolidated subsidiaries and the notes thereto, presented elsewhere herein.

Balance Sheets

	Dec. 29, 1984	Dec. 31, 1983
Assets		
Cash and invested cash	$ 9,036	$ 4,492
Investment in marketable equity securities at cost (market: Dec. 31, 1983 — $188,056)	—	139,976
Investment in subsidiaries (including unrealized appreciation of marketable equity securities owned by insurance subsidiaries, net of taxes, amounting to $486,953 at Dec. 29, 1984 and $483,280 at Dec. 31, 1983)	1,335,349	1,062,695
Accounts receivable and inventories of parent company's textile business	11,020	10,039
Other assets	12,367	3,821
	$1,367,772	$1,221,023
Liabilities and Stockholders' Equity		
Accounts payable and accrued expenses	$ 7,945	$ 10,291
Term debt and other borrowings	88,066	89,445
Current and deferred income taxes	—	2,094
	96,011	101,830
Stockholders' equity (See Consolidated Balance Sheets)	1,271,761	1,119,193
	$1,367,772	$1,221,023

Statements of Earnings

	1984	1983	1982
Income items:			
From subsidiaries:			
Interest	$ 470	$ 347	$ 440
Dividends	24,732	105,414	12,139
Undistributed earnings	121,990	2,673	44,926
	147,192	108,434	57,505
Interest and dividends — other investments	3,626	7,736	2,120
Gross profit from textile products sales	2,862	1,992	882
Other income	8,430	5,205	1,176
Income tax credit	2,190	6,352	—
	164,300	129,719	61,683
Cost and expense items:			
Administrative and selling expenses of textile business	2,279	2,147	2,486
Corporate administration*	2,352	4,338	2,005
Interest expense	10,774	11,068	10,818
	15,405	17,553	15,309
Net earnings	$148,895	$112,166	$46,374

**Corporate administration costs include Parent's contributions pursuant to Berkshire's shareholder designated contributions program. (Additional such contributions were made by a wholly-owned subsidiary in 1984 and 1982.)*

BERKSHIRE HATHAWAY INC.
SUPPLEMENTAL INFORMATION ON THE EFFECTS OF CHANGING PRICES
(dollars in thousands except per share amount)

This information is unaudited. Historical figures shown herein have been determined on the basis of current consolidation practices. The Financial Accounting Standards Board ("FASB") requires disclosure by certain companies of supplementary data intended to reflect the effects of inflation on portions of the financial statements. The method of measuring the impact from inflation is in the development stage and conceivably subject to future changes. Therefore, evaluation of the data presented should be made with caution and only with reference to other financial data.

Selected Financial Data as Reported and as Adjusted for General Inflation

This table presents certain prescribed data as reported* and then as adjusted to average 1984 constant dollars. The latter is determined by the Consumer Price Index.

	Fiscal Year Ended Saturday nearest December 31,				
	1984	*1983*	*1982*	*1981*	*1980*
Total revenues:					
As reported*	$ 729,179	$ 602,726	$521,472	$529,234	$536,414
As adjusted	729,179	628,378	561,155	604,644	676,169
Earnings from continuing operations before realized investment gain:					
Total as reported*	$ 70,201	$ 48,614	$ 31,497	$ 39,723	$ 38,484
Total as adjusted	70,201	50,683	33,894	45,383	48,510
Per share as reported*	$ 61.21	$ 45.57	$ 31.93	$ 40.27	$ 37.47
Per share as adjusted	61.21	47.51	34.36	46.01	47.23
Stockholders' equity:					
As reported*	$1,271,761	$1,119,193	$727,483	$519,463	$395,214
As adjusted	1,271,761	1,166,826	782,843	593,481	498,181
Market price per common share at year end:					
Historical amount	$ 1,275.00	$ 1,310.00	$ 775.00	$ 560.00	$ 425.00
As adjusted	1,275.00	1,366.00	834.00	640.00	536.00
Average consumer price index (1967 = 100)	311.1	298.4	289.1	272.3	246.8

**Or as would have been reported following current consolidation practices.*

Gain in Purchasing Power from Holding Net Monetary Items

In general, assets or liabilities which are fixed in terms of the amount of cash held, receivable or payable are "monetary items". At the end of each of the last six years, Berkshire held, on a consolidated basis, net monetary liabilities, i.e., consolidated monetary items which were liabilities exceeded consolidated monetary items which were assets. In an inflationary period, a gain in purchasing power results from holding net monetary liabilities, since this calculation presumes that the net liabilities can be redeemed with dollars of declining value. The calculated purchasing power gain resulting from this calculation, as to Berkshire and its consolidated subsidiaries for each of the past five years — stated in average 1984 dollars — is as follows:

1984	$ 6,935
1983	8,830
1982	6,750
1981	14,424
1980	18,562

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Additional FASB Requirements

Another FASB requirement is for restating at "current cost" inventories, assets used in production and depreciation thereon, and reporting the net effect on reported net income of these restatements. Since these items are not relatively material to Berkshire's operating income or financial position, this information has been omitted.

The 1984 Annual Report of Wesco Financial Corporation included the following letter to Wesco stockholders from the Chairman of the Company.

To Our Shareholders:

Consolidated "normal" operating income (i.e., before all unusual operating income and all net gains from sales of securities) for the calendar year 1984 increased to $10,060,000 ($1.42 per share) from $8,507,000 ($1.20 per share) in the previous year.

Consolidated net income (i.e., after unusual operating income and all net gains from sales of securities), increased to $23,656,000 ($3.32 per share) from $10,553,000 ($1.48 per share) in the previous year.

Despite the high numbers reported, 1984 was a so-so year in terms of real gain in strength. While "normal" net operating income increased satisfactorily, total net income was swollen in a major way only because of an unusual item of operating income and the cashing in of some unrealized appreciation in marketable securities which had occurred in earlier years.

Wesco has two major subsidiaries, Mutual Savings, in Pasadena, and Precision Steel, headquartered in Chicago and engaged in the steel warehousing and specialty metal products businesses. Consolidated net income for the two years just ended breaks down as follows (in 000s except for per-share amounts)[1]:

	"Normal" Net Operating Income of					
	Mutual Savings	Precision Steel Businesses	All Other "Normal" Net Operating Income(2)	Gain from Unrealized Appreciation in Forward Commitment of Mutual Savings to Buy GNMA Certificates	Net Gains on Sales of Securities(3)	Wesco Consolidated Net Income
December 31, 1984 .	$3,476	$2,034	$4,550	$458	$13,138	$23,656
Per Wesco share . .	.49	.29	.64	.06	1.84	3.32
December 31, 1983 .	3,046	1,622	3,839	—	2,046	10,553
Per Wesco share . .	.43	.23	.54	—	.28	1.48

(1) All figures are net of income taxes.
(2) After deduction of interest and other corporate expenses. Income was from ownership of the Mutual Savings' headquarters office building, primarily leased to outside tenants, and interest and dividend income from cash equivalents and marketable securities owned outside the savings and loan subsidiary.
(3) Includes $1,080,000 ($.15 per share), which, under different accounting treatment, might have been both (1) shifted to a different income category and (2) increased by $1,765,000 ($.25 per share). See "Unusual Income and Certain Accounting Quirks in 1984 Reporting" below.

The foregoing breakdown (of the same aggregate earnings) differs somewhat from that used in audited financial statements, which follow standard accounting convention as interpreted from time to time by Wesco's outside auditor. The supplementary breakdown of earnings is furnished because it is considered useful to shareholders.

Much of this letter is a word-for-word repeat of last year's letter with updated numbers. The repetition of wording occurs because it is believed (1) that the duplicated material remains correct and is worth repeating, and (2) that in Wesco's case any time and money required to change wording would be better spent elsewhere.

Parsimony, however, does not wholly predominate. So much kidding occurred concerning the 1960s automobiles in the old photograph of the Mutual Savings' building, which was used in last year's annual report to avoid incurring the cost of a new photograph, that the purse has been opened a little. Shareholders comparing the new photograph (on the inside front cover of this report) with the old will note that the trees have grown a lot in the intervening years. Fortunately, so has the value of the building. See the last section of this letter. The building, which works very well and attracts high quality tenants regarded as friends, is a constant reminder of the good sense of Louis R. Vincenti and Richard D. Aston, the Wesco executives responsible for its creation.

Mutual Savings

Mutual Savings' "normal" net operating income of $3,476,000 in 1984, represented an increase of 14.1% from the $3,046,000 figure the previous year. In both years such "normal" net operating income, while economically real and probably of at least average quality as reported savings and loan industry incomes go, was below the top quality possible because such earnings came entirely or partly from income tax savings obtained through inclusion of Mutual Savings in the consolidated income tax return of a parent corporation. Earnings so derived from income tax savings are not of the top quality possible because they can be impaired by future changes in tax laws and have less cushion in reserve against future adversity than earnings from ordinary operating income on which income taxes have been paid in full in cash at the highest corporate rate and are recoverable from the I.R.S. in the event of future operating losses.

Separate balance sheets of Mutual Savings at yearend 1983 and 1984 are set forth at the end of this annual report. They show (1) total savings accounts rising to $228 million from $203 million the year before, (2) a very high ratio of shareholders' equity to savings account liabilities (probably the highest for any mature U.S. savings and loan association), (3) a substantial portion of savings account liabilities offset by cash equivalents and marketable securities, and (4) a loan portfolio (mostly real estate mortgages) of about $95 million at the end of 1984, down 11% from the $107 million at the end of 1983. The loan portfolio at the end of 1984 bore a fixed average interest rate of only 7.63%, probably the lowest for any U.S. savings and loan association and far below the average interest rate which now must be paid to hold savings accounts.

The capital-rich, mortgage-loan-interest-rate-poor position of Mutual Savings came from (1) success many years ago as a construction lender at above-average interest rates, plus (2) sale in 1980 by Mutual Savings of all branch offices (except for one satellite office in a major shopping center across the street from the Pasadena headquarters) under terms where only the lowest-yielding mortgage loans from its large portfolio were retained, plus (3) drastic curtailment by Mutual Savings of mortgage lending following the sale of its branch offices, plus (4) profits in every recent year, no matter how high interest rates went.

Mutual Savings has remained profitable because the adverse effects from its old low-yielding, fixed-rate mortgage loan portfolio are more than offset by favorable effects from its large shareholders' equity and a tax-equivalent yield on its marketable securities (utility preferred stocks, tax-exempt bonds and common stocks) considerably higher than that prevailing on the mortgage loan portfolio of a typical savings and loan association. The old low-yielding, fixed-rate mortgage loan portfolio has shrunk from pay-backs at 9.8% per year over the last three years, and the shrinkage is expected to

continue at about the same rate. With portfolio shrinkage, loan credit quality problems have been reduced to a meaningless trace, because the old mortgages have large real estate equities supporting secured credit extended. And the foreclosed property on hand (mostly 22 vacant, largely oceanfront, acres in Santa Barbara) over a long holding period has plainly become worth considerably more than its $2 million balance sheet carrying cost.

It should be noted, however, that Mutual Savings' total mortgage loan portfolio did not, in substance as distinguished from accounting form, decrease in 1984 by the 11% mentioned above, determined by comparing audited year end balance sheet totals for loans. Mutual Savings has agreed to buy in 1986 U.S. Government guaranteed mortgage equivalents (GNMA certificates) at a price of about $19 million and has pre-funded this forward commitment by buying U.S. Treasury Notes maturing near the time the certificates will be purchased. After taking into account this forward commitment to purchase GNMA certificates, Mutual Savings' total mortgage loan portfolio has, in substance, *increased* by about 7% in 1984.

The 1984 increase in substance of mortgages owned reflects Mutual Savings' intention to keep at least 60% of assets in mortgages or mortgage equivalents, exactly as the Federal Home Loan Bank Board wisely exhorts the savings and loan industry to do if it expects to remain under a regulatory system separate from that of banks. And as a result of anticipated steady shrinkage through repayment of remaining old 7.63% mortgages, combined with purchases of new mortgages or mortgage equivalents bearing much higher interest rates, Mutual Savings expects in due course significantly to raise the average rate of interest on the entire mortgage loan portfolio, thus improving earnings so long as interest rates on savings accounts do not greatly increase. The GNMA certificates purchased for 1986 delivery at a price of about $19 million are expected to yield about 15% on such price, getting under way the process of "blending" the mortgage loan portfolio yield to a higher average level.

Mutual Savings has adapted in its own way to the dramatic changes which have occurred in recent years in interest rates and the regulatory structure of the banking and savings and loan industries. At Mutual Savings, as well as the rest of the savings and loan industry, the standard practice used to be to borrow short from savers while lending long on fixed-rate mortgages, to have high financial leverage for shareholders' equity and to grant mortgagors easy prepayment terms. The practice was profitable for decades but always involved something like a "hurricane risk," and the equivalent of a hurricane came in 1981-82 as interest rates rose to unprecedented levels and caused widespread losses. Results were good for shareholders before 1981-82 only because interest rates were stable or rose slowly as mortgage-loan portfolios steadily and rapidly expanded under a regulatory structure which both fostered growth and protected operating margins by requiring that on all insured savings accounts fixed rates be paid that were slightly higher than the low rates specified for banks. Thus a small deposit-attracting rate advantage over banks was given to savings and loan associations, while competitive pressure was dampened for both types of institution.

Although interest rates have subsided from the 1981-82 peak, the low and slowly changing interest rates of former years are plainly gone with the wind, as are the former government-decreed limits on interest rate competition for savings accounts and the favoritism for savings and loan associations over banks. But an agency of the U.S. Government (FSLIC) continues to insure savings accounts in the savings and loan

industry, just as it did before. The result may well be bolder and bolder conduct by many savings and loan associations. A sort of Gresham's law ("bad loan practice drives out good") may take effect for fully competitive but deposit-insured institutions, through increased copying by cautious institutions of whatever apparent-high-yield loan and investment strategies seem to allow competitors to bid away their savings accounts and yet report substantial earnings. If so, if "bold conduct drives out conservative conduct," there eventually could be widespread insolvencies caused by bold credit extensions come to grief.

And if serious credit-quality troubles come to the savings and loan industry, they will merely add to troubles from the borrowed-short, lent-long-at-fixed-rates problem, which is far from completely removed, and which destroys shareholder wealth at startling speed whenever interest rates are rising rapidly, even when the credit quality of mortgagors or other borrowers is excellent.

The Federal Home Loan Bank Board, under its current Chairman Edwin R. Gray, shares Wesco's concerns. Wesco approves its attempts by regulation and by "jaw-boning" to limit follies to come from (1) sharing the U.S. Government's credit with optimistic new entrants to the savings and loan business, often coming from the real estate development and stock brokerage businesses, given ample scope to venture under widened investment authority, and (2) high financial leverage throughout the savings and loan industry, combined with continuing maturity mismatch of fixed rate assets and liabilities. Logic and history would suggest that Mr. Gray is right to pull on the reins, but this is an unpopular task since many powerful activity-cravers feel the bit and create political heat in opposition to even limited (and almost surely inadequate) financial discipline which would protect the federal deposit-insurance system by demanding a significant margin-of-safety factor in financial institutions, just as in bridges. Wesco is not optimistic either that the present rules of the savings and loan game will stand the test of time or that drastic changes in the rules will occur until huge future trouble comes, sooner or later.

Developing a short-term operating plan for Mutual Savings which would sharply increase its reported earnings next year would be a near-absolute cinch. For instance, savings accounts could be expanded greatly by paying a high rate of interest on "jumbo" deposits in $100,000 multiples, and proceeds plus cash equivalents on hand could be placed in long-term mortgages at a substantial current interest spread while, in addition, some origination fees could be "front-ended" into income. However, taking long-term risks into account, it is much harder to find a sound operating plan. Money is the ultimate fungible commodity. In the new order of things, an association is not only in a tough, competitive, commodity-type business on the lending side but also finds that, with decontrol of government-insured rates paid savers, every competitive association has virtually unlimited credit to fund increased lending, by paying premiums over interest rates generally prevailing on savings accounts. Under such conditions, when all risks are considered, including those created by that portion of competitors motivated primarily by short-term effects, it is quite naturally difficult to earn over a long period an attractive return on shareholders' equity. How could it be otherwise?

A few years ago, about the time Mutual Savings reacted to new conditions by curtailing lending and financial leverage, most other associations decided instead to keep lending aggressively but under new adjustable-rate mortgages under which some portion (but far from all) of the interest-rate-fluctuation risk is shifted to the homeowner.

Despite widespread use of these new adjustable-rate mortgages, savings and loan industry earnings remain dependent to a material extent, as they always were, on an interest rate spread attributable to: (1) borrowing short while lending long, and/or (2) making loans which can be priced high enough to provide a profit only because they involve a very material credit risk, compared to the risk of owning government-backed securities of comparable maturity.

Under present conditions of strong competition from bold competitors accompanied by high interest-rate-fluctuation risk, the result tends to be that each year of reported attractive earnings in the savings and loan industry occurs only in the absence of two now much more likely events: (1) sharply rising interest rates, and (2) widespread credit losses. Thus, each good year reported is a lot like the year when a Texas hurricane insurer reports satisfactory earnings because there have been no hurricanes. Mutual Savings has a considerable share of this uncomfortable position and will continue to have it. It has not yet developed a long-term operating strategy with which it is satisfied, and it continues to seek one. Just as Mutual Savings has been idiosyncratic in the past as it sold branch offices in 1980 (a practice since adopted to some extent by other savings and loan associations and major banks), it will probably be idiosyncratic in the future. It will seek some non-standard way of rendering socially constructive service while operating with acceptable profits accompanied by an acceptable level of risk for shareholders' capital, likely gains considered.

Eventually, by maintaining unusual capital strength and liquidity, and by having a parent corporation which does likewise, Mutual Savings hopes to stand in particular favor with federal and state regulatory authorities and be in a position soundly to expand again, perhaps dramatically, and perhaps involving additional shareholder investment in Mutual Savings by the parent corporation.

Recent growth in savings accounts, considered on an incremental-effects basis, constitutes loss business, because Mutual Savings has incurred in interest and other expense more than it has received from employing proceeds in short-term interest-bearing investments far above regulatory requirements for liquidity. Moreover, some of the attendant expense may not have hit the books. In due course (starting in 1985) Mutual Savings, which with its large ratio of shareholders' equity to total liabilities imposes a virtually zero risk on FSLIC (the U.S. agency which insures safety of accounts in savings and loan associations), will be required to pay to FSLIC extra insurance premiums, based on Mutual Savings' gross size, to help fund FSLIC's protection of account holders in other savings and loan associations finally recognized as insolvent. In this process Mutual Savings, in effect, will retroactively pay extra interest-equivalent expense by reason of having attracted new savings. Mutual Savings' position at the moment is like that of a sober and careful automobile driver of 2000 miles per year, disadvantaged by his limited activity, yet forced to pay mutualized, standardized insurance premiums so long as he lives based on inclusion in a liability insurance pool (1) which is composed almost entirely of much worse risks, (2) which contains a considerable number of traveling salesmen previously convicted of drunk driving, and (3) which discovers liabilities, partly through institutional design, long after their occurrence. Deliberate growth in savings, under such conditions, reflects considerable optimism, perhaps Micawberish, that Mutual Savings will eventually have better ideas and opportunities and that its officers (including the Chairman) will make fewer of the sort of mistakes in which they participated in the past, leading to difficulties now decried.

The foregoing comments, designed to communicate reality for Wesco shareholders as it appears to Wesco management, should not be taken as criticism of FSLIC management. In recent years FSLIC management has bordered on heroic, considering economic and legal changes, political pressures, extraordinary work burden, novel problems and limited resources.

Precision Steel

Wesco's Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, was acquired for approximately $15 million on February 28, 1979. The price was roughly book value for a company which carried its inventories on a conservative LIFO accounting basis and which contained significant cash balances. More important, it had reached its position from a modest beginning through maintenance of sound, customer-oriented business values inculcated over a long time by a gifted founder and his successors. Precision Steel owns a well-established steel service center business and a subsidiary engaged in the manufacture and distribution of tool room supplies and other specialty metal products.

Precision Steel's businesses contributed $2,034,000 to "normal" net operating income in 1984, up 25% compared with $1,622,000 in 1983. Such a sharp increase in 1984 profit was not anticipated and was largely attributable to (1) increased sales (up 20% to $55,098,000) and (2) some favorable quantity-order prices on steel purchased.

Under the leadership of David Hillstrom, Precision Steel's businesses are now quite satisfactory, taking into account the financial leverage put into Wesco's consolidated picture incident to their acquisition. The 1984 year could be a hard act to follow.

Shortly after Wesco's purchase of Precision Steel, a substantial physical expansion of steel warehousing facilities was authorized, involving a new building in Charlotte, North Carolina. The new building and the whole North Carolina operation are now very successful, contributing $8,589,000 to sales in 1984 at a profit percentage higher than has prevailed in the long-established Chicago headquarters' facility.

Precision Steel's businesses, despite their mundane nomenclature, are steps advanced on the quality scale from mere commodity-type businesses. Many customers of Precision Steel, needing dependable supply on short notice of specialized grades of high-quality, cold-rolled strip steel, reasonable prices, technical excellence in cutting to order, and remembrance when supplies are short, rightly believe that they have no fully comparable alternative in Precision Steel's market area. Indeed, many customers at locations remote from Chicago and Charlotte (for instance, Los Angeles) seek out Precision Steel's service.

Wesco remains interested in logical expansion of Precision Steel's businesses, using liquid assets available.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, rose to $4,550,000 in 1984 from $3,839,000 in 1983. Sources were (1) rents ($2,078,000 gross, excluding rent from Mutual Savings) from Wesco's Pasadena office building block (predominantly leased to outsiders although Mutual Savings is the ground floor tenant) and (2) interest and dividends from cash equivalents and

marketable securities held by Precision Steel and its subsidiaries and at the parent company level.

Net Gains on Sales of Securities

Wesco's aggregate net gains on sales of securities, combined, after income taxes, increased to $13,138,000 in 1984 from $2,046,000 in 1983. The large 1984 gains do not indicate special acumen or good fortune in 1984. It merely happened that in 1984 unrealized appreciation occurring in previous years was cashed in.

A $1,080,000 portion of 1984 securities gains, if a different accounting treatment had been used, would have been both: (1) shifted to a different income category and (2) increased by $1,765,000. See next section.

Unusual Income and Certain Accounting Quirks in 1984 Reporting

Wesco's consolidated audited figures for net earnings contained in this Annual Report are lower by $1,328,000 in aggregate ($.19 per share) with respect to the nine months ended September 30, 1984, than the figures contained in Wesco's previously-issued quarterly reports covering such nine months.

The downward restatement of earlier reported earnings occurred because, after the close of the year, Wesco's outside auditor made an unanticipated interpretation of generally accepted accounting principles applicable to an unusual business transaction.

The unusual business transaction was cash paid by General Foods for transfer of General Foods' stock from Wesco to General Foods under a written arrangement with General Foods, specifying intention to create an exact dividend-equivalent, which kept Wesco's percentage ownership of General Foods the same at all times. Under such circumstances, income tax law quite naturally treats all proceeds of the in-form "sale" of General Foods stock as a dividend, which is the I.R.S. view as well as Wesco's view of the underlying economic substance. Last year, in a virtually identical case, Wesco's outside auditor approved, for the consolidated group of which Wesco is a part, financial statements including accounting treatment in conformity with in-substance dividend reporting to the I.R.S. and Wesco's 1984 quarterly reports of earnings followed this precedent with no objection. But, after much deliberation, the outside auditor's opinion early in 1985 came down in favor of treating the 1984 transactions with General Foods as sales instead of dividend-equivalents, except that income tax provision continued to be computed on the in-substance dividend basis.

From the Wesco shareholders' vantage point the result from the outside auditing decision made is that the error, if any, existing in the audited accounts by reason of the Wesco-auditor disagreement is now on the side of underreporting income. Wesco's audited net income for the full year 1984 is now lower by $1,765,000 ($.25 per share) than would have been reported if all proceeds of the 1984 business transaction with General Foods had been reported as unusual dividends or dividend-equivalents, following Wesco's view of substance. Either way, any income from the Wesco-General Foods business transaction is reported as "unusual" or from an irregular source (securities gains), and, either way, the 1984 year end balance sheet is exactly the same, except that in one case (Wesco's view) the after-tax balance sheet carrying cost would have been $1,765,000 higher for an identical number of General Foods' shares owned, with the $1,765,000 increase augmenting book net worth of Wesco.

While Wesco disagrees with its outside auditor on the accounting issue, Wesco can find something to applaud in (1) a de-emphasis of year-to-year consistency in search for an answer best in the auditor's latest view and (2) an auditor's favoring of a decision, where it has any doubt, which may err on the side of under-reporting income, considering a common tendency of corporate clients to favor decisions in the opposite direction.

Were Wesco running a national accounting partnership it would want a system where a high-ranked partner, free of business-retaining pressure, could reverse accounting decisions urged by field partners, so Wesco can hardly complain about the inconsistent messages from an audit-management system which forced Wesco in 1984 to change at year end quarterly income figures earlier reported. However, in this murky case, where we happen to know that one of the country's most eminent accountants agrees with the Wesco view, we must admit to minor irritation with the fates. Wesco makes special effort aimed at high-quality reporting to shareholders. (For instance, only with respect to competitively proprietary information, such as transactions in marketable securities, does Wesco consciously keep communication with shareholders to the legal minimum.) Thus when the audit quality-control system of its outside C.P.A. firm selects Wesco for forced restatement of numbers previously given shareholders, we feel much as if we were a duty-obsessed engineering student at Brigham Young University, accidentally tear-gassed by the national guard in a necessary program to control campus unrest.

The subject of this restatement of a small part of Wesco's earnings is covered at length here only because, much more often than not, it is a bad sign for shareholders when a full year-end audit decreases income reported as earned in previous quarterly reports. A full explanation is therefore appropriate.

The inconsistency between quarterly and final income figures is not the only accounting quirk in Wesco's audited 1984 financial statements. It seems odd, as highlighted above in the unconventional breakdown of earnings, that unrealized appreciation of $458,000 in a forward commitment to buy mortgage-equivalents was taken into Mutual Savings' income in 1984, which happened because the commitment was made in a futures market on a commodities exchange. A forward commitment to buy the same mortgage equivalents, made in some other manner, for instance by simple contract, would not, under the applicable accounting rules, result in the same unrealized appreciation's being reported as income. And, even though the unrealized appreciation is recognized as income in the 1984 earnings statement, shareholders must look deep into a footnote to the audited 1984 financial statements to find the only reference to the mortgage equivalents which produced the appreciation. The balance sheet standing alone discloses only short-term investments (U.S. Treasury Notes in this instance) the proceeds of which will be used in 1986 to close the forward commitment to buy the mortgage equivalents.

It also seems odd, in view of the substantial additional costs FSLIC membership will in the near future impose on Mutual Savings, that prepaid FSLIC premiums amounting to $3,146,000 are included in the audited consolidated balance sheet, without offset for anticipated new cost of sharing FSLIC liabilities. We do not object to the accounting convention at work. All complexities and interests considered, the accounting profession is doing all right by the civilization; the FSLIC relationship has long been a valuable asset in the savings and loan industry, with its mutualized nature of no practical adverse consequence; and both accounting and public-policy considerations disfavor quick invention of new accounting convention to anticipate in current financial statements future increases in burden from FSLIC membership by reason of facts already known.

But quirks (at least as diagnosed by Wesco) required (probably wisely, on balance) by accounting convention, do contribute to causing Wesco to break down and discuss its earnings unconventionally in its management letter and also to call shareholders' attention to audit footnotes. The use of both footnotes and letter is needed for a best-feasible understanding of economic reality as it appears to Wesco management.

It is recognized, of course, by most certified public accountants as well as by Wesco that audited statements alone, unless accompanied by a letter giving management's view of economic reality where inconsistent with the image created by accounting convention, is an improperly incomplete form of annual communication with corporate owners. There is a limit to the communication which properly standardized accounting can create, and Wesco's outside auditors (and its parent companies' auditors) over the years have been quite supportive of Wesco's approach to expanding numerate communication in the management letter, even though outside auditing jurisdiction.

Written arrangements creating the issue of unusual dividend-equivalent income, of the type which caused reporting quirks in 1984 as a result of transactions with General Foods, can hardly be expected to be made year after year. However, Wesco does anticipate, based on an agreement already signed, that in 1985 more of the same sort of transactions will occur with General Foods, probably somewhat smaller in aggregate amount than in 1984.

Consolidated Balance Sheet and Related Discussion

Wesco's consolidated balance sheet (1) retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others and (2) reflects a continuing failure to acquire additional businesses because none are found available, despite constant search, at prices deemed rational when the interest of Wesco shareholders is taken into account.

As indicated in Note 2 to the accompanying financial statements, the aggregate market value of Wesco's marketable equity securities was higher than their aggregate cost at December 31, 1984 by about $13 million, down sharply from about $29 million one year earlier.

Wesco's Pasadena office building block (containing about 165,000 net rentable square feet including Mutual Savings' space) has a market value substantially in excess of carrying value, demonstrated by (1) mortgage debt ($5,182,000 at 9.25% fixed) against this real property now exceeding its depreciated carrying value ($3,069,000) in Wesco's balance sheet at December 31, 1984, and (2) substantial current net cash flow to Wesco after debt service on the mortgage.

Wesco remains in a prudent position when total debt is compared to total shareholders' equity and total liquid assets. Wesco's practice has been to do a certain amount of long-term borrowing in advance of specific need, in order to have maximum financial flexibility to face both hazards and opportunities.

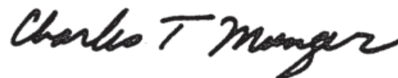
It is expected that the balance sheet strength of the consolidated enterprise will in due course be used in one or more business extensions. The extension activity, however, requires some patience, as suitable opportunities are not always present.

As indicated in Schedule I accompanying Wesco's financial statements, common stock investments, both those in the savings and loan subsidiary and those held temporarily elsewhere pending sale to fund business extension, tend to be concentrated in a very few companies. Through this concentration practice better understanding is sought with respect to the few decisions made.

The ratio of Wesco's annual reported consolidated net income to reported consolidated shareholders' equity, about 13% in 1982-84, (1) was dependent to a considerable extent on securities gains, irregular by nature, and (2) nonetheless leaves something to be desired from the Wesco shareholders' point of view. Wesco began life as a savings and loan holding company in what became a very tough industry in which the real value, as distinguished from the reported book value, of most shareholders' equity became impaired, particularly in 1981-82. Damaged along with the rest of its industry, Wesco has been proceeding slowly under shortened sail, while it assesses damage and repairs the ship, instead of trying to make fast time by getting all canvas aloft. However, progress ultimately helpful to shareholders has not been restricted to what has shown up neatly in the income account covering this period. Increases over recent years in both (1) aggregate reported shareholders' equity and (2) the percentage of such equity outside Wesco's savings and loan segment are expected to be useful in the future.

On January 24, 1985, Wesco increased its regular quarterly dividend from 14½ cents per share to 15½ cents per share, payable March 7, 1985 to shareholders of record as of the close of business on February 19, 1985.

This annual report contains Form 10-K, a report filed with the Securities and Exchange Commission, and includes detailed information about Wesco and its subsidiaries as well as audited financial statements bearing extensive footnotes. As usual, your careful attention is sought with respect to these items.



Charles T. Munger
Chairman of the Board

February 12, 1985

BERKSHIRE HATHAWAY INC.

SHAREHOLDER-DESIGNATED CONTRIBUTIONS

On October 14, 1981 a letter was sent to shareholders giving the reasons for initiation of a program of shareholder-designated contributions. Portions of that letter follow:

"On September 30, 1981 Berkshire received a tax ruling from the U.S. Treasury Department that, in most years, should produce a significant benefit for charities of your choice.

"Each Berkshire shareholder — on a basis proportional to the number of shares of Berkshire that he owns — will be able to designate recipients of charitable contributions by our company. You'll name the charity; Berkshire will write the check. The ruling states that there will be no personal tax consequences to our shareholders from making such designations.

"Thus, our approximately 1500 owners now can exercise a perquisite that, although routinely exercised by the owners in closely-held businesses, is almost exclusively exercised by the managers in more widely-held businesses.

"In a widely-held corporation the executives ordinarily arrange all charitable donations, with no input at all from shareholders, in two main categories:

(1) Donations considered to benefit the corporation directly in an amount roughly commensurate with the cost of the donation; and
(2) Donations considered to benefit the corporation indirectly through hard-to-measure, long-delayed feedback effects of various kinds.

"I and other Berkshire executives have arranged in the past, as we will arrange in the future, all charitable donations in the first category. However, the aggregate level of giving in such category has been quite low, and very likely will remain quite low, because not many gifts can be shown to produce roughly commensurate direct benefits to Berkshire.

"In the second category, Berkshire's charitable gifts have been virtually nil, because I am not comfortable with ordinary corporate practice and had no better practice to substitute. What bothers me about ordinary corporate practice is the way gifts tend to be made based more on who does the asking and how corporate peers are responding than on an objective evaluation of the donee's activities. Conventionality often overpowers rationality.

"A common result is the use of the stockholder's money to implement the charitable inclinations of the corporate manager, who usually is heavily influenced by specific social pressures on him. Frequently there is an added incongruity; many corporate managers deplore governmental allocation of the taxpayer's dollar but embrace enthusiastically their own allocation of the shareholder's dollar.

"For Berkshire, a different model seems appropriate. Just as I wouldn't want you to implement your personal judgments by writing checks on my bank account for charities of your choice. I feel it inappropriate to write checks on your corporate "bank account" for charities of my choice. Your charitable preferences are as good as mine and, for both you and me, funds available to foster charitable interests in a tax-deductible manner reside largely at the corporate level rather than in our own hands.

"Under such circumstances, I believe Berkshire should imitate more closely-held companies, not larger public companies. If you and I each owned 50% of a corporation, our charitable decision making would be simple. Charities very directly related to the operations of the business would have first claim on our available charitable funds. Any balance available after the "operations-related' contributions would be divided among various charitable interests of the two of us, on a basis roughly proportional to our ownership interest. If the manager of our company had some suggestions, we would listen carefully — but the final decision would be ours. Despite our corporate form, in this aspect of the business we probably would behave as if we were a partnership.

"Wherever feasible, I believe in maintaining such a partnership frame of mind, even though we operate through a large, fairly widely-held corporation. Our Treasury ruling will allow such partnership-like behavior in this area . . .

"I am pleased that Berkshire donations can become owner-directed. It is ironic, but understandable, that a large and growing number of major corporations have charitable policies pursuant to which they will match gifts made by their employees (and — brace yourself for this one — many even match gifts made by directors) but none, to my knowledge, has a plan matching charitable gifts by owners. I say "understandable" because much of the stock of many large corporations is owned on a "revolving door" basis by institutions that have short-term investment horizons, and that lack a long-term owner's perspective . . .

"Our own shareholders are a different breed. As I mentioned in the 1979 annual report, at the end of each year more than 98% of our shares are owned by people who were shareholders at the beginning of the year. This long-term commitment to the business reflects an owner mentality which, as your manager, I intend to acknowledge in all feasible ways. The designated contributions policy is an example of that intent."

* * *

Contributions were $2 per share in 1981, $1 per share in 1982, and $3 per share in both 1983 and 1984. In the latter year, 97.2% of eligible shares participated and Berkshire contributed a total of $3,179,049 to 1519 charities. In addition, Berkshire and subsidiaries continue to make certain contributions pursuant to local level decisions made by our operating managers.

There may be an occasional year when contributions by Berkshire will produce substandard tax deductions — or none at all. In those years we will not effect our shareholder-designated charitable program. In all other years we expect to inform you about October 10th of the amount per share that you may designate. A reply form will accompany the notice, and you will be given about three weeks to respond with your designation. *To qualify, your shares must be registered in your own name or the name of an owning trust, corporation, partnership or estate, if applicable, on our stockholder list of September 30th, or the Friday preceding if such date falls on a Saturday or Sunday.*

BERKSHIRE HATHAWAY INC.
Selected Financial Data
(dollars in thousands — except per share amounts)

	Fiscal Year			
	1964	*1969*	*1974*	*1979*
Revenues of consolidated companies:				
Insurance premiums earned	$ —	$25,258	$ 60,574	$181,949
Sales and service revenues	49,983	40,427	32,592	286,493
Interest and dividend income	—	2,052	8,030	32,890
Earnings (loss):				
Earnings (loss) from continuing operations before realized investment gain or loss*	$ (2,824)	$ 2,698	$ 4,290	$ 30,961
Realized investment gain (loss), net	—	4,090	(1,340)	6,896
Earnings from discontinued operation**	—	1,165	4,093	4,960
Net earnings (loss)	$ (2,824)	$ 7,953	$ 7,043	$ 42,817
Average shares of common stock outstanding — in thousands	1,171	985	980	1,027
Earnings (loss) per share:				
Earnings (loss) from continuing operations before realized investment gain or loss	$ (2.41)	$ 2.74	$ 4.38	$ 30.14
Net earnings (loss)	(2.41)	8.07	7.19	41.68
Balance Sheet items (at end of Fiscal Year):				
Total assets	$ 27,887	$ 95,746	$216,214	$933,288
Term debt and other borrowings	2,500	7,419	21,830	85,790
Minority shareholders' interest	—	—	—	59,891
Shareholders' equity — total	22,139	43,918	88,199	344,962
Shares of common stock outstanding — in thousands	1,138	980	980	1,027
Shareholders' equity — per outstanding share	19.46	44.83	90.04	335.85

The 1964 fiscal year ended October 3, 1964. All other years presented ended on the Saturday nearest December 31. Data have been restated if required to conform to current consolidation practices. Data have not been restated, with respect to years prior to the merger of Diversified Retailing Company, Inc., to give retroactive effect to the poolings of interests concept applied in accounting for the merger. An increase of 56,470 outstanding Berkshire shares resulted from that transaction in 1978.

**The loss for 1964 includes a write-down of $3,000 recognized in that year with respect to textile properties subsequently sold or abandoned.*

***The Company divested of its interest in the Illinois National Bank as of December 31, 1980. The Company's equity in earnings of that former subsidiary for years prior to 1981 is reflected above as earnings from discontinued operation.*

	Fiscal Year				
	1980	1981	1982	1983	1984
Revenues of consolidated companies:					
Insurance premiums earned	$ 185,187	$ 159,013	$ 152,945	$ 152,480	$ 140,242
Sales and service revenues	300,837	312,105	306,564	381,674	500,219
Interest and dividend income	42,414	54,035	58,003	64,903	84,161
Earnings:					
Earnings from continuing operations before realized investment gain	$ 38,484	$ 39,723	$ 31,497	$ 48,644	$ 70,201
Realized investment gain, net	9,907	22,881	14,877	63,522	78,694
Earnings from discontinued operation**	4,731	—	—	—	—
Net earnings	$ 53,122	$ 62,604	$ 46,374	$ 112,166	$ 148,895
Average shares of common stock outstanding — in thousands	1,027	986	987	1,067	1,147
Earnings per share:					
Earnings from continuing operations before realized investment gain	$ 37.47	$ 40.27	$ 31.93	$ 45.60	$ 61.21
Net earnings	51.72	63.47	47.01	105.15	129.82
Balance Sheet items (at end of Fiscal Year);					
Total assets	$1,054,111	$1,199,837	$1,533,284	$1,837,543	$2,035,203
Term debt and other borrowings	136,869	130,192	169,947	128,984	127,104
Minority shareholders' interest	70,111	81,762	101,177	17,990	22,299
Shareholders' equity — total	395,214	519,463	727,483	1,119,193	1,271,761
Shares of common stock outstanding — in thousands	986	987	987	1,147	1,147
Shareholders' equity — per outstanding share	400.80	526.57	737.43	975.83	1,108.77

COMMON STOCK DATA

Shareholders

The Company had approximately 3,125 record holders of its common stock at March 6, 1985.

Market Prices

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market and is regularly quoted in the NASDAQ System under the symbol BKHT. The per-share high and low bid prices in each quarter of 1984 and 1983 are set forth in the following table. The quotations represent prices between dealers and do not include retail markup, markdown or commission. They do not represent actual transactions.

1984	*High*	*Low*	*1983*	*High*	*Low*
First Quarter	1,360	1,240	First Quarter	995	775
Second Quarter	1,345	1,220	Second Quarter	985	890
Third Quarter	1,305	1,230	Third Quarter	1,245	905
Fourth Quarter	1,305	1,265	Fourth Quarter	1,385	1,240

Dividends

Berkshire has not declared a cash dividend since 1967.

Stock Transfer Agent

The First National Bank of Boston, P.O. Box 644, Boston, MA 02102 serves as Transfer Agent for the Company's common stock. Certificates to be transferred should be mailed directly to the Transfer Agent, preferably by registered mail. Certificates to be transferred should not be mailed to the Company.

BERKSHIRE HATHAWAY INC.

DIRECTORS AND OFFICERS OF THE COMPANY

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

CHARLES T. MUNGER, *Director and Vice Chairman of the Board*

KENNETH V. CHACE, *Director*
Retired, Former Chief Operating Officer of the Textile Operations

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

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

ROBERT H. BIRD, *Vice President*

MICHAEL A. GOLDBERG, *Vice President*

DANIEL J. JAKSICH, *Controller*

J. WILLIAM SCOTT, *Vice President*

OPERATING MANAGERS

DIVISIONS OF THE COMPANY

Page E. Golsan, III	President	K & W Products Division 8319 So. Allport Ave., Santa Fe Springs, CA 90670
Garry W. Morrison	President	Textile Products Division 59 Cove Street, New Bedford, MA 02744

INSURANCE GROUP

Joseph W. Elliott	President	Cornhusker Casualty Company 9140 West Dodge Road, Omaha, NE 68114
Brunhilde Hufnagl	General Manager	Reinsurance Division National Indemnity Company/Columbia Insurance Company 2 Penn Center Plaza, Suite 1400, Philadelphia, PA 19102
Roland D. Miller	President	National Indemnity Company/National Fire & Marine Ins. Co. 3024 Harney Street, Omaha, NE 68131
Thomas H. Rowley	President	Continental Divide Insurance Company 7935 East Prentice Ave., Bldg. 40 DTC, Englewood, CO 80111
Floyd[illegible] Taylor	President	Kansas Fire & Casualty Company 400 Kansas Avenue, Topeka, KS 66601
Milton [illegible] Thornton	President	Cypress Insurance Company 1017 South Fair Oaks Ave., Pasadena, CA 91105
Donald F. Wurster	General Manager	Structured Settlements and Loss Portfolio Assumptions National Indemnity Company/Columbia Insurance Company 3024 Harney Street, Omaha, NE 68131

OTHER SUBSIDIARY OPERATIONS

Louie Blumkin	President	Nebraska Furniture Mart, Inc. 700 South 72 Street, Omaha, NE 68114
Har[illegible] R. Dettmann	President	Mutual Savings & Loan Association 315 East Colorado Blvd., Pasadena, CA 91109
Davi[illegible] Hillstrom	President	Precision Steel Warehouse, Inc. 3500 North Wolf Road, Franklin Park, IL 60131
Char[illegible] N. Huggins	President	See's Candy Shops, Incorporated 210 El Camino Real, South San Francisco, CA 94080
Dona[illegible] Koeppel	President	Blue Chip Stamps 5801 South Eastern Avenue, Los Angeles, CA 90040
Bern[illegible] Kyrouac	President	Associated Retail Stores, Inc. 50-01 Northern Boulevard, Long Island City, NY 1110[illegible]
Stan[illegible]ipsey	Publisher	Buffalo News One News Plaza, Buffalo, NY 14240

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