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Exhibit 13

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BERKSHIRE HATHAWAY INC.

1985
ANNUAL REPORT TO THE STOCKHOLDERS

BERKSHIRE HATHAWAY INC.
Selected Financial Data
at Five-Year Intervals
(dollars in thousands — except per share amounts)

	1965	1970	1975	1980	1985
Revenues of consolidated companies					
Insurance premiums earned	$ —	$ 39,173	$ 58,336	$ 185,187	$ 317,059
Sales and service revenues	49,301	24,569	32,833	259,200	508,764
Interest and dividend income	—	3,138	8,918	38,966	107,662
Earnings					
Before realized investment gain	$ 2,279	$ 4,507	$ 6,714	$ 43,215	$ 92,948
Realized investment gain (loss)	—	58	(2,022)	9,907	342,867
Net earnings	$ 2,279	$ 4,565	4,692	$ 53,122	$ 435,815
Year-end data					
Total assets	$ 28,222	$113,212	$225,741	$1,010,581	$3,180,718
Term debt and other borrowings ...	—	5,891	24,108	104,344	117,879
Minority shareholders' interest	—	—	—	59,851	34,360
Stockholders' equity — total	24,520	48,483	92,890	395,214	1,885,330
Shares of common stock outstanding — in thousands	1,017	980	980	986	1,147
Stockholders' equity per outstanding share	$ 24.10	$ 49.49	$ 94.79	$ 400.81	$ 1,643.71

Data is shown as originally reported, except that data for 1970 reflects insurance subsidiaries on a consolidated basis, consistent with the presentation practice for later years. The 1965 fiscal year ended on October 2, 1965. Other years ended on the Saturday nearest December 31.

BERKSHIRE HATHAWAY INC.

1985 ANNUAL REPORT

TABLE OF CONTENTS

Selected Financial Data At Five-Year Intervals .... Inside Front Cover

Owner-Related Business Principles 2

Chairman's Letter* 4

Accountants' Certificate 24

Consolidated Financial Statements 25

Summarized Financial Statements — Parent Company Only 43

Business Activities of The Company 44

Managements' Discussion 49

Annual Report Letter — Wesco Financial Corporation 56

Shareholder-Designated Contributions 66

Changing Price Data 68

Shareholders' Views re. Advisory Matters 69

Common Stock Data 70

Selected Financial Data For The Past Five Years 71

Directors, Officers and Operating Managers ....Inside Back Cover

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BERKSHIRE HATHAWAY INC.

OWNER-RELATED BUSINESS PRINCIPLES

Reproduced from Chairman's letter in 1983 Annual Report

With so many new shareholders, it's appropriate to summarize the major business principles we follow that pertain to the manager-owner relationship.

- Although our form is corporate, our attitude is partnership. Charlie Munger and I think of our shareholders as owner-partners, and of ourselves as managing partners. (Because of the size of our shareholdings we also are, for better or worse, controlling partners.) We do not view the company itself as the ultimate owner of our business assets but, instead, view the company as a conduit through which our shareholders own the assets.

- In line with this owner-orientation, our directors are all major shareholders of Berkshire Hathaway. In the case of at least four of the five, over 50% of family net worth is represented by holdings of Berkshire. We eat our own cooking.

- Our long-term economic goal (subject to some qualifications mentioned later) is to maximize the average annual rate of gain in intrinsic business value on a per-share basis. We do not measure the economic significance or performance of Berkshire by its size; we measure by per-share progress. We are certain that the rate of per-share progress will diminish in the future — a greatly enlarged capital base will see to that. But we will be disappointed if our rate does not exceed that of the average large American corporation.

- Our preference would be to reach this goal by directly owning a diversified group of businesses that generate cash and consistently earn above-average returns on capital. Our second choice is to own parts of similar businesses, attained primarily through purchases of marketable common stocks by our insurance subsidiaries. The price and availability of businesses and the need for insurance capital determine any given year's capital allocation.

- Because of this two-pronged approach to business ownership and because of the limitations of conventional accounting, consolidated reported earnings may reveal relatively little about our true economic performance. Charlie and I, both as owners and managers, virtually ignore such consolidated numbers. However, we will also report to you the earnings of each major business we control, numbers we consider of great importance. These figures, along with other information we will supply about the individual businesses, should generally aid you in making judgments about them.

- Accounting consequences do not influence our operating or capital-allocation decisions. When acquisition costs are similar, we much prefer to purchase $2 of earnings that is not reportable by us under standard accounting principles than to purchase $1 of earnings that is reportable. This is precisely the choice that often faces us since entire businesses (whose earnings will be fully reportable) frequently sell for double the pro-rata price of small portions (whose earnings will be largely unreportable). In aggregate and over time, we expect the unreported earnings to be fully reflected in our intrinsic business value through capital gains.

- We rarely use much debt and, when we do, we attempt to structure it on a long-term fixed-rate basis. We will reject interesting opportunities rather than over-leverage our balance sheet. This conservatism has penalized our results but it is the only behavior that leaves us comfortable, considering our fiduciary obligations to policyholders, depositors, lenders and the many equity holders who have committed unusually large portions of their net worth to our care. (As one of the Indianapolis "500" winners said: "To finish first, you must first finish.")

• A managerial "wishlist" will not be filled at shareholder expense. We will not diversify by purchasing entire businesses at control prices that ignore long-term economic consequences to our shareholders. We will only do with your money what we would do with our own, weighing fully the values you can obtain by diversifying your own portfolios through direct purchases in the stock market.

• We feel noble intentions should be checked periodically against results. We test the wisdom of retaining earnings by assessing whether retention, over time, delivers shareholders at least $1 of market value for each $1 retained. To date, this test has been met. We will continue to apply it on a five-year rolling basis. As our net worth grows, it is more difficult to use retained earnings wisely.

• We will issue common stock only when we receive as much in business value as we give. This rule applies to all forms of issuance — not only mergers or public stock offerings, but stock-for-debt swaps, stock options, and convertible securities as well. We will not sell small portions of your company — and that is what the issuance of shares amounts to — on a basis inconsistent with the value of the entire enterprise.

• You should be fully aware of one attitude Charlie and I share that hurts our financial performance: regardless of price, we have no interest at all in selling any good businesses that Berkshire owns, and are very reluctant to sell sub-par businesses as long as we expect them to generate at least some cash and as long as we feel good about their managers and labor relations. We hope not to repeat the capital-allocation mistakes that led us into such sub-par businesses. And we react with great caution to suggestions that our poor businesses can be restored to satisfactory profitability by major capital expenditures. (The projections will be dazzling — the advocates will be sincere — but, in the end, major additional investment in a terrible industry usually is about as rewarding as struggling in quicksand.) Nevertheless, gin rummy managerial behavior (discard your least promising business at each turn) is not our style. We would rather have our overall results penalized a bit than engage in it.

• We will be candid in our reporting to you, emphasizing the pluses and minuses important in appraising business value. Our guideline is to tell you the business facts that we would want to know if our positions were reversed. We owe you no less. Moreover, as a company with a major communications business, it would be inexcusable for us to apply lesser standards of accuracy, balance and incisiveness when reporting on ourselves than we would expect our news people to apply when reporting on others. We also believe candor benefits us as manager: the CEO who misleads others in public may eventually mislead himself in private.

• Despite our policy of candor, we will discuss our activities in marketable securities only to the extent legally required. Good investment ideas are rare, valuable and subject to competitive appropriation just as good product or business acquisition ideas are. Therefore, we normally will not talk about our investment ideas. This ban extends even to securities we have sold (because we may purchase them again) and to stocks we are incorrectly rumored to be buying. If we deny those reports but say "no comment" on other occasions, the no-comments become confirmation.

That completes the catechism . . .

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

You may remember the wildly upbeat message of last year's report: nothing much was in the works but our experience had been that something big popped up occasionally. This carefully-crafted corporate strategy paid off in 1985. Later sections of this report discuss (a) our purchase of a major position in Capital Cities/ABC, (b) our acquisition of Scott & Fetzer, (c) our entry into a large, extended-term participation in the insurance business of Fireman's Fund, and (d) our sale of our stock in General Foods.

Our gain in net worth during the year was $613.6 million, or 48.2%. It is fitting that the visit of Halley's Comet coincided with this percentage gain: neither will be seen again in my lifetime. Our gain in per-share book value over the last twenty-one years (that is, since present management took over) has been from $19.46 to $1643.71, or 23.2% compounded annually, another percentage that will not be repeated.

Two factors make anything approaching this rate of gain unachievable in the future. One factor — probably transitory — is a stock market that offers very little opportunity compared to the markets that prevailed throughout much of the 1964-1984 period. Today we cannot find significantly-undervalued equities to purchase for our insurance company portfolios. The current situation is 180 degrees removed from that existing about a decade ago, when the only question was which bargain to choose.

This change in the market also has negative implications for our present portfolio. In our 1974 annual report I could say: "We consider several of our major holdings to have great potential for significantly increased values in future years." I can't say that now. It's true that our insurance companies currently hold major positions in companies with exceptional underlying economics and outstanding managements, just as they did in 1974. But current market prices generously appraise these attributes, whereas they were ignored in 1974. Today's valuations mean that our insurance companies have no chance for future portfolio gains on the scale of those achieved in the past.

The second negative factor, far more telling, is our size. Our equity capital is more than twenty times what it was only ten years ago. And an iron law of business is that growth eventually dampens exceptional economics. Just look at the records of high-return companies once they have amassed even $1 billion of equity capital. None that I know of has managed subsequently, over a ten-year period, to keep on earning 20% or more on equity while reinvesting all or substantially all of its earnings. Instead, to sustain their high returns, such companies have needed to shed a lot of capital by way of either dividends or repurchases of stock. Their shareholders would have been far better off if all earnings could have been reinvested at the fat returns earned by these exceptional businesses. But the companies simply couldn't turn up enough high-return opportunities to make that possible.

Their problem is our problem. Last year I told you that we needed profits of $3.9 billion over the ten years then coming up to earn 15% annually. The comparable figure for the ten years now ahead is $5.7 billion, a 48% increase that corresponds — as it must mathematically — to the growth in our capital base during 1985. (Here's a little perspective: leaving aside oil companies, only about 15 U.S. businesses have managed to earn over $5.7 billion during the past ten years.)

Charlie Munger, my partner in managing Berkshire, and I are reasonably optimistic about Berkshire's ability to earn returns superior to those earned by corporate America generally, and you will benefit from the company's retention of all earnings as long as those returns are forthcoming. We have several things going for us: (1) we don't have to worry about quarterly or annual figures but, instead, can focus on whatever actions will maximize long-term value; (2) we can expand the business into any areas that make sense — our scope is not circumscribed by history, structure, or concept; and (3) we love our work. All of these help. Even so, we will also need a full measure of good fortune to average our hoped-for 15% — far more good fortune than was required for our past 23.2%.

We need to mention one further item in the investment equation that could affect recent purchasers of our stock. Historically, Berkshire shares have sold modestly below intrinsic business value. With the price there, purchasers could be certain (as long as they did not experience a widening of this discount) that their personal investment experience would at least equal the financial experience of the business. But recently the discount has disappeared, and occasionally a modest premium has prevailed.

The elimination of the discount means that Berkshire's market value increased even faster than business value (which, itself, grew at a pleasing pace). That was good news for any owner holding while that move took place, but it is bad news for the new or prospective owner. If the financial experience of new owners of Berkshire is merely to match the future financial experience of the company, any premium of market value over intrinsic business value that they pay must be maintained.

Management cannot determine market prices, although it can, by its disclosures and policies, encourage rational behavior by market participants. My own preference, as perhaps you'd guess, is for a market price that consistently approximates business value. Given that relationship, all owners prosper precisely as the business prospers during their period of ownership. Wild swings in market prices far above and below business value do not change the final gains for owners in aggregate; in the end, investor gains must equal business gains. But long periods of substantial undervaluation and/or overvaluation will cause the gains of the business to be inequitably distributed among various owners, with the investment result of any given owner largely depending upon how lucky, shrewd, or foolish he happens to be.

Over the long term there has been a more consistent relationship between Berkshire's market value and business value than has existed for any other publicly-traded equity with which I am familiar. This is a tribute to you. Because you have been rational, interested, and investment-oriented, the market price for Berkshire stock has almost always been sensible. This unusual result has been achieved by a shareholder group with unusual demographics: virtually all of our shareholders are individuals, not institutions. No other public company our size can claim the same.

You might think that institutions, with their large staffs of highly-paid and experienced investment professionals, would be a force for stability and reason in financial markets. They are not: stocks heavily owned and constantly monitored by institutions have often been among the most inappropriately valued.

Ben Graham told a story 40 years ago that illustrates why investment professionals behave as they do: An oil prospector, moving to his heavenly reward, was met by St. Peter with bad news. "You're qualified for residence", said St. Peter, "but, as you can see, the compound reserved for oil men is packed. There's no way to squeeze you in." After thinking a moment, the prospector asked if he might say just four words to the present occupants. That seemed harmless to St. Peter, so the prospector cupped his hands and yelled, "Oil discovered in hell." Immediately the gate to the compound opened and all of the oil men marched out to head for the nether regions. Impressed, St. Peter invited the prospector to move in and make himself comfortable. The prospector paused. "No," he said, "I think I'll go along with the rest of the boys. There might be some truth to that rumor after all."

Sources of Reported Earnings

The table on the next page shows the major sources of Berkshire's reported earnings. These numbers, along with far more detailed sub-segment numbers, are the ones that Charlie and I focus upon. We do not find consolidated figures an aid in either managing or evaluating Berkshire and, in fact, never prepare them for internal use.

Segment information is equally essential for investors wanting to know what is going on in a multi-line business. Corporate managers always have insisted upon such information before making acquisition decisions but, until a few years ago, seldom made it available to investors faced with acquisition and disposition decisions of their own. Instead, when owners wishing to understand the economic realities of their business asked for data, managers usually gave them a we-can't-tell-you-what-is-going-on-because-it-would-hurt-the-company answer. Ultimately the SEC ordered disclosure of segment data and management began supplying real answers. The change in their behavior recalls an insight of Al Capone: "You can get much further with a kind word and a gun than you can with a kind word alone."

In the table, 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 aggregated as a separate item. (A compendium of the 1977-1984 letters is available upon request.) In the Business Segment Data and Management's Discussion sections on pages 39-41 and 49-55, much additional information regarding our businesses is provided, including Goodwill and Goodwill Amortization figures for each of the segments. I urge you to read those sections as well as Charlie Munger's letter to Wesco shareholders, which starts on page 56.

	(000s omitted)			
	Pre-Tax Earnings		*Berkshire's Share of Net Earnings (after taxes and minority interests)*	
	1985	*1984*	*1985*	*1984*
Operating Earnings:				
Insurance Group:				
Underwriting	$ (44,230)	$ (48,060)	$ (23,569)	$ (25,955)
Net Investment Income	95,217	68,903	79,716	62,059
Associated Retail Stores	270	(1,072)	134	(579)
Blue Chip Stamps	5,763	(1,843)	2,813	(899)
Buffalo News	29,921	27,328	14,580	13,317
Mutual Savings and Loan	2,622	1,456	4,016	3,151
Nebraska Furniture Mart	12,686	14,511	5,181	5,917
Precision Steel	3,896	4,092	1,477	1,696
See's Candies	28,989	26,644	14,558	13,380
Textiles	(2,395)	418	(1,324)	226
Wesco Financial	9,500	9,777	4,191	4,828
Amortization of Goodwill	(1,475)	(1,434)	(1,475)	(1,434)
Interest on Debt	(14,415)	(14,734)	(7,288)	(7,452)
Shareholder-Designated Contributions	(4,006)	(3,179)	(2,164)	(1,716)
Other	3,106	4,932	2,102	3,475
Operating Earnings	125,449	87,739	92,948	70,014
Special General Foods Distribution	4,127	8,111	3,779	7,294
Special Washington Post Distribution	14,877	—	13,851	—
Sales of Securities	468,903	104,699	325,237	71,587
Total Earnings — all entities	$613,356	$200,549	$435,815	$148,895

Our 1985 results include unusually large earnings from the sale of securities. This fact, in itself, does not mean that we had a particularly good year (though, of course, we did). Security profits in a given year bear similarities to a college graduation ceremony in which the knowledge gained over four years is recognized on a day when nothing further is learned. We may hold a stock for a decade or more, and during that period it may grow quite consistently in both business and market value. In the year in which we finally sell it there may be no increase in value, or there may even be a decrease. But all growth in value since purchase will be reflected in the accounting earnings of the year of sale. (If the stock owned is in our insurance subsidiaries, however, any gain or loss in market value will be reflected in net worth annually.) Thus, reported capital gains or losses in any given year are meaningless as a measure of how well we have done in the current year.

A large portion of the realized gain in 1985 ($338 million pre-tax out of a total of $488 million) came about through the sale of our General Foods shares. We held most of these shares since 1980, when we had purchased them at a price far below what we felt was their per/share business value. Year by year, the managerial efforts of Jim Ferguson and Phil Smith substantially increased General Foods' business value and, last fall, Philip Morris made an offer for the company that reflected the increase. We thus benefited from four factors: a bargain purchase price, a business with fine underlying economics, an able management concentrating on the interests of shareholders, and a buyer willing to pay full business value. While that last factor is the only one that produces reported earnings, we consider identification of the first three to be the key to building value for Berkshire shareholders. In selecting common stocks, we devote our attention to attractive purchases, not to the possibility of attractive sales.

We have again reported substantial income from special distributions, this year from Washington Post and General Foods. (The General Foods transactions obviously took place well before the Philip Morris offer.) Distributions of this kind occur when we sell a portion of our shares in a company back to it simultaneously with its purchase of shares from other shareholders. The number of shares we sell is contractually set so as to leave our percentage ownership in the company precisely the same after the sale as before. Such a transaction is quite properly regarded by the IRS as substantially equivalent to a dividend since we, as a shareholder, receive cash while maintaining an unchanged ownership interest. This tax treatment benefits us because corporate taxpayers, unlike individual taxpayers, incur much lower taxes on dividend income than on income from long-term capital gains. (This difference will be widened further if the House-passed tax bill becomes law: under its provisions, capital gains realized by corporations will be taxed at the same rate as ordinary income.) However, accounting rules are unclear as to proper treatment for shareholder reporting. To conform with last year's treatment, we have shown these transactions as capital gains.

Though we have not sought out such transactions, we have agreed to them on several occasions when managements initiated the idea. In each case we have felt that non-selling shareholders (all of whom had an opportunity to sell at the same price we received) benefited because the companies made their repurchases at prices below intrinsic business value. The tax advantages we receive and our wish to cooperate with managements that are increasing values for all shareholders have sometimes led us to sell — but only to the extent that our proportional share of the business was undiminished.

At this point we usually turn to a discussion of some of our major business units. Before doing so, however, we should first look at a failure at one of our smaller businesses. Our Vice Chairman, Charlie Munger, has always emphasized the study of mistakes rather than successes, both in business and other aspects of life. He does so in the spirit of the man who said: "All I want to know is where I'm going to die so I'll never go there." You'll immediately see why we make a good team: Charlie likes to study errors and I have generated ample material for him, particularly in our textile and insurance businesses.

Shutdown of Textile Business

In July we decided to close our textile operation, and by yearend this unpleasant job was largely completed. The history of this business is instructive.

When Buffett Partnership, Ltd., an investment partnership of which I was general partner, bought control of Berkshire Hathaway 21 years ago, it had an accounting net worth of $22 million, all devoted to the textile business. The company's intrinsic business value, however, was considerably less because the textile assets were unable to earn returns commensurate with their accounting value. Indeed, during the previous nine years (the period in which Berkshire and Hathaway operated as a merged company) aggregate sales of $530 million had produced an aggregate loss of $10 million. Profits had been reported from time to time but the net effect was always one step forward, two steps back.

At the time we made our purchase, southern textile plants — largely non-union — were believed to have an important competitive advantage. Most northern textile operations had closed and many people thought we would liquidate our business as well.

We felt, however, that the business would be run much better by a long-time employee whom we immediately selected to be president, Ken Chace. In this respect we were 100% correct: Ken and his recent successor, Garry Morrison, have been excellent managers, every bit the equal of managers at our more profitable businesses.

In early 1967 cash generated by the textile operation was used to fund our entry into insurance via the purchase of National Indemnity Company. Some of the money came from earnings and some from reduced investment in textile inventories, receivables, and fixed assets. This pullback proved wise: although much improved by Ken's management, the textile business never became a good earner, not even in cyclical upturns.

Further diversification for Berkshire followed, and gradually the textile operation's depressing effect on our overall return diminished as the business became a progressively smaller portion of the corporation. We remained in the business for reasons that I stated in the 1978 annual report (and summarized at other times also): "(1) our textile businesses are very important employers in their communities, (2) management has been straightforward in reporting on problems and energetic in attacking them, (3) labor has been cooperative and understanding in facing our common problems, and (4) the business should average modest cash returns relative to investment." I further said, "As long as these conditions prevail — and we expect that they will — we intend to continue to support our textile business despite more attractive alternative uses for capital."

It turned out that I was very wrong about (4). Though 1979 was moderately profitable, the business thereafter consumed major amounts of cash. By mid-1985 it became clear, even to me, that this condition was almost sure to continue. Could we have found a buyer who would continue operations, I would have certainly preferred to sell the business rather than liquidate it, even if that meant somewhat lower proceeds for us. But the economics that were finally obvious to me were also obvious to others, and interest was nil.

I won't close down businesses of sub-normal profitability merely to add a fraction of a point to our corporate rate of return. However, I also feel it inappropriate for even an exceptionally profitable company to fund an operation once it appears to have unending losses in prospect. Adam Smith would disagree with my first proposition, and Karl Marx would disagree with my second; the middle ground is the only position that leaves me comfortable.

I should reemphasize that Ken and Garry have been resourceful, energetic and imaginative in attempting to make our textile operation a success. Trying to achieve sustainable profitability, they reworked product lines, machinery configurations and distribution arrangements. We also made a major acquisition, Waumbec Mills, with the expectation of important synergy (a term widely used in business to explain an acquisition that otherwise makes no sense). But in the end nothing worked and I should be faulted for not quitting sooner. A recent *Business Week* article stated that 250 textile mills have closed since 1980. Their owners were not privy to any information that was unknown to me; they simply processed it more objectively. I ignored Comte's advice — "the intellect should be the servant of the heart, but not its slave" — and believed what I preferred to believe.

The domestic textile industry operates in a commodity business, competing in a world market in which substantial excess capacity exists. Much of the trouble we experienced was attributable, both directly and indirectly, to competition from foreign countries whose workers are paid a small fraction of the U.S. minimum wage. But that in no way means that our labor force deserves any blame for our closing. In fact, in comparison with employees of American industry generally, our workers were poorly paid, as has been the case throughout the textile business. In contract negotiations, union leaders and members were sensitive to our disadvantageous cost position and did not push for unrealistic wage increases or unproductive work practices. To the contrary, they tried just as hard as we did to keep us competitive. Even during our liquidation period they performed superbly. (Ironically, we would have been better off financially if our union had behaved unreasonably some years ago; we then would have recognized the impossible future that we faced, promptly closed down, and avoided significant future losses.)

Over the years, we had the option of making large capital expenditures in the textile operation that would have allowed us to somewhat reduce variable costs. Each proposal to do so looked like an immediate winner. Measured by standard return-on-investment tests, in fact, these proposals usually promised greater economic benefits than would have resulted from comparable expenditures in our highly-profitable candy and newspaper businesses.

But the promised benefits from these textile investments were illusory. Many of our competitors, both domestic and foreign, were stepping up to the same kind of expenditures and, once enough companies did so, their reduced costs became the baseline for reduced prices industrywide. Viewed individually, each company's capital investment decision appeared cost-effective and rational; viewed collectively, the decisions neutralized each other and were irrational (just as happens when each person watching a parade decides he can see a little better if he stands on tiptoes). After each round of investment, all the players had more money in the game and returns remained anemic.

Thus, we faced a miserable choice: huge capital investment would have helped to keep our textile business alive, but would have left us with terrible returns on ever-growing amounts of capital. After the investment, moreover, the foreign competition would still have retained a major, continuing advantage in labor costs. A refusal to invest, however, would make us increasingly non-competitive, even measured against domestic textile manufacturers. I always thought myself in the position described by Woody Allen in one of his movies: "More than any other time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness, the other to total extinction. Let us pray we have the wisdom to choose correctly."

For an understanding of how the to-invest-or-not-to-invest dilemma plays out in a commodity business, it is instructive to look at Burlington Industries, by far the largest U.S. textile company both 21 years ago and now. In 1964 Burlington had sales of $1.2 billion against our $50 million. It had strengths in both distribution and production that we could never hope to match and also, of course, had an earnings record far superior to ours. Its stock sold at 60 at the end of 1964; ours was 13.

Burlington made a decision to stick to the textile business, and in 1985 had sales of about $2.8 billion. During the 1964-85 period, the company made capital expenditures of about $3 billion, far more than any other U.S. textile company and more than $200-per-share on that $60 stock. A very large part of the expenditures, I am sure, was devoted to cost improvement and expansion. Given Burlington's basic commitment to stay in textiles, I would also surmise that the company's capital decisions were quite rational.

Nevertheless, Burlington has lost sales volume in real dollars and has far lower returns on sales and equity now than 20 years ago. Split 2-for-1 in 1965, the stock now sells at 34 — on an adjusted basis, just a little over its $60 price in 1964. Meanwhile, the CPI has more than tripled. Therefore, each share commands about one-third the purchasing power it did at the end of 1964. Regular dividends have been paid but they, too, have shrunk significantly in purchasing power.

This devastating outcome for the shareholders indicates what can happen when much brain power and energy are applied to a faulty premise. The situation is suggestive of Samuel Johnson's horse: "A horse that can count to ten is a remarkable horse — not a remarkable mathematician." Likewise, a textile company that allocates capital brilliantly within its industry is a remarkable textile company — but not a remarkable business.

My conclusion from my own experiences and from much observation of other businesses is that a good managerial record (measured by economic returns) is far more a function of what business boat you get into than it is of how effectively you row (though intelligence and effort help considerably, of course, in any business, good or bad). Some years ago I wrote: "When a management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact." Nothing has since changed my point of view on that matter. Should you find yourself in a chronically-leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks.

• • •

There is an investment postscript in our textile saga. Some investors weight book value heavily in their stock-buying decisions (as I, in my early years, did myself). And some economists and academicians believe replacement values are of considerable importance in calculating an appropriate price level for the stock market as a whole. Those of both persuasions would have received an education at the auction we held in early 1986 to dispose of our textile machinery.

The equipment sold (including some disposed of in the few months prior to the auction) took up about 750,000 square feet of factory space in New Bedford and was eminently usable. It originally cost us about $13 million, including $2 million spent in 1980-84, and had a current book value of $866,000 (after accelerated depreciation). Though no sane management would have made the investment, the equipment could have been replaced new for perhaps $30-$50 million.

Gross proceeds from our sale of this equipment came to $163,122. Allowing for necessary pre- and post-sale costs, our net was less than zero. Relatively modern looms that we bought for $5,000 apiece in 1981 found no takers at $50. We finally sold them for scrap at $26 each, a sum less than removal costs.

Ponder this: the economic goodwill attributable to two paper routes in Buffalo — or a single See's candy store — considerably exceeds the proceeds we received from this massive collection of tangible assets that not too many years ago, under different competitive conditions, was able to employ over 1,000 people.

Three Very Good Businesses (and a Few Thoughts About Incentive Compensation)

When I was 12, I lived with my grandfather for about four months. A grocer by trade, he was also working on a book and each night he dictated a few pages to me. The title — brace yourself — was "How to Run a Grocery Store and a Few Things I Have Learned About Fishing". My grandfather was sure that interest in these two subjects was universal and that the world awaited his views. You may conclude from this section's title and contents that I was overexposed to Grandpa's literary style (and personality).

I am merging the discussion of Nebraska Furniture Mart, See's Candy Shops, and Buffalo Evening News here because the economic strengths, weaknesses, and prospects of these businesses have changed little since I reported to you a year ago. The shortness of this discussion, however, is in no way meant to minimize the importance of these businesses to us: in 1985 they earned an aggregate of $72 million pre-tax. Fifteen years ago, before we had acquired any of them, their aggregate earnings were about $8 million pre-tax.

While an increase in earnings from $8 million to $72 million sounds terrific — and usually is — you should not automatically assume that to be the case. You must first make sure that earnings were not severely depressed in the base year. If they were instead substantial in relation to capital employed, an even more important point must be examined: how much additional capital was required to produce the additional earnings?

In both respects, our group of three scores well. First, earnings 15 years ago were excellent compared to capital then employed in the businesses. Second, although annual earnings are now $64 million greater, the businesses require only about $40 million more in invested capital to operate than was the case then.

The dramatic growth in earning power of these three businesses, accompanied by their need for only minor amounts of capital, illustrates very well the power of economic goodwill during an inflationary period (a phenomenon explained in detail in the 1983 annual report). The financial characteristics of these businesses have allowed us to use a very large portion of the earnings they generate elsewhere. Corporate America, however, has had a different experience: in order to increase earnings significantly, most companies have needed to increase capital significantly also. The average American business has required about $5 of additional capital to generate an additional $1 of annual pre-tax earnings. That business, therefore, would have required over $300 million in additional capital from its owners in order to achieve an earnings performance equal to our group of three.

When returns on capital are ordinary, an earn-more-by-putting-up-more record is no great managerial achievement. You can get the same result personally while operating from your rocking chair. Just quadruple the capital you commit to a savings account and you will quadruple your earnings. You would hardly expect hosannas for that particular accomplishment. Yet, retirement announcements regularly sing the praises of CEOs who have, say, quadrupled earnings of their widget company during their reign — with no one examining whether this gain was attributable simply to many years of retained earnings and the workings of compound interest.

If the widget company consistently earned a superior return on capital throughout the period, or if capital employed only doubled during the CEO's reign, the praise for him may be well deserved. But if return on capital was lackluster and capital employed increased in pace with earnings, applause should be withheld. A savings account in which interest was reinvested would achieve the same year-by-year increase in earnings — and, at only 8% interest, would quadruple its annual earnings in 18 years.

The power of this simple math is often ignored by companies to the detriment of their shareholders. Many corporate compensation plans reward managers handsomely for earnings increases produced solely, or in large part, by retained earnings — i.e., earnings withheld from owners. For example, ten-year, fixed-price stock options are granted routinely, often by companies whose dividends are only a small percentage of earnings.

An example will illustrate the inequities possible under such circumstances. Let's suppose that you had a $100,000 savings account earning 8% interest and "managed" by a trustee who could decide each year what portion of the interest you were to be paid in cash. Interest not paid out would be "retained earnings" added to the savings account to compound. And let's suppose that your trustee, in his superior wisdom, set the "pay-out ratio" at one-quarter of the annual earnings.

Under these assumptions, your account would be worth $179,084 at the end of ten years. Additionally, your annual earnings would have increased about 70% from $8,000 to $13,515 under this inspired management. And, finally, your "dividends" would have increased commensurately, rising regularly from $2,000 in the first year to $3,378 in the tenth year. Each year, when your manager's public relations firm prepared his annual report to you, all of the charts would have had lines marching skyward.

Now, just for fun, let's push our scenario one notch further and give your trustee-manager a ten-year fixed-price option on part of your "business" (i.e., your savings account) based on its fair value in the first year. With such an option, your manager would reap a substantial profit at your expense — just from having held on to most of your earnings. If he were both Machiavellian and a bit of a mathematician, your manager might also have cut the pay-out ratio once he was firmly entrenched.

This scenario is not as farfetched as you might think. Many stock options in the corporate world have worked in exactly that fashion: they have gained in value simply because management retained earnings, not because it did well with the capital in its hands.

Managers actually apply a double standard to options. Leaving aside warrants (which deliver the issuing corporation immediate and substantial compensation), I believe it is fair to say that nowhere in the business world are ten-year fixed-price options on all or a portion of a business granted to outsiders. Ten months, in fact, would be regarded as extreme. It would be particularly unthinkable for managers to grant a long-term option on a business that was regularly adding to its capital. Any outsider wanting to secure such an option would be required to pay fully for capital added during the option period.

The unwillingness of managers to do-unto-outsiders, however, is not matched by an unwillingness to do-unto-themselves. (Negotiating with one's self seldom produces a barroom brawl.) Managers regularly engineer ten-year, fixed-price options for themselves and associates that, first, totally ignore the fact that retained earnings automatically build value and, second, ignore the carrying cost of capital. As a result, these managers end up profiting much as they would have had they had an option on that savings account that was automatically building up in value.

Of course, stock options often go to talented, value-adding managers and sometimes deliver them rewards that are perfectly appropriate. (Indeed, managers who are really exceptional almost always get far less than they should.) But when the result is equitable, it is accidental. Once granted, the option is blind to individual performance. Because it is irrevocable and unconditional (so long as a manager stays in the company), the sluggard receives rewards from his options precisely as does the star. A managerial Rip Van Winkle, ready to doze for ten years, could not wish for a better "incentive" system.

(I can't resist commenting on one long-term option given an "outsider": that granted the U.S. Government on Chrysler shares as partial consideration for the government's guarantee of some life-saving loans. When these options worked out well for the government, Chrysler sought to modify the payoff, arguing that the rewards to the government were both far greater than intended and outsize in relation to its contribution to Chrysler's recovery. The company's anguish over what it saw as an imbalance between payoff and performance made national news. That anguish may well be unique: to my knowledge, no managers — anywhere — have been similarly offended by unwarranted payoffs arising from options granted to themselves or their colleagues.)

Ironically, the rhetoric about options frequently describes them as desirable because they put managers and owners in the same financial boat. In reality, the boats are far different. No owner has ever escaped the burden of capital costs, whereas a holder of a fixed-price option bears no capital costs at all. An owner must weigh upside potential against downside risk; an option holder has no downside. In fact, the business project in which you would wish to have an option frequently is a project in which you would reject ownership. (I'll be happy to accept a lottery ticket as a gift — but I'll never buy one.)

In dividend policy also, the option holders' interests are best served by a policy that may ill serve the owner. Think back to the savings account example. The trustee, holding his option, would benefit from a no-dividend policy. Conversely, the owner of the account should lean to a total payout so that he can prevent the option-holding manager from sharing in the account's retained earnings.

Despite their shortcomings, options can be appropriate under some circumstances. My criticism relates to their indiscriminate use and, in that connection, I would like to emphasize three points:

First, stock options are inevitably tied to the overall performance of a corporation. Logically, therefore, they should be awarded only to those managers with overall responsibility. Managers with limited areas of responsibility should have incentives that pay off in relation to results under their control. The .350 hitter expects, and also deserves, a big payoff for his performance — even if he plays for a cellar-dwelling team. And the .150 hitter should get no reward — even if he plays for a pennant winner. Only those with overall responsibility for the team should have their rewards tied to its results.

Second, options should be structured carefully. Absent special factors, they should have built into them a retained-earnings or carrying-cost factor. Equally important, they should be priced realistically. When managers are faced with offers for their companies, they unfailingly point out how unrealistic market prices can be as an index of real value. But why, then, should these same depressed prices be the valuations at which managers sell portions of their businesses to themselves? (They may go further: officers and directors sometimes consult the Tax Code to determine the *lowest* prices at which they can, in effect, sell part of the business to insiders. While they're at it, they often elect plans that produce the *worst* tax result for the company.) Except in highly unusual cases, owners are not well served by the sale of part of their business at a bargain price — whether the sale is to outsiders or to insiders. The obvious conclusion: options should be priced at true business value.

Third, I want to emphasize that some managers whom I admire enormously — and whose operating records are far better than mine — disagree with me regarding fixed-price options. They have built corporate cultures that work, and fixed-price options have been a tool that helped them. By their leadership and example, and by the use of options as incentives, these managers have taught their colleagues to think like owners. Such a culture is rare and when it exists should perhaps be left intact — despite inefficiencies and inequities that may infest the option program. "If it ain't broke, don't fix it" is preferable to "purity at any price".

At Berkshire, however, we use an incentive-compensation system that rewards key managers for meeting targets in their own bailiwicks. If See's does well, that does not produce incentive compensation at the News — nor vice versa. Neither do we look at the price of Berkshire stock when we write bonus checks. We believe good unit performance should be rewarded whether Berkshire stock rises, falls, or stays even. Similarly, we think average performance should earn no special rewards even if our stock should soar. "Performance", furthermore, is defined in different ways depending upon the underlying economics of the business: in some our managers enjoy tailwinds not of their own making, in others they fight unavoidable headwinds.

The rewards that go with this system can be large. At our various business units, top managers sometimes receive incentive bonuses of five times their base salary, or more, and it would appear possible that one manager's bonus could top $2 million in 1986. (I hope so.) We do not put a cap on bonuses, and the potential for rewards is not hierarchical. The manager of a relatively small unit can earn far more than the manager of a larger unit if results indicate he should. We believe, further, that such factors as seniority and age should not affect incentive compensation (though they sometimes influence basic compensation). A 20-year-old who can hit .300 is as valuable to us as a 40-year-old performing as well.

Obviously, all Berkshire managers can use their bonus money (or other funds, including borrowed money) to buy our stock in the market. Many have done just that — and some now have large holdings. By accepting both the risks and the carrying costs that go with outright purchases, these managers truly walk in the shoes of owners.

Now let's get back — at long last — to our three businesses:

At Nebraska Furniture Mart our basic strength is an exceptionally low-cost operation that allows the business to regularly offer customers the best values available in home furnishings. NFM is the largest store of its kind in the country. Although the already-depressed farm economy worsened considerably in 1985, the store easily set a new sales record. I also am happy to report that NFM's Chairman, Rose Blumkin (the legendary "Mrs. B"), continues at age 92 to set a pace at the store that none of us can keep up with. She's there wheeling and dealing seven days a week, and I hope that any of you who visit Omaha will go out to the Mart and see her in action. It will inspire you, as it does me.

At See's we continue to get store volumes that are far beyond those achieved by any competitor we know of. Despite the unmatched consumer acceptance we enjoy, industry trends are not good, and we continue to experience slippage in poundage sales on a same-store basis. This puts pressure on per-pound costs. We now are willing to increase prices only modestly and, unless we can stabilize per-shop poundage, profit margins will narrow.

At the News volume gains are also difficult to achieve. Though linage increased during 1985, the gain was more than accounted for by preprints. ROP linage (advertising printed on our own pages) declined. Preprints are far less profitable than ROP ads, and also more vulnerable to competition. In 1985, the News again controlled costs well and our household penetration continues to be exceptional.

One problem these three operations do not have is management. At See's we have Chuck Huggins, the man we put in charge the day we bought the business. Selecting him remains one of our best business decisions. At the News we have Stan Lipsey, a manager of equal caliber. Stan has been with us 17 years, and his unusual business talents have become more evident with every additional level of responsibility he has tackled. And, at the Mart, we have the amazing Blumkins — Mrs. B, Louie, Ron, Irv, and Steve — a three-generation miracle of management.

I consider myself extraordinarily lucky to be able to work with managers such as these. I like them personally as much as I admire them professionally.

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 Policyholder 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	4.5	111.9
1984 (Revised)	9.2	117.9
1985 (Estimated)	20.9	118.0

Source: Best's Aggregates and Averages

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.

The industry's 1985 results were highly unusual. The revenue gain was exceptional, and had insured losses grown at their normal rate of most recent years — that is, a few points above the inflation rate — a significant drop in the combined ratio would have occurred. But losses in 1985 didn't cooperate, as they did not in 1984. Though inflation slowed considerably in these years, insured losses perversely accelerated, growing by 16% in 1984 and by an even more startling 17% in 1985. The year's growth in losses therefore exceeds the inflation rate by over 13 percentage points, a modern record.

Catastrophes were not the culprit in this explosion of loss cost. True, there were an unusual number of hurricanes in 1985, but the aggregate damage caused by all catastrophes in 1984 and 1985 was about 2% of premium volume, a not unusual proportion. Nor was there any burst in the number of insured autos, houses, employers, or other kinds of "exposure units".

A partial explanation for the surge in the loss figures is all the additions to reserves that the industry made in 1985. As results for the year were reported, the scene resembled a revival meeting: shouting "I've sinned, I've sinned", insurance managers rushed forward to confess they had underreserved in earlier years. Their corrections significantly affected 1985 loss numbers.

A more disturbing ingredient in the loss surge is the acceleration in "social" or "judicial" inflation. The insurer's ability to pay has assumed overwhelming importance with juries and judges in the assessment of both liability and damages. More and more, "the deep pocket" is being sought and found, no matter what the policy wording, the facts, or the precedents.

This judicial inflation represents a wild card in the industry's future, and makes forecasting difficult. Nevertheless, the short-term outlook is good. Premium growth improved as 1985 went along (quarterly gains were an estimated 15%, 19%, 24% and 22%) and, barring a supercatastrophe, the industry's combined ratio should fall sharply in 1986.

The profit improvement, however, is likely to be of short duration. Two economic principles will see to that. First, commodity businesses achieve good levels of profitability only when prices are fixed in some manner or when capacity is short. Second, managers quickly add to capacity when prospects start to improve and capital is available.

In my 1982 report to you, I discussed the commodity nature of the insurance industry extensively. The typical policyholder does not differentiate between products but concentrates instead on price. For many decades a cartel-like procedure kept prices up, but this arrangement has disappeared for good. The insurance product now is priced as any other commodity for which a free market exists: when capacity is tight, prices will be set remuneratively; otherwise, they will not be.

Capacity currently is tight in many lines of insurance — though in this industry, unlike most, capacity is an attitudinal concept, not a physical fact. Insurance managers can write whatever amount of business they feel comfortable writing, subject only to pressures applied by regulators and Best's, the industry's authoritative rating service. The comfort level of both managers and regulators is tied to capital. More capital means more comfort, which in turn means more capacity. In the typical commodity business, furthermore, such as aluminum or steel, a long gestation precedes the birth of additional capacity. In the insurance industry, capital can be secured instantly. Thus, any capacity shortage can be eliminated in short order.

That's exactly what's going on right now. In 1985, about 15 insurers raised well over $3 billion, piling up capital so that they can write all the business possible at the better prices now available. The capital-raising trend has accelerated dramatically so far in 1986.

If capacity additions continue at this rate, it won't be long before serious price-cutting appears and next a fall in profitability. When the fall comes, it will be the fault of the capital-raisers of 1985 and 1986, not the price-cutters of 198X. (Critics should be understanding, however: as was the case in our textile example, the dynamics of capitalism cause each insurer to make decisions that for itself appear sensible, but that collectively slash profitability.)

In past reports, I have told you that Berkshire's strong capital position — the best in the industry — should one day allow us to claim a distinct competitive advantage in the insurance market. With the tightening of the market, that day arrived. Our premium volume more than tripled last year, following a long period of stagnation. Berkshire's financial strength (and our record of maintaining unusual strength through thick and thin) is now a major asset for us in securing good business.

We correctly foresaw a flight to quality by many large buyers of insurance and reinsurance who belatedly recognized that a policy is only an IOU — and who, in 1985, could not collect on many of their IOUs. These buyers today are attracted to Berkshire because of its strong capital position. But, in a development we did not foresee, we also are finding buyers drawn to us because our ability to insure substantial risks sets us apart from the crowd.

To understand this point, you need a few background facts about large risks. Traditionally, many insurers have wanted to write this kind of business. However, their willingness to do so has been almost always based upon reinsurance arrangements that allow the insurer to keep just a small portion of the risk itself while passing on ("laying off") most of the risk to its reinsurers. Imagine, for example, a directors and officers ("D & O") liability policy providing $25 million of coverage. By various "excess-of-loss" reinsurance contracts, the company issuing that policy might keep the liability for only the first $1 million of any loss that occurs. The liability for any loss above that amount up to $24 million would be borne by the reinsurers of the issuing insurer. In trade parlance, a company that issues large policies but retains relatively little of the risk for its own account writes a large gross line but a small net line.

In any reinsurance arrangement, a key question is how the premiums paid for the policy should be divided among the various "layers" of risk. In our D & O policy, for example, what part of the premium received should be kept by the issuing company to compensate it fairly for taking the first $1 million of risk and how much should be passed on to the reinsurers to compensate them fairly for taking the risk between $1 million and $25 million?

One way to solve this problem might be deemed the Patrick Henry approach: "I have but one lamp by which my feet are guided, and that is the lamp of experience." In other words, how much

Fireman's Fund Quota-Share Contract

Never one to let go of a meal ticket, we have followed Jack Byrne to Fireman's Fund ("FFIC") where he is Chairman and CEO of the holding company.

On September 1, 1985 we became a 7% participant in all of the business in force of the FFIC group, with the exception of reinsurance they write for unaffiliated companies. Our contract runs for four years, and provides that our losses and costs will be proportionate to theirs throughout the contract period. If there is no extension, we will thereafter have no participation in any ongoing business. However, for a great many years in the future, we will be reimbursing FFIC for our 7% of the losses that occurred in the September 1, 1985 — August 31, 1989 period.

Under the contract FFIC remits premiums to us promptly and we reimburse FFIC promptly for expenses and losses it has paid. Thus, funds generated by our share of the business are held by us for investment. As part of the deal, I'm available to FFIC for consultation about general investment strategy. I'm not involved, however, in specific investment decisions of FFIC, nor is Berkshire involved in any aspect of the company's underwriting activities.

Currently FFIC is doing about $3 billion of business, and it will probably do more as rates rise. The company's September 1, 1985 unearned premium reserve was $1.324 billion, and it therefore transferred 7% of this, or $92.7 million, to us at initiation of the contract. We concurrently paid them $29.4 million representing the underwriting expenses that they had incurred on the transferred premium. All of the FFIC business is written by National Indemnity Company, but two-sevenths of it is passed along to Wesco-Financial Insurance Company ("Wes-FIC"), a new company organized by our 80%-owned subsidiary, Wesco Financial Corporation. Charlie Munger has some interesting comments about Wes-FIC and the reinsurance business on pages 60-62.

To the Insurance Segment tables on page 41, we have added a new line, labeled Major Quota-Share Contracts. The 1985 results of the FFIC contract are reported there, though the newness of the arrangement makes these results only very rough approximations.

After the end of the year, we secured another quota-share contract, whose 1986 volume should be over $50 million. We hope to develop more of this business, and industry conditions suggest that we could: a significant number of companies are generating more business than they themselves can prudently handle. Our financial strength makes us an attractive partner for such companies.

Marketable Securities

We show below our 1985 yearend net holdings in marketable equities. All positions with a market value over $25 million are listed, and the interests attributable to minority shareholders of Wesco and Nebraska Furniture Mart are excluded.

No. of Shares		*Cost*	*Market*
		(000s omitted)	
1,036,461	Affiliated Publications, Inc.	$ 3,516	$ 55,710
900,800	American Broadcasting Companies, Inc.	54,435	108,997
2,350,922	Beatrice Companies, Inc.	106,811	108,142
6,850,000	GEICO Corporation	45,713	595,950
2,379,200	Handy & Harman	27,318	43,718
847,788	Time, Inc.	20,385	52,669
1,727,765	The Washington Post Company	9,731	205,172
		267,909	1,170,358
	All Other Common Stockholdings	7,201	27,963
	Total Common Stocks	$275,110	$1,198,321

We mentioned earlier that in the past decade the investment environment has changed from one in which great businesses were totally unappreciated to one in which they are appropriately recognized. The Washington Post Company ("WPC") provides an excellent example.

We bought all of our WPC holdings in mid-1973 at a price of not more than one-fourth of the then per-share business value of the enterprise. Calculating the price/value ratio required no unusual insights. Most security analysts, media brokers, and media executives would have estimated WPC's intrinsic business value at $400 to $500 million just as we did. And its $100 million stock market valuation was published daily for all to see. Our advantage, rather, was attitude: we had learned from Ben Graham that the key to successful investing was the purchase of shares in good businesses when market prices were at a large discount from underlying business values.

Most institutional investors in the early 1970s, on the other hand, regarded business value as of only minor relevance when they were deciding the prices at which they would buy or sell. This now seems hard to believe. However, these institutions were then under the spell of academics at prestigious business schools who were preaching a newly-fashioned theory: the stock market was totally efficient, and therefore calculations of business value — and even thought, itself — were of no importance in investment activities. (We are enormously indebted to those academics: what could be more advantageous in an intellectual contest — whether it be bridge, chess, or stock selection — than to have opponents who have been taught that thinking is a waste of energy?)

Through 1973 and 1974, WPC continued to do fine as a business, and intrinsic value grew. Nevertheless, by yearend 1974 our WPC holding showed a loss of about 25%, with market value at $8 million against our cost of $10.6 million. What we had thought ridiculously cheap a year earlier had become a good bit cheaper as the market, in its infinite wisdom, marked WPC stock down to well below 20¢ on the dollar of intrinsic value.

You know the happy outcome. Kay Graham, CEO of WPC, had the brains and courage to repurchase large quantities of stock for the company at those bargain prices, as well as the managerial skills necessary to dramatically increase business values. Meanwhile, investors began to recognize the exceptional economics of the business and the stock price moved closer to underlying value. Thus, we experienced a triple dip: the company's business value soared upward, per-share business value increased considerably faster because of stock repurchases and, with a narrowing of the discount, the stock price outpaced the gain in per-share business value.

We hold all of the WPC shares we bought in 1973, except for those sold back to the company in 1985's proportionate redemption. Proceeds from the redemption plus yearend market value of our holdings total $221 million.

If we had invested our $10.6 million in any of a half-dozen media companies that were investment favorites in mid-1973, the value of our holdings at yearend would have been in the area of $40 — $60 million. Our gain would have far exceeded the gain in the general market, an outcome reflecting the exceptional economics of the media business. The extra $160 million or so we gained through ownership of WPC came, in very large part, from the superior nature of the managerial decisions made by Kay as compared to those made by managers of most media companies. Her stunning business success has in large part gone unreported but among Berkshire shareholders it should not go unappreciated.

Our Capital Cities purchase, described in the next section, required me to leave the WPC Board early in 1986. But we intend to hold indefinitely whatever WPC stock FCC rules allow us to. We expect WPC's business values to grow at a reasonable rate, and we know that management is both able and shareholder-oriented. However, the market now values the company at over $1.8 billion, and there is no way that the value can progress from that level at a rate anywhere close to the rate possible when the company's valuation was only $100 million. Because market prices have also been bid up for our other holdings, we face the same vastly-reduced potential throughout our portfolio.

You will notice that we had a significant holding in Beatrice Companies at yearend. This is a short-term arbitrage holding — in effect, a parking place for money (though not a totally safe one, since deals sometimes fall through and create substantial losses). We sometimes enter the arbitrage field when we have more money than ideas, but only to participate in announced mergers and sales. We would be a lot happier if the funds currently employed on this short-term basis found a long-term home. At the moment, however, prospects are bleak.

At yearend our insurance subsidiaries had about $400 million in tax-exempt bonds, of which $194 million at amortized cost were issues of Washington Public Power Supply System ("WPPSS") Projects 1, 2, and 3. I discussed this position fully last year, and explained why we would not disclose further purchases or sales until well after the fact (adhering to the policy we follow on stocks). Our unrealized gain on the WPPSS bonds at yearend was $62 million, perhaps one-third arising from the upward movement of bonds generally, and the remainder from a more positive investor view toward WPPSS 1, 2, and 3s. Annual tax-exempt income from our WPPSS issues is about $30 million.

Capital Cities/ABC, Inc.

Right after yearend, Berkshire purchased 3 million shares of Capital Cities/ABC, Inc. ("Cap Cities") at $172.50 per share, the market price of such shares at the time the commitment was made early in March, 1985. I've been on record for many years about the management of Cap Cities: I think it is the best of any publicly-owned company in the country. And Tom Murphy and Dan Burke are not only great managers, they are precisely the sort of fellows that you would want your daughter to marry. It is a privilege to be associated with them — and also a lot of fun, as any of you who know them will understand.

Our purchase of stock helped Cap Cities finance the $3.5 billion acquisition of American Broadcasting Companies. For Cap Cities, ABC is a major undertaking whose economics are likely to be unexciting over the next few years. This bothers us not an iota; we can be very patient. (No matter how great the talent or effort, some things just take time: you can't produce a baby in one month by getting nine women pregnant.)

As evidence of our confidence, we have executed an unusual agreement: for an extended period Tom, as CEO (or Dan, should he be CEO) votes our stock. This arrangement was initiated by Charlie and me, not by Tom. We also have restricted ourselves in various ways regarding sale of our shares. The object of these restrictions is to make sure that our block does not get sold to anyone who is a large holder (or intends to become a large holder) without the approval of management, an arrangement similar to ones we initiated some years ago at GEICO and Washington Post.

Since large blocks frequently command premium prices, some might think we have injured Berkshire financially by creating such restrictions. Our view is just the opposite. We feel the long-term economic prospects for these businesses — and, thus, for ourselves as owners — are enhanced by the arrangements. With them in place, the first-class managers with whom we have aligned ourselves can focus their efforts entirely upon running the businesses and maximizing long-term values for owners. Certainly this is much better than having those managers distracted by "revolving-door capitalists" hoping to put the company "in play". (Of course, some managers place their own interests above those of the company and its owners and deserve to be shaken up — but, in making investments, we try to steer clear of this type.)

Today, corporate instability is an inevitable consequence of widely-diffused ownership of voting stock. At any time a major holder can surface, usually mouthing reassuring rhetoric but frequently harboring uncivil intentions. By circumscribing our blocks of stock as we often do, we intend to promote stability where it otherwise might be lacking. That kind of certainty, combined with a good manager and a good business, provides excellent soil for a rich financial harvest. That's the economic case for our arrangements.

The human side is just as important. We don't want managers we like and admire — and who have welcomed a major financial commitment by us — to ever lose any sleep wondering whether surprises might occur because of our large ownership. I have told them there will be no surprises, and these agreements put Berkshire's signature where my mouth is. That signature also means the managers have a corporate commitment and therefore need not worry if my personal participation in Berkshire's affairs ends prematurely (a term I define as any age short of three digits).

Our Cap Cities purchase was made at a full price, reflecting the very considerable enthusiasm for both media stocks and media properties that has developed in recent years (and that, in the case of some property purchases, has approached a mania). It's no field for bargains. However, our Cap Cities investment allies us with an exceptional combination of properties and people — and we like the opportunity to participate in size.

Of course, some of you probably wonder why we are now buying Cap Cities at $172.50 per share given that your Chairman, in a characteristic burst of brilliance, sold Berkshire's holdings in the same company at $43 per share in 1978-80. Anticipating your question, I spent much of 1985 working on a snappy answer that would reconcile these acts.

A little more time, please.

Acquisition of Scott & Fetzer

Right after yearend we acquired The Scott & Fetzer Company ("Scott Fetzer") of Cleveland for about $320 million. (In addition, about $90 million of pre-existing Scott Fetzer debt remains in place.) In the next section of this report I describe the sort of businesses that we wish to buy for Berkshire. Scott Fetzer is a prototype — understandable, large, well-managed, a good earner.

The company has sales of about $700 million derived from 17 businesses, many leaders in their fields. Return on invested capital is good to excellent for most of these businesses. Some well-known products are Kirby home-care systems, Campbell Hausfeld air compressors, and Wayne burners and water pumps.

World Book, Inc. — accounting for about 40% of Scott Fetzer's sales and a bit more of its income — is by far the company's largest operation. It also is by far the leader in its industry, selling more than twice as many encyclopedia sets annually as its nearest competitor. In fact, it sells more sets in the U.S. than its four biggest competitors combined.

Charlie and I have a particular interest in the World Book operation because we regard its encylopedia as something special. I've been a fan (and user) for 25 years, and now have grandchildren consulting the sets just as my children did. World Book is regularly rated the most useful encyclopedia by teachers, librarians and consumer buying guides. Yet it sells for less than any of its major competitors. Childcraft, another World Book, Inc. product, offers similar value. This combination of exceptional products and modest prices at World Book, Inc. helped make us willing to pay the price demanded for Scott Fetzer, despite declining results for many companies in the direct-selling industry.

An equal attraction at Scott Fetzer is Ralph Schey, its CEO for nine years. When Ralph took charge, the company had 31 businesses, the result of an acquisition spree in the 1960s. He disposed of many that did not fit or had limited profit potential, but his focus on rationalizing the original potpourri was not so intense that he passed by World Book when it became available for purchase in 1978. Ralph's operating and capital-allocation record is superb, and we are delighted to be associated with him.

The history of the Scott Fetzer acquisition is interesting, marked by some zigs and zags before we became involved. The company had been an announced candidate for purchase since early 1984. A major investment banking firm spent many months canvassing scores of prospects, evoking interest from several. Finally, in mid-1985 a plan of sale, featuring heavy participation by an ESOP (Employee Stock Ownership Plan), was approved by shareholders. However, as difficulty in closing followed, the plan was scuttled.

I had followed this corporate odyssey through the newspapers. On October 10, well after the ESOP deal had fallen through, I wrote a short letter to Ralph, whom I did not know. I said we admired the company's record and asked if he might like to talk. Charlie and I met Ralph for dinner in Chicago on October 22 and signed an acquisition contract the following week.

The Scott Fetzer acquisition, plus major growth in our insurance business, should push revenues above $2 billion in 1986, more than double those of 1985.

Miscellaneous

The Scott Fetzer purchase illustrates our somewhat haphazard approach to acquisitions. We have no master strategy, no corporate planners delivering us insights about socioeconomic trends, and no staff to investigate a multitude of ideas presented by promoters and intermediaries. Instead, we simply hope that something sensible comes along — and, when it does, we act.

To give fate a helping hand, we again repeat our regular "business wanted" ad. The only change from last year's copy is in (1): because we continue to want any acquisition we make to have a measurable impact on Berkshire's financial results, we have raised our minimum profit requirement.

Here's what we're looking for:
(1) large purchases (at least $10 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. Indeed, following recent advances in the price of Berkshire stock, transactions involving stock issuance may be quite feasible. 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.

On the other hand, we frequently get approached about acquisitions that don't come close to meeting our tests: new ventures, turn-arounds, auction-like sales, and the ever-popular (among brokers) "I'm-sure-something-will-work-out-if-you-people-get-to-know-each-other". None of these attracts us in the least.

* * *

Besides being interested in the purchases of entire businesses as described above, we are also interested in the negotiated purchase of large, but not controlling, blocks of stock, as in our Cap Cities purchase. Such purchases appeal to us only when we are very comfortable with both the economics of the business and the ability and integrity of the people running the operation. We prefer large transactions: in the unusual case we might do something as small as $50 million (or even smaller), but our preference is for commitments many times that size.

* * *

About 96.8% of all eligible shares participated in Berkshire's 1985 shareholder-designated contributions program. Total contributions made through the program were $4 million, and 1,724 charities were recipients. We conducted a plebiscite last year in order to get your views about this program, as well as about our dividend policy. (Recognizing that it's possible to influence the answers to a question by the framing of it, we attempted to make the wording of ours as neutral as possible.) We present the ballot and the results in the Appendix on page 69. I think it's fair to summarize your response as highly supportive of present policies and your group preference — allowing for the tendency of people to vote for the status quo — to be for increasing the annual charitable commitment as our asset values build.

We urge new shareholders to read the description of our shareholder-designated contributions program that appears on pages 66 and 67. 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, 1986 will be ineligible for the 1986 program.

* * *

Five years ago we were required by the Bank Holding Company Act of 1969 to dispose of our holdings in The Illinois National Bank and Trust Company of Rockford, Illinois. Our method of doing so was unusual: we announced an exchange ratio between stock of Rockford Bancorp Inc. (the Illinois National's holding company) and stock of Berkshire, and then let each of our shareholders — except me — make the decision as to whether to exchange all, part, or none of his Berkshire shares for Rockford shares. I took the Rockford stock that was left over and thus my own holding in Rockford was determined by your decisions. At the time I said, "This technique embodies the world's oldest and most elementary system of fairly dividing an object. Just as when you were a child and one person cut the cake and the other got first choice, I have tried to cut the company fairly, but you get first choice as to which piece you want."

Last fall Illinois National was sold. When Rockford's liquidation is completed, its shareholders will have received per-share proceeds about equal to Berkshire's per-share intrinsic value at the time of the bank's sale. I'm pleased that this five-year result indicates that the division of the cake was reasonably equitable.

* * *

Last year I put in a plug for our annual meeting, and you took me up on the invitation. Over 250 of our more than 3,000 registered shareholders showed up. Those attending behaved just as those present in previous years, asking the sort of questions you would expect from intelligent and interested owners. You can attend a great many annual meetings without running into a crowd like ours. (Lester Maddox, when Governor of Georgia, was criticized regarding the state's abysmal prison system. "The solution", he said, "is simple. All we need is a better class of prisoners." Upgrading annual meetings works the same way.)

I hope you come to this year's meeting, which will be held on May 20 in Omaha. There will be only one change: after 48 years of allegiance to another soft drink, your Chairman, in an unprecedented display of behavioral flexibility, has converted to the new Cherry Coke. Henceforth, it will be the Official Drink of the Berkshire Hathaway Annual Meeting.

And bring money: Mrs. B promises to have bargains galore if you will pay her a visit at The Nebraska Furniture Mart after the meeting.

Warren E. Buffett
Chairman of the Board

March 4, 1986

Touche Ross & Co.

March 10, 1986

To the Board of Directors and Stockholders
Berkshire Hathaway Inc.

We have examined the consolidated balance sheet of Berkshire Hathaway Inc. and consolidated subsidiaries as of December 28, 1985, and the related consolidated statements of earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries for the years ended December 29, 1984 and December 31, 1983, were examined by other auditors whose report dated March 13, 1985, except as to Note 21 to the 1984 financial statements which was as of March 18, 1985, expressed an unqualified opinion on those statements.

In our opinion, the 1985 consolidated financial statements referred to above present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries as of December 28, 1985, and the results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche Ross & Co.

Touche Ross & Co.

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	Dec. 28, 1985	Dec. 29, 1984
ASSETS		
Cash and temporary cash investments	$1,017,667	$ 173,721
Investments, other than investments in affiliates:		
Obligations with fixed maturities, principally bonds — at cost (market value: Dec. 28, 1985 — $543,101, Dec. 29, 1984 — $317,734)	475,216	303,928
Marketable equity securities (Notes 3 and 4)	1,183,476	1,235,903
Investment in Mutual Savings and Loan Association (Note 5)	29,810	32,927
Investment in The Scott & Fetzer Company (Note 18)	57,215	—
Accounts receivable from customers, agents and others (Note 6)	156,362	88,489
Inventories	37,386	41,332
Real estate, equipment, furniture and leasehold improvements (Note 7)	69,369	67,919
Deferred insurance premium acquisition costs	51,368	7,444
Goodwill of acquired businesses	75,169	77,269
Other assets	27,680	6,271
	$3,180,718	$2,035,203
LIABILITIES AND STOCKHOLDERS' EQUITY		
Losses and loss adjustment expenses	$ 411,305	$ 243,298
Unearned premiums	229,440	49,099
Liability for unredeemed trading stamps (Note 8)	48,187	58,957
Accounts payable, accruals and other liabilities	72,636	73,346
Current income taxes	97,180	11,432
Deferred income taxes (Note 9)	284,401	177,907
Term debt and other borrowings (Note 10)	117,879	127,104
	1,261,028	741,143
Minority shareholders' interests	34,360	22,299
Stockholders' equity (Notes 11 and 12):		
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	664,707	486,953
Retained earnings	1,097,308	661,493
	1,926,268	1,312,699
Less common stock in treasury, at cost (228,274 shares)	40,938	40,938
Total stockholders' equity	1,885,330	1,271,761
Commitments and subsequent events (Note 18)		
	$3,180,718	$2,035,203

See accompanying Notes to Consolidated Financial Statements

(51)

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

	Fiscal Year Ended Saturday Nearest December 31		
	1985	*1984*	*1983*
Income items:			
Insurance premiums earned	$ 317,059	$ 140,242	$ 152,480
Sales and service revenues	508,764	500,219	381,674
Interest and dividend income (Note 13)	107,662	84,161	64,903
Equity in earnings excluding realized investment gain of unconsolidated subsidiaries	6,379	4,557	3,669
	939,864	729,179	602,726
Cost and expense items:			
Insurance losses and loss adjustment expenses	280,249	141,550	134,109
Cost of products and services sold	285,925	296,770	214,362
Insurance underwriting expenses	81,040	46,752	52,243
Selling, general and administrative expenses	150,423	138,875	122,023
Interest and financing costs	14,415	14,734	15,104
	812,052	638,681	537,841
Earnings from operations including minority interest in consolidated subsidiaries, before applicable income taxes and before realized investment gain	127,812	90,498	64,885
Income taxes applicable to above (Note 14)	31,271	16,420	8,904
	96,541	74,078	55,981
Minority interest applicable to above	3,593	3,877	7,337
Earnings before realized investment gain	92,948	70,201	48,644
Realized investment gain, net (Note 15)	342,867	78,694	63,522
Net earnings	$ 435,815	$ 148,895	$ 112,166
Average shares outstanding	1,146,909	1,146,909	1,066,709
Per share:			
Earnings before realized investment gain	$ 81.04	$ 61.21	$ 45.60
Net earnings	379.99	129.82	105.15

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

December 28, 1985

(dollars in thousands)

	Fiscal Year Ended Saturday Nearest December 31		
	1985	*1984*	*1983*
Consolidated assets at beginning of year	$2,035,203	$1,837,543	$1,514,431
Changes during the year resulted from:			
Net earnings	435,815	148,895	112,166
Net increase in losses, loss adjustment expenses and unearned premiums of insurance subsidiaries ...	348,348	23,908	16,598
Net increase (decrease) in deferred income taxes, other than increases related to unrealized appreciation of securities	35,277	3,355	(4,420)
Net increase (decrease) in other consolidated liabilities	65,043	14,581	(46,488)
Increases essentially from operations	884,483	190,739	77,856
Increase (decrease) in deferred income taxes, relating to unrealized appreciation of securities	71,217	(1,061)	48,899
Net increase, reflected in stockholders' equity, in unrealized appreciation of securities	177,754	3,673	125,159
Net increase (decrease) in minority interests	12,061	4,309	(83,187)*
Issuance of capital stock	—	—	154,665 *
Purchase of treasury stock	—	—	(280)
Total changes	1,145,515	197,660	323,112
Consolidated assets at end of year	$3,180,718	$2,035,203	$1,837,543

**The minority interest in net assets of Blue Chip Stamps at the beginning of 1983 was $88,234. On July 28, 1983, Berkshire acquired that minority interest in exchange for its stock, resulting in a net decrease during the year in the aggregate interest of minority shareholders in the net assets of consolidated subsidiaries.*

The presentation format of this statement differs from that of prior years. It is the view of Berkshire's management that the revised presentation provides disclosures regarding changes in the Company's consolidated resources in a more meaningful manner.

See accompanying Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 28, 1985

(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. Berkshire accounts for its investments in non-consolidated subsidiaries 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 16.

(b) Corporate Changes in 1983 Influencing Comparability of Earnings

Merger of Blue Chip Stamps

For part of 1983, Berkshire owned 59.6% of Blue Chip Stamps ("Blue Chip") and, accordingly, there was a charge to Berkshire's consolidated net earnings applicable to the 40.4% outstanding minority interest in Blue Chip. That charge was eliminated for periods after July 28, 1983 when, in a merger transaction that was accounted for by Berkshire as a purchase, Berkshire acquired the interests of the minority shareholders in exchange for its issuance of 160,900 shares of its common stock plus its payment of cash in lieu of issuance of fractional common shares. Blue Chip operated a promotional services business, it owned 100% of See's Candy Shops, Incorporated, 100% of the Buffalo News, and 80.1% of Wesco Financial Corporation.

Purchase of Majority Interest in Nebraska Furniture Mart, Inc.

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 furnishings. Results of operations of the business from the date of purchase are reflected in the accompanying Consolidated Statements of Earnings.

(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 furnishings 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 — are stated at cost, adjusted where appropriate for accretion of discount or amortization of premium.

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.

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.

(1) Significant Accounting Policies and Practices (Continued)

(e) Inventories

Inventories are stated at cost, determined principally using the first-in, first-out ("FIFO"), or average cost method. Inventory costs that were determined using the last-in, first-out ("LIFO") method comprised 26% of inventory carrying value in the consolidated balance sheet at December 28, 1985 (41% at December 29, 1984). Liquidation of prior years' LIFO inventory layers had the effect of increasing 1985 income before taxes by approximately $3,098. Of such amount, $2,602 relates to liquidation or write-off in 1985 of domestic inventories of the Company's textile division. Variations in LIFO layers in 1983 and 1984 were not significant.

(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 fair value of net assets of acquired businesses is amortized on a straight line basis over forty years.

(h) Insurance Premium Acquisition Costs

For financial reporting purposes, costs of acquiring insurance premiums are deferred, subject to ultimate recoverability, and charged to income as the premiums are earned. With respect to premiums received under major quota-share reinsurance contracts, the computation of ultimate recoverability of the directly related acquisition costs takes into account investment income anticipated to be earned on funds held subject to the contracts. Otherwise, ultimate recoverabilty of premium acquisition costs is determined without regard to investment income. For statutory insurance accounting and income tax reporting purposes, premium acquisition costs are charged to 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 $16,157 and $10,531 at December 31, 1985 and 1984, respectively.

An aggregate liability amounting to $40,841 and $15,944 at December 31, 1985 and 1984, 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 specific present value discount rate applicable to a given contract is dependent upon market interest rates at the contract inception date. The weighted average discount rate for all such contracts at December 31, 1985 for financial reporting purposes was approximately 11.5%. For statutory insurance accounting and tax reporting purposes, these liabilities were discounted at a rate of 7% as prescribed by regulatory authority.

(1) Significant Accounting Policies and Practices (Continued)

(j) Losses and Loss Adjustment Expenses (Continued)

Additionally at December 31, 1985 and 1984, an aggregate liability amounting to $47,036 and $14,712, respectively, was established with respect to portfolio reinsurance obligations of the Insurance Group. Liabilities under these contracts are established at their inception dates at amounts approximately equal to the consideration then received, and thereafter at experience-modified amounts.

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. 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 $4,398 and $1,780 at December 31, 1985 and 1984, 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 $5,243 for 1985, $3,110 for 1984, and $4,955 for 1983.

(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. Period redemption costs reflect any change during the period in the liability for unredeemed trading stamps, an account for which 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.

(n) Income Taxes

The carrying value of investments in, and equity in earnings of the non-consolidated subsidiaries are determined on an after-tax basis. Thus, income taxes reflected in the Consolidated Financial Statements represent those of the Company and those of its subsidiaries that are consolidated therein.

Certain items of income and deductions 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. Recording the tax effects of these "timing differences" gives rise to recognition in the financial statements of net deferred income taxes.

(2) Acquisition of Businesses of The Scott & Fetzer Company in January, 1986

On January 6, 1986, Berkshire succeeded to all of the assets of The Scott & Fetzer Company ("Scott Fetzer") subject to all of Scott Fetzer's liabilities in a merger whereby Scott Fetzer became an indirectly wholly-owned subsidiary of Berkshire. The resulting business combination will be accounted for as a purchase by Berkshire of Scott Fetzer's assets.

The following sets forth on an unaudited pro forma basis certain 1985 consolidated earnings statement information as if the combination of the businesses had been consummated, on its same terms, at the beginning of 1985.

Revenues	$1,642,990
Net earnings	$ 448,815
Net earnings per share	$ 391.33

See also Note 18.

(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. All of these investments at December 31, 1985 were held by members of the Insurance Group.

	December 31, 1985			
	Cost	*Unrealized Gain*	*Market*	*Carrying Value*
Common stock of:				
American Broadcasting Companies, Inc.	$ 54,435	$ 54,562	$ 108,997	$ 108,997
GEICO Corporation	45,713	550,237	595,950	595,950
The Washington Post Company	9,731	195,441	205,172	205,172
All Others	150,558	122,799	273,357	273,357
	$260,437	$923,039	$1,183,476	$1,183,476

There were no unrealized losses with respect to these securities at December 31, 1985.

	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

As of December 29, 1984, gross unrealized gain of $686,522 was reduced by unrealized loss of $438 in determining net unrealized gain of $686,084 as reflected above.

Investment in shares of Capital Cities Communications, Inc.

On January 2, 1986, subsidiaries of Berkshire purchased for cash three million common shares of Capital Cities/ABC Inc. ("Capital Cities") pursuant to a Letter Agreement between Berkshire and Capital Cities dated March 18, 1985. The shares represented approximately 18.7% of the total outstanding shares of Capital Cities immediately after the transaction. The purchase price was $172.50 per share; the aggregate cost was $517,500. Berkshire subsidiaries hold the shares subject to an agreement the terms of which, among other provisions, grant to Capital Cities a right of first refusal to purchase the shares and otherwise govern until January 3, 1997 the manner by which the shares may be sold or transferred. Also, Berkshire and its subsidiaries have delivered to Capital Cities irrevocable proxies with respect to these shares in favor of Thomas S. Murphy so long as he shall be the chief executive officer of Capital Cities, or Daniel B. Burke, so long as he shall be the chief executive officer of Capital Cities, to vote the shares at any and all meetings of shareholders of Capital Cities. The proxies expire on January 2, 1997 or at the earlier date when neither of such persons is chief executive officer of Capital Cities.

See also Note 18.

(4) Investment in GEICO Corporation

Subsidiaries of Berkshire, at both December 28, 1985 and at December 29, 1984, owned 6,850,000 shares of common stock of GEICO Corporation. The shares possessed approximately 38½% of the voting rights of all GEICO shares outstanding at December 28, 1985 (36½% 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.

(5) Investment in Mutual Savings and Loan Association

Mutual is wholly owned by Wesco Financial Corporation, an 80.1% beneficially owned subsidiary of Berkshire.

The carrying value of the investment in Mutual in the accompanying Consolidated Balance Sheets represents the original cost assigned to the asset, adjusted for amortization of negative goodwill that arose at the various dates of acquisition and for equity in Mutual's undistributed earnings of ensuing periods. 80.1% of Mutual's stated net book value at December 31, 1985 is $46,120. The excess of such figure over Berkshire's $29,810 carrying value of its investment in Mutual is $16,310, representing remaining unamortized negative goodwill.

Summarized consolidated financial information of Mutual is as follows:

	December 31	
Balance Sheet Data	*1985*	*1984*
Assets		
Cash and marketable securities	$235,969	$188,851
Loans receivable, net	83,425	95,120
Other assets	12,203	11,071
	$331,597	$295,042
Liabilities and Shareholder's Equity		
Savings accounts	$269,313	$227,585
Other liabilities	4,705	5,906
Total liabilities	274,018	233,491
Shareholder's equity, substantially restricted	57,579	61,551
	$331,597	$295,042

Earnings Statement Data	*1985*	*1984*	*1983*
Total revenues	$38,798	$26,887	$22,741
Net income	$ 9,330	$ 6,844	$ 3,047
Cash dividends paid to Wesco	$14,000	$ —	$ —

58

(6) Accounts Receivable

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

	Dec. 28, 1985	Dec. 29, 1984
Trade accounts receivable, net of allowances for doubtful accounts	$ 48,322	$ 47,647
Agents' balances and premiums in course of collection	74,001	19,935
Reinsurance recoverable on loss payments	490	522
Investment income due and accrued	32,060	18,342
Amounts due from sales of securities	1,489	2,043
	$156,362	$ 88,489

(7) 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. 28, 1985	Dec. 29, 1984
Land	$ 7,455	$ 7,486
Buildings	40,708	39,418
Machinery and equipment	65,810	60,821
Furniture, fixtures and leasehold improvements	33,760	32,040
	147,733	139,765
Less accumulated depreciation and amortization	78,364	71,846
	$ 69,369	$ 67,919

(8) Liability for Unredeemed Trading Stamps

The probability for ultimate redemption of trading stamps issued by Blue Chip Stamps is a factor that must be estimated and taken into account in computing Blue Chip's liability for issued but unredeemed stamps (the "unredeemed liability"). Management's estimate of that probability factor has trended downward in recent years, as Blue Chip's volume of stamp issuances steadily declined. The revisions of the redemption-probability factor in 1983 and 1984 did not appreciably affect Berkshire's earnings for those years. During 1985, in order to provide uniform, improved service to all of its stamp savers, Blue Chip commenced a centralized program whereby orders are received at its headquarters on a postage-collect basis and merchandise is shipped from its distribution center to redeemers on a freight-prepaid basis. The outlying redemption outlets (22 at the beginning of the year) were closed. A notable reduction in redemption activity followed the closings, and the factor for redemption-probability used in the computation of the 1985 year-end unredeemed liability was revised further downward. The revision had the effect of reducing the unredeemed liability at December 28, 1985, and Berkshire's 1985 cost of services sold, by approximately $10,800. The after-tax effect was to increase Berkshire's 1985 net earnings approximately $5,300 ($4.62 per share).

(9) Deferred Income Taxes

The liability for deferred income taxes shown in the Consolidated Balance Sheets includes $258,164 at December 28, 1985, and $186,198 at December 29, 1984, which amounts are deemed applicable to unrealized appreciation of marketable equity securities carried at market value. That liability is increased by deferred taxes, and reduced by 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 deferred and prepaid income taxes arising from timing differences.

	Dec. 28, 1985	*Dec. 29, 1984*
Deferred taxes relating to timing differences in accounting for:		
Structured settlements and portfolio reinsurance liabilities	$13,111	$ 5,471
Deferred insurance premium acquisition costs	23,630	3,423
Depreciation of property, plant & equipment	2,862	1,622
	39,603	10,516
Prepaid taxes relating to timing differences in accounting for:		
Trading stamp liability	9,797	15,839
State income and franchise taxes	2,755	1,008
Unearned carrying charges	644	950
All other	170	1,010
	13,366	18,807
Net deferred at December 28, 1985	$26,237	
Net prepaid at December 29, 1984		$ 8,291

(10) Term Debt and Other Borrowings

Consolidated term debt and other borrowings were as follows:

	Dec. 28, 1985	*Dec. 29, 1984*
Berkshire:		
12¾% debentures maturing from August 1, 1991 through August 1, 2005 at $4,004 annually	$ 60,000	$ 60,000
Other notes, debentures and capitalized lease obligations maturing through 1993 in varying annual installments, with interest at rates varying principally from 8% to 9%	19,261	28,066
	79,261	88,066
Consolidated Subsidiaries:		
10⅛% notes maturing in June, 1991	25,000	25,000
Notes and capitalized lease obligations maturing through 2007 in varying installments, with interest at rates varying principally from 6% to 10%	13,618	14,038
Total consolidated term debt	$117,879	$127,104

(10) Term Debt and Other Borrowings *(Continued)*

Various covenants of borrowing Agreements to which the Company or its subsidiaries are parties are not materially restrictive as to the Company's current or prospective actions and activities.

Principal payments on term debt outstanding at December 28, 1985 are required during the succeeding five years as follows:

1986	$2,867
1987	2,756
1988	2,788
1989	2,448
1990	2,456

Revolving Credit and Term Loan Agreements between Berkshire and certain banks, which made available up to $175,000 in borrowings by Berkshire, were in effect from February, 1984 until October, 1985, when Berkshire exercised its option to terminate the Agreements.

(11) 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 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
Increase during 1985 in unrealized appreciation included in carrying value of marketable equity securities	248,978		
Change during 1985 in deemed applicable income taxes	(71,217)		
Minority shareholders' interest	(7)		
Net earnings 1985		435,815	
Balance at December 28, 1985	$664,707	$1,097,308	$40,938

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.

(12) Dividend Restrictions — Insurance Subsidiaries

Payments of dividends by Insurance Group members are restricted by insurance statutes and regulations. In early January, 1986, dividends of approximately $205,000 were paid by Insurance Group members to Berkshire after necessary approvals were obtained from the Nebraska Department of Insurance. Payment to Berkshire by Insurance Group members of additional dividends in 1986 which exceed $43,137 would require approval of regulatory authorities.

Combined stockholders' equity of insurance subsidiaries, determined pursuant to statutory accounting rules, was $1,681,874 and $1,291,103 at December 31, 1985 and 1984, respectively. Corresponding amounts determined on the basis of generally accepted accounting principles were $1,410,976 and $1,101,947.

(13) Interest and Dividend Income

Investment income for each of the past three years was comprised of the following:

	1985	*1984*	*1983*
Dividends:			
American Broadcasting Companies	$ 1,441	$ —	$ —
Exxon Corporation	5,588	2,585	—
GEICO Corporation	6,850	6,028	5,121
General Foods Corporation	7,727	10,923	9,428
The Washington Post Company	1,726	1,495	1,233
All Others	10,786	20,933	29,151
Total dividends	34,118	41,964	44,933
Interest exempt from Federal income taxes	36,579	23,896	9,677
Other interest	36,965	18,301	10,293
Interest and dividend income	$107,662	$84,161	$64,903

(14) 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 income taxes		
Applicable to	*1985*	*1984*	*1983*
Operating earnings	$ 31,271	$ 16,420	$ 8,904
Realized investment gain of consolidated companies	140,946	31,221	21,849
	$172,217	$ 47,641	$ 30,753
These taxes are comprised of:			
Federal	$158,603	$ 39,128	$ 26,728
State	13,593	8,455	3,920
Foreign	21	58	105
	$172,217	$ 47,641	$ 30,753
Taxes payable currently	$137,689	$ 44,286	$ 35,173
Changes in prepaid/deferred taxes	34,528	3,355	(4,420)
	$172,217	$ 47,641	$ 30,753

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

	1985	*1984*	*1983*
Net earnings including minority interest, before applicable income taxes	$620,035	$203,031	$151,720
Hypothetical amounts applicable to above computed at the Federal statutory rate (46%)	$285,216	$ 93,394	$ 69,791
Decreases, resulting from:			
Tax-exempt interest income	(16,826)	(10,992)	(4,310)
85% dividends received deduction relating to dividend income reported herein	(13,340)	(16,408)	(17,714)
Rate differentials relating to realized investment gains	(86,828)	(21,209)	(19,391)
State income taxes, less Federal income tax benefit	7,340	4,636	2,117
Net other differences	(3,345)	(1,780)	260
Total income taxes	$172,217	$ 47,641	$ 30,753

(15) Realized Investment Gain

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

	1985	*1984*	*1983*
Special share redemption proceeds*:			
From General Foods Corporation	$ 8,845	$ 21,844	$ —
From The Washington Post Company	15,774	—	—
From GEICO Corporation	—	—	21,000
	24,619	21,844	21,000
Less: Cost of shares redeemed	5,615	13,733	1,425
Pre-tax gain realized from special share redemption transactions	19,004	8,111	19,575
Pre-tax gain realized on sale of General Foods stock**	333,479	—	—
Pre-tax net gain realized on other sales of securities by consolidated companies	135,424	101,692	67,260
Applicable income taxes	(140,946)	(31,221)	(21,849)
Applicable minority interest	(7,551)	(2,035)	(1,464)
	339,410	76,547	63,522
Equity in after-tax gain realized by Mutual Savings and Loan Association, an unconsolidated subsidiary	3,457	2,147	—
Realized investment gain, net	$342,867	$ 78,694	$63,522

**Share redemption proceeds were received in transactions that resulted in no change therefrom, in Berkshire's percentage ownership of investees and are therefore viewed by management as equivalent to dividend income. Generally accepted accounting principles require that the proceeds be reflected in realized investment gain and that in determining income from the transactions, the proceeds must be reduced for the cost of the shares redeemed. Income taxes applicable to the resulting net gain are reflected at the rate (6.9%) applicable to dividend income. Stated on after-tax basis, the redemption transactions contributed $17,629, $7,294 and $18,224 to Berkshire's consolidated net earnings for 1985, 1984 and 1983, respectively. Such amounts equate to $15.37, $6.36 and $17.08 per share for those respective years.*

***Berkshire subsidiaries sold their investment in General Foods Corporation common stock in the fourth quarter of 1985 to Philip Morris Company in response to the latter's tender offer at a large premium over the then prevailing market price. Stated on an after-tax basis and after deducting applicable minority interests, Berkshire's gain from this transaction amounted to $227,797 ($198.62 per share).*

(16) Quarterly Data

A summary of earnings by quarter for the past two years is presented in the following table. This information is unaudited.

1985	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter[a]
Income items	$178,693	$190,116	$227,761	$343,294
Earnings before realized investment gain	22,708	18,696	18,253	33,291
Realized investment gain	22,289	48,065	37,200	235,313
Net earnings	$ 44,997	$ 66,761	$ 55,453	$268,604
Per average outstanding share:				
Earnings before realized investment gain	$ 19.80	$ 16.30	$ 15.91	$ 29.03
Net earnings	39.23	58.21	48.35	234.20
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

[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.*

(17) Business Segment Data

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

Revenues

	1985	*1984*	*1983*
Insurance	$412,481	$209,523	$196,729
Candy	145,103	136,053	133,616
Newspaper	107,864	101,639	90,161
Retailing of home furnishings	123,292	118,176	28,910
Steel service center	51,305	55,305	46,266
Retailing of apparel	43,115	41,966	41,997
Textiles	25,696	32,444	26,611
Revenues not identified with segments	31,008	34,073	38,436
	$939,864	$729,179	$602,726

Operating Profit Before Taxes

	1985	*1984*	*1983*
Insurance	$ 50,987	$ 20,843	$ 9,938
Candy	28,014	25,669	26,697
Newspaper	29,322	26,729	19,039
Retailing of home furnishings	12,177	14,044	3,642
Steel service center	3,896	4,092	3,241
Retailing of apparel	270	(1,072)	697
Textiles	(2,395)	418	(100)
Pre-tax operating profits not identified with segments	25,687	19,230	21,173
Corporate expenses	(1,725)	(1,543)	(1,272)
Shareholder designated contributions	(4,006)	(3,178)	(3,066)
Interest expense	(14,415)	(14,734)	(15,104)
	$127,812	$ 90,498	$ 64,885

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

	1985	*1984*	*1983*
Insurance	$ 623	$ 441	$ 282
Candy	3,756	3,727	2,406
Newspaper	3,602	734	788
Retailing of home furnishings	1,665	623	—
Steel service center	492	409	159
Retailing of apparel	628	612	1,269
Textiles	285	320	470
Other	672	720	972
	$11,723	$ 7,586	$ 6,346

Expenditures which were part of business acquisitions are excluded.

(17) Business Segment Data (Continued)

Depreciation and Amortization of Tangible Assets

	1985	1984	1983
Insurance	$ 531	$ 492	$ 550
Candy	2,613	2,386	2,264
Newspaper	2,762	2,592	2,557
Retailing of home furnishings	1,098	922	228
Steel service center	673	633	633
Retailing of apparel	538	457	400
Textiles	698	662	689
Other	679	620	632
	$ 9,592	$ 8,764	$ 7,953

Amortization of Intangible Assets

	1985	1984	1983
Candy	$ 975	$ 975	$ 714
Newspaper	599	599	314
Retailing of home furnishings	509	467	128
Mutual	(624)	(624)	(624)
Other	16	17	—
	$ 1,475	$ 1,434	$ 532

Identifiable Assets At Year-End

	1985	1984	1983
Identified with segments:			
Insurance	$2,627,957	$1,615,274	$1,322,160
Candy — other than goodwill	34,606	28,631	27,791
— goodwill	33,523	34,497	35,472
Newspaper — other than goodwill	37,515	37,653	37,292
— goodwill	22,307	22,907	23,506
Retailing of home furnishings			
— other than goodwill	45,319	40,560	35,165
— goodwill	19,298	19,807	20,274
Steel service center	18,608	18,182	17,672
Retailing of apparel	15,163	13,186	13,435
Textiles	6,465	16,085	14,789
Other	9,264	9,487	10,575
	2,870,025	1,856,269	1,558,131
Not identified with segments:			
Investment in unconsolidated subsidiaries	31,027	33,235	27,216
Corporate cash and marketable securities of parent and non-insurance subsidiaries	279,666	145,699	252,196
	$3,180,718	$2,035,203	$1,837,543

(17) Business Segment Data (Continued)

Revenues of the Insurance Segment

	1985	*1984*	*1983*
Premiums written	$497,400	$133,558	$149,849
Premiums earned:			
Specialized auto and general liability	123,410	64,003	68,148
Workers' compensation*	17,715	22,665	19,278
Home-state multiple lines	43,208	32,598	35,328
Subtotal — excludes reinsurance assumed	184,333	119,266	122,754
Reinsurance	12,616	16,066	26,460
Major quota-share reinsurance**	70,261	—	—
Structured settlements and portfolio reinsurance	49,849	4,910	3,266
Total premiums earned	317,059	140,242	152,480
Investment income	95,422	69,281	44,249
	$412,481	$209,523	$196,729

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

***Seven percent (7%) of business of Fireman's Fund Insurance Companies from September 1, 1985 to December 31, 1985.*

Insurance Segment Operating Profit Before Taxes

	1985	*1984*	*1983*
Underwriting (loss):			
Specialized auto and general liability	$ (2,950)	$(16,049)	$(14,880)
Workers' compensation	(2,406)	(12,703)	(1,406)
Home-state multiple lines	(2,791)	(4,101)	(8,834)
Subtotal — excludes reinsurance assumed	(8,147)	(32,853)	(25,120)
Reinsurance	(19,712)	(12,560)	(8,072)
Major quota-share reinsurance**	(10,261)	—	—
Structured settlements and portfolio reinsurance	(6,110)	(2,647)	(680)
Total underwriting (loss)	(44,230)	(48,060)	(33,872)
Net investment income	95,217	68,903	43,810
	$ 50,987	$ 20,843	$ 9,938

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

***Seven percent (7%) of business of Fireman's Fund Insurance Companies from September 1, 1985 to December 31, 1985.*

(18) Commitments and Subsequent Events

On January 2, 1986, Berkshire subsidiaries purchased, for $517,500 cash, three million shares of common stock of Capital Cities Communications, Inc. See the preceding Note 3. Additionally, on January 6, 1986, the businesses of Scott Fetzer were acquired. See the preceding note 2. In that merger transaction, Berkshire contributed on the merger date approximately $260,000 cash consideration for the merger, and Berkshire thereby succeeded to the assets, subject to the liabilities, of Scott Fetzer. These transactions had significant impact on Berkshire's consolidated balance sheet, including, among other things, a large reduction in cash.

The following unaudited pro forma condensed consolidated balance sheet results from combination of (a) Scott Fetzer's historical condensed consolidated balance sheet as of November 30, 1985 with (b) Berkshire's condensed consolidated balance sheet as of December 28, 1985, as if the business combination had occurred, on its same terms, at the close of business on December 28, 1985. Also given pro forma effect is the January 2, 1986 purchase of the Capital Cities shares.

Pro forma assets	
Cash and temporary cash investments	$ 247,498
Securities with fixed maturities	475,216
Marketable equity securities	1,849,951
Accounts receivable	247,457
Inventories	150,630
Property, plant and equipment, net	212,256
Goodwill	94,418
Other assets	209,154
	$3,486,580
Pro forma liabilities and stockholders' equity	
Losses, loss adjustment expenses and unearned premium of insurance subsidiaries	$ 640,745
Accounts payable, accruals and similar liabilities	335,574
Deferred income taxes	326,114
Term debt and other borrowings	157,195
	1,459,628
Minority shareholders' interests	34,360
Stockholders' equity	1,992,592
	$3,486,580

Pro forma stockholders' equity exceeds by $107,262 that reflected in Berkshire's consolidated balance sheet as of December 28, 1985. This is the result of including, in the pro forma data, the investment by Berkshire's insurance subsidiaries in Capital Cities shares at their market value on the date of acquisition. The then market value of the shares exceeded the purchase price, which was contractually fixed on March 18, 1985.

Certain estimates, using tentative and preliminary data, were required for the making of the pro forma adjustments, the effects of which are reflected above, relating to the Scott Fetzer acquisition. Data recorded by Berkshire in its actual accounting for the Scott Fetzer merger will differ immaterially. Among other differences, Scott Fetzer's data as of the actual merger date will be the basis for the purchase accounting, as opposed to November 30, 1985 data used for purposes of the above pro forma balance sheet.

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.

Balance Sheets

	Dec. 28, 1985	Dec. 29, 1984**
Assets		
Cash and invested cash	$ 2,724	$ 9,036
Investment in subsidiaries (including unrealized appreciation of marketable equity securities owned by insurance subsidiaries, net of taxes, amounting to $664,707 at Dec. 28, 1985 and $486,953 at Dec. 29, 1984)	2,055,879	1,349,268
Other assets	5,734	15,710
	$2,064,337	$1,374,014
Liabilities and Stockholders' Equity		
Accounts payable and accrued expenses	$ 7,020	$ 7,945
Term debt and other borrowings	79,261	88,066
Income taxes	92,726	6,242
	179,007	102,253
Stockholders' equity (See Consolidated Balance Sheets)	1,885,330	1,271,761
	$2,064,337	$1,374,014

Statements of Earnings

	1985	1984**	1983**
Income items:			
From subsidiaries:			
Interest	$ 507	$ 470	$ 347
Dividends	86,094	24,732	105,414
Undistributed earnings	355,396	121,990	2,673
	441,997	147,192	108,434
Interest and dividends — other investments	1,276	3,626	7,736
Other income	2,904	11,292	7,197
Income tax credit	4,529	2,190	6,352
	450,706	164,300	129,719
Cost and expense items:			
Administrative and selling expenses of textile business	1,850	2,279	2,147
Corporate administration	1,725	1,544	1,271
Shareholder designated contributions*	805	808	3,067
Interest expense	10,511	10,774	11,068
	14,891	15,405	17,553
Net earnings	$435,815	$148,895	$112,166

**Additional contributions were made by wholly-owned subsidiaries in 1985 and 1984.*

***Certain amounts are reclassified to conform to current presentation.*

BERKSHIRE HATHAWAY INC.
BUSINESS ACTIVITIES OF THE COMPANY AND ITS SUBSIDIARIES

December 28, 1985

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. Reductions in scope of Berkshire's textile activities occurred from time to time, albeit irregularly, after about 1960. In 1985, Berkshire entirely ceased its manufacture of textile products.

Investment activities and decisions and all other major 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.

* * *

In 1967, redeploying capital from the Company's textile business, the Company acquired two entities that were engaged in the property and casualty insurance business. Thereafter, insurance operations were expanded and controlling interests in several other businesses were acquired. At the end of 1985, Berkshire's diverse activities were conducted through wholly-owned or substantially-wholly-owned subsidiaries. Four major business activities so conducted were:

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

A description of these major business activities and others of Berkshire appears below and on the following pages. The businesses of The Scott & Fetzer Company acquired shortly after the end of 1985 (on January 6, 1986) are also briefly described.

(a) Underwriting of Property and Casualty Insurance. Several Berkshire subsidiaries, collectively referred to in this report as the "Berkshire Hathaway Insurance Group", provide insurance coverages with respect to property and casualty insurance risks. Coverages are provided on both a direct and reinsurance basis ("Direct" in this context refers to an insurance company's issuance of policies in the names of persons directly subject to risk of loss, whereas "reinsurance" refers to transfers of insured risks between insurance companies.)

For descriptive and reporting purposes, the underwriting activities of the Insurance Group have been divided into six subsegments, as follows:

(i) Specialized automobile and general liability insurance,
(ii) Reinsurance,
(iii) Major quota-share reinsurance,
(iv) Structured settlements and portfolio reinsurance,
(v) Home-state multiple lines, and
(vi) Workers' compensation

Members of the Berkshire Hathaway Insurance Group with a common staff and sharing a home office in Omaha, Nebraska are National Indemnity Company ("NICO"), National Fire and Marine Insurance Company and Columbia Insurance Company, each a wholly-owned, Nebraska chartered subsidiary of Berkshire. Also now sharing that staff and home office is Wesco-Financial Insurance Company (Wes-FIC), also Nebraska chartered, formed in 1985 as a wholly-owned subsidiary of Berkshire's 80.1%-owned Wesco Financial Corporation ("Wesco" — see below). As an initial insurance transaction, Wes-FIC assumed a portion of a major quota-share reinsurance contract entered into by NICO. These companies, in differing degrees by each, share the business of the Berkshire Hathaway Insurance

Group that is categorized in Berkshire's segment data (note 17 to Berkshire's consolidated financial statements) as (i) specialized automobile and general liability, (ii) reinsurance, (iii) major quota-share reinsurance, and (iv) structured settlements and portfolio reinsurance.

(i) The *specialized automobile and general liability business* includes the underwriting on a direct basis of non-standard commercial motor vehicle (e.g., buses and long haul trucks) liability insurance and non-standard commercial general liability risks. Definitions do not exist that separate "standard" from "non-standard" risks. Herein we refer to "non-standard" risks as those that involve some type of unusual exposure for which premium charges may be higher than for those that are not perceived to involve distinguishing unusual exposure. Risks viewed by industry participants as "standard" when insurance coverages are readily available come to be viewed as "non-standard" when industry insuring capacity decreases. Public and industry perceptions of lack of insuring capacity appear to have increased sharply in 1985, resulting in a greatly increased number of non-standard risk offerings to, and acceptances by, the Berkshire Hathaway Insurance Group.

A separate division was established in 1985 within the Berkshire Hathaway Insurance Group to underwrite large-premium risk offerings. Some business was written as a result of this new division's efforts, although 1985 earned premiums of about $8 million was less than the $40 million volume of premiums written.

Earned premiums from this subsegment of the business that writes specialized liability insurance are expected to increase in 1986 over 1985, following a 93% increase in 1985 over the 1984 figure. The tail (claim reporting and settlement period) of this type of business is long, so that it will be years before the degree of profitability or unprofitability of the business will be fully known.

(ii) The Berkshire Hathaway Insurance Group underwrites various types of property/casualty treaty reinsurance. The division which manages this business was established in 1969 and is currently located in Philadelphia. The volume generated by this subsegment has been limited in recent years but could increase significantly as a result of the reduction of insuring capacity in the reinsurance marketplace.

(iii) As of September 1, 1985, NICO entered into a major quota-share reinsurance arrangement with the Fireman's Fund Insurance Companies ("FFC"), whereby it will, for a four-year period, receive 7% of all the property and casualty insurance premiums written by FFC and will, in turn, pay 7% of all costs incurred by FFC related to this 7% of their business. This arrangement, shared by NICO with Wes-FIC, is expected to generate in 1986 more than $200 million in premium volume for the Berkshire Hathaway Insurance Group.

In January, 1986, The Berkshire Hathaway Insurance Group entered into another quota-share reinsurance arrangement with another major company. This one-year renewable term arrangement will generate earned premiums for 1986 estimated at about $50 million.

While the terms of these treaties are similar to some classified in (ii) as "reinsurance", the significant volume of business anticipated from these major contracts has motivated the reporting of results therefrom as a separate subsegment of the business.

(iv) Assumption by members of the Berkshire Hathaway Insurance Group of liabilities of other insurance companies for periodic payments of settled claims ("structured settlements") and portfolio risk assumptions was incepted in 1982. The number of periodic payment obligations assumed in 1985 increased significantly over the number of assumptions in 1984. Additionally, earned premiums in 1985 of about $23 million resulted from a single portfolio assumption transaction. The Berkshire Hathaway Insurance Group's structured settlement activity may continue to increase in 1986. Management cannot forecast with any degree of confidence the extent of future premium income from portfolio assumption activity.

(a) Underwriting of Property and Casualty Insurance *(Continued)*

(v) Home-state subsidiaries were formed, in the 1970s, by Berkshire (as NICO subsidiaries) in certain states to write standard multiple line property and casualty insurance principally in their domiciliary states. Their underwriting operations are locally managed and conducted with a view to providing to agents and policyholders service that is competitively-superior because of their proximity to the Home-state companies' headquarters. Home-state subsidiaries presently include Cornhusker Casualty Company in Omaha, Nebraska, Kansas Fire & Casualty Company in Topeka, Kansas, and Continental Divide Insurance Company in Inglewood, Colorado.

(vi) Workers' compensation insurance operations are conducted as a specialty business of Cypress Insurance Company, a Berkshire subsidiary located in Pasadena, California.

* * *

In recent years, financial failures in the insurance industry have received considerable attention from news media, regulatory authorities and rating agencies. As one result, industry participants and the public have been made more aware of the benefits derived from dealing with insurers whose financial resources supported, with significant margins of safety against adversity, their promises. In this respect Berkshire Hathaway Insurance Group members are competitively well positioned. They possess notable above-average financial strength, particularly of benefit in areas of insurance that feature significantly extended claims settlement periods. That feature is integral to most of the businesses of the Berkshire Hathaway Insurance Group, with the possible exception of the Home-state companies' businesses.

* * *

Approximately 600 employees were engaged in the conduct of Berkshire's insurance business at December 31, 1985.

* * *

(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 215 retail shops in twelve western and midwestern states including Hawaii. Additional retailing activities are conducted from five of seven full-time quantity order centers that were in operation in 1985; fifteen additional quantity order centers were in temporary operation to serve peak seasonal requirements in the fourth quarter of 1985.

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., which is in its 105th year of publishing in Buffalo, New York. It presently publishes the Buffalo News, an all-day newspaper published seven days a week, with seven editions printed each weekday. It is the only metropolitan newspaper published daily within its ten-county distribution area. The Buffalo News is number one in penetration among newspapers in the top 50 primary market areas in the United States, with 79% penetration on weekdays and 82% penetration on Sundays. It currently ranks 24th among the nation's daily newspapers in daily circulation.

The assets of the Buffalo Evening News, Inc. were purchased by Blue Chip Stamps in April, 1977. It became wholly owned by Berkshire in 1983 through Berkshire's merger of Blue Chip.

The News employs about 970 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 home furnishings retail store in the United States. It has sizable 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.

At the end of 1985, Nebraska Furniture Mart employed about 600 persons.

* * *

WESCO FINANCIAL CORPORATION is a savings and loan and insurance holding company, 80.1% beneficially owned by Berkshire. It owns, operates 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 savings account deposits of approximately $269 million and 60 employees at December 31, 1985) and Precision Steel Warehouse Inc., Franklin Park, Illinois and Charlotte, North Carolina. Precision operates a metals service center business and employs about 265 persons. In September, 1985, Wesco invested $45 million in cash equivalents in a newly organized, wholly-owned, Nebraska chartered insurance company, Wesco-Financial Insurance Company ("Wes-FIC"). Wes-FIC is accounted for in Berkshire's consolidated financial statements as a member of the Berkshire Hathaway Insurance Group. See above. Its business in 1985 consisted of accepting, as a retrocession from National Indemnity Company, a portion (two sevenths) of the business that NICO wrote with the Fireman's Fund Insurance Companies under arrangements heretofore described.

* * *

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 90 employees at December 31, 1985, is also wholly-owned by Berkshire. It operates a west coast trading stamp business from its Los Angeles headquarters.

* * *

Berkshire is also 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.

Berkshire owns real property and about 15 acres of land with building improvements, in New Bedford, Massachusetts, principally occupied until recently by its discontinued textile weaving operations. Berkshire is currently holding this property for prospective lease to others.

* * *

Businesses of The Scott & Fetzer Company, acquired January 6, 1986

On January 6, 1986, Berkshire acquired to beneficial ownership of all of the outstanding capital stock of The Scott & Fetzer Company ("Scott Fetzer"). Scott Fetzer, headquartered in Westlake, Ohio, conducts diversified manufacturing and marketing activities. Two of Scott Fetzer's principal product lines are vacuum cleaners and related accessories primarily for home use sold under the *Kirby* and other brand names, and encyclopedias and related education products sold under the *World Book* name. Scott Fetzer also manufactures through its Campbell Hausfeld division a variety of products related to transmission of air and other fluids, such as air compressors, units for the spraying of paints and other liquids, air receivers and high pressure sprayers and washers. Under the *Wayne Home Equipment* name, Scott Fetzer assembles and sells domestically water circulation pumps, sump and other pumps, and power oil and gas burners. Scott Fetzer's 17 operating units are located in 12 states, and their businesses involve manufacture and sale of a variety of other products and services.

Berkshire paid approximately $320 million (of which approximately $260 million was paid in cash on January 6, 1986) to acquire Scott Fetzer. Scott Fetzer's revenues in its fiscal year ended November 30, 1985 were approximately $690 million. Of those revenues, approximately 41% were derived from *World Book* products, 17% — *Kirby* and related private label products, 12% — Campbell Hausfeld products, and 6% — Wayne home equipment products. Various other products contributed about 24% of Scott Fetzer's fiscal 1985 revenues.

Scott Fetzer employed about 21,000 persons at December 31, 1985.

* * *

Investments and Investment Income

Significant amounts of investment income are generated by investments in securities by members of the Berkshire Hathaway Insurance Group. Investable funds of the Insurance Group derive from extensive capital funds committed to the operations, and from policyholder funds derived from unearned premium and loss reserves. Also, additional investment income, varying in amount from year to year, derives from securities held from time to time by Berkshire and by Berkshire subsidiaries outside of the Insurance Group. Additional information regarding investments in securities, investment income and realized gains from securities transactions is reflected in the accompanying consolidated financial statements and notes thereto.

* * *

Berkshire's executive offices are in Omaha, Nebraska.

* * *

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 of net earnings. Extensive data with respect to the various Berkshire operations appears in Note 17 (the "Segment Note") to the Consolidated Financial Statements appearing elsewhere herein. This discussion should be read in conjunction with that data. The section of this report relating to "Business Activities of the Company . . ." at pages 44 to 48 is also pertinent.

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*		
	1985	*1984*	*1983*
Insurance underwriting	$ (23,569)	$ (25,955)	$ (18,400)
Candy business	13,583	12,406	11,498
Newspaper business	13,980	12,717	8,518
Retailing of home furnishings	4,672	5,451	1,352
Interest and dividend income	86,204	71,017	53,341
Interest and financing costs	(7,288)	(7,452)	(7,346)
Other operating items, net	5,366	2,017	(319)
Earnings before realized investment gain	92,948	70,201	48,644
Realized investment gain, net	342,867	78,694	63,522
Net earnings	$435,815	$148,895	$112,166

Insurance underwriting

A summary of the underwriting results of the Berkshire Hathaway Insurance Group is presented below, on the basis of generally accepted accounting principles ("GAAP"), for the past three years, with dollars in thousands:

	1985		*1984*		*1983*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Premiums written	$497,400		$133,558		$149,849	
Premiums earned	317,059	100.0	140,242	100.0	152,480	100.0
Losses and loss expenses	280,249	88.4	141,550	100.9	134,109	87.9
Underwriting expenses	81,040	25.6	46,752	33.4	52,243	34.3
Total losses and expenses	361,289	114.0	188,302	134.3	186,352	122.2
Underwriting loss — pre-tax	(44,230)		(48,060)		(33,872)	
Applicable income tax credit	20,346		22,105		15,472	
Applicable minority interest	315		—		—	
After-tax loss	$ (23,569)		$ (25,955)		$ (18,400)	

The percentage figures 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, underwriting results, computed on a GAAP basis, 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%.

Insurance Underwriting *(Continued)*

For a period of several years prior to 1985, the insurance industry's prices (premium rates) were inadequate to cover its costs, and coverages were quite readily available to insurance buyers. That changed, commencing in 1984, but more significantly in 1985, when premium rates increased significantly, financial failures occurred in the industry, and a decrease occurred in the industry's insuring capacity. The extensive financial resources of the Berkshire Hathaway Insurance Group permitted it to significantly increase its volume of business in 1985, as the number of business offerings to the group, at higher prices, increased.

Summaries of aggregate loss and loss expense data for the Berkshire Hathaway Insurance Group for the past three years are shown in the following table.

	000s Omitted		
	1985	*1984*	*1983*
Unpaid losses and loss expense at beginning of year	$243,298	$212,706	$193,477
Incurred losses recorded:			
Current year occurrences	257,384	122,043	130,101
All prior years' occurrences	22,865	19,507	4,008
	280,249	141,550	134,109
Payments with respect to:			
Current year occurrences	36,439	32,648	43,062
All prior years' occurrences	75,803	78,310	71,818
	112,242	110,958	114,880
Unpaid losses and loss expense at end of year	$411,305	$243,298	$212,706

Adverse loss development is represented by the figures for incurred losses captioned "All prior years' occurrences" ($22,865,000 for 1985, $19,507,000 for 1984, and $4,008,000 for 1983). These figures represent increases in the given year to the estimates of prior years' loss occurrences, based on information that came to light in that given year with respect to such prior occurrences. If the prior year-end estimation processes would have been perfect, all of the costs related to prior years' occurrences would have been charged to prior years' results. Thus, the amount of "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. It is 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 will become available and events will 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. 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.

* * *

Aggregation of underwriting data of the Berkshire Hathaway Insurance Group serves a purpose in any broad analysis of Berkshire's total operations. However, analysis and discussion that deals only with Berkshire's insurance operations requires further disaggregation of Insurance Group data. Various sub-groupings are possible, one of which is reflected in the last two tables of the Segment Note appearing at page 41. That breakdown aligns with managements' view of the components of Berkshire's insurance business. The balance of this discussion centers around that breakdown, summarized as to (i) business other than reinsurance assumed, and (ii) reinsurance assumed.

Insurance Underwriting *(Continued)*

Insurance Operations Excluding Reinsurance Assumed Business

A summary follows of the combined underwriting results of the Berkshire Hathaway Insurance Group, excluding reinsurance assumed business. Dollars are in thousands.

	1985		*1984*		*1983*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Premiums written	$269,057		$118,090		$119,809	
Premiums earned	184,333	100.0	119,266	100.0	122,754	100.0
Losses and loss expenses	140,029	76.0	110,491	92.6	102,880	83.8
Underwriting expenses	52,451	28.4	41,628	34.9	44,994	36.7
Total losses and expenses	192,480	104.4	152,119	127.5	147,874	120.5
Underwriting loss — pre-tax	(8,147)		(32,853)		(25,120)	
Applicable income tax credit	3,748		15,110		11,474	
After-tax loss	$ (4,399)		$ (17,743)		$ (13,646)	

Administrative costs, largely charged to underwriting expenses, did not increase in proportion to the increase in premiums written, with the result that a meaningful decrease, from 34.9% in 1984 to 28.4% in 1985, is reflected for premium acquisition costs.

Significant adverse loss development in these businesses was recorded in 1984, as shown below. It amounted to $8,105,000 and it contributed 6.8 points to the 1984 loss and loss expense ratio. In contrast, adverse loss development in 1985 was only nominal. Summarized below is loss and loss expense data for the Berkshire Hathaway Insurance Group's business, excluding reinsurance assumed business, for the past three years.

	000s Omitted		
	1985	*1984*	*1983*
Unpaid losses and loss expense at beginning of year	$164,776	$150,804	$144,091
Incurred losses recorded:			
Current year occurrences	139,966	102,386	103,861
All prior years' occurrences	63	8,105	(981)
	140,029	110,491	102,880
Payments with respect to:			
Current year occurrences	35,419	36,608	40,553
All prior years' occurrences	60,150	59,911	55,614
	95,569	96,519	96,167
Unpaid losses and loss expense at end of year	$209,236	$164,776	$150,804

Insurance Underwriting *(Continued)*

Reinsurance Assumed Activities

The combined underwriting results of the Berkshire Hathaway Insurance Group for subsegments of the business involving reinsurance assumed, other than Structured settlements and portfolio reinsurance, are summarized in the following table, with dollars in thousands.

	1985		*1984*		*1983*	
	Amount	%	*Amount*	%	*Amount*	%
Premiums written	$178,502		$ 10,542		$ 26,774	
Premiums earned	82,877	100.0	16,066	100.0	26,460	100.0
Losses and loss expenses	85,670	103.4	23,720	147.6	27,358	103.4
Underwriting expenses	27,180	32.8	4,906	30.5	7,174	27.1
Total losses and expenses	112,850	136.2	28,626	178.1	34,532	130.5
Underwriting loss — pre-tax	(29,973)		(12,560)		(8,072)	
Applicable income tax credit	13,788		5,777		3,687	
Applicable minority interest	315		—		—	
After-tax loss	$ (15,870)		$ (6,783)		$ (4,385)	

Summarized below is loss and loss expense data with respect to the above summarized assumed business for the past three years.

	000s Omitted		
	1985	*1984*	*1983*
Unpaid losses and loss expense at beginning of year	$ 47,867	$ 45,664	$ 45,820
Incurred losses recorded:			
Current year occurrences	66,228	14,055	22,773
All prior years' occurrences	19,442	9,665	4,585
	85,670	23,720	27,358
Payments with respect to:			
Current year occurrences	5,155	4,212	11,687
All prior years' occurrences	14,191	17,305	15,827
	19,346	21,517	27,514
Unpaid losses and loss expense at end of year	$114,191	$ 47,867	$ 45,664

The above data includes the significant amounts that resulted from the quota-share reinsurance arrangement involving 7% of the post 8/31/85 business of Fireman's Fund Insurance Companies ("FFC"). (See the Segment Note.) None of the adverse development ("All prior years' occurrences") reflected in the immediately preceding table relates to the FFC arrangements since those arrangements did not involve assumption of any FFC's prior occurrence liabilities. All of the adverse development reflected in the preceding table relates to other reinsurance contracts written in earlier years. Significant adverse development in reinsurance assumed business has been common to the reinsurance industry in recent years. Its revelation has been a major contributing cause to the shrinkage in capacity that has occurred in the reinsurance market.

Comparable summaries of the Structured settlements and portfolio subsegment of the reinsurance business are not informative, since different ratio analyses are applicable, depending on the varying nature of the several different arrangements included in this very specialized area. Reference is made to the Segment Note which reflects this subsegment's premium and pre-tax loss information.

Candy Business

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

	000s omitted			
	Profit before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings*
1985	$28,014	$14,431	$ —	$13,583
1984	25,670	13,264	—	12,406
1983	26,697	13,712	1,487	11,498

This business became wholly-owned by Berkshire in 1983 as a result of the merger of Blue Chip Stamps. For some time prior to that merger, See's was approximately 60% beneficially owned by Berkshire.

Unit volume (pounds of candy sold) has been relatively static in the past three years, actually declining somewhat on a store-for-store basis. In 1984, a nominal percentage increase in selling price was somewhat less than the percentage increases in yearly costs, so that profit before taxes in 1984 declined slightly from 1983. A somewhat higher percentage increase in 1985 selling prices — about 6% — overcame the percentage increase in costs, permitting increased 1985 profit.

Newspaper Business

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

	000s omitted			
	Profit before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings*
1985	$29,321	$15,341	$ —	$13,980
1984	26,728	14,011	—	12,717
1983	19,039	9,000	1,521	8,518

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.

In both 1985 and 1984 advertising and circulation revenues each increased from the immediately preceding year. Total revenues in 1985 increased about 6% over 1984 amounts. Revenues in 1984 increased 12% over 1983. A lesser rate of increase in costs in each of the two most recent years 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. In both 1985 and 1984, income of the News was fully subject to both state and federal income taxes.

Retailing of Home Furnishings

The table below reflects data with respect to the Nebraska Furniture Mart's operations for periods after Berkshire's purchase on September 30, 1983.

	000s omitted			
	Profit before taxes	*Applicable income taxes*	*Applicable minority interest*	*Net earnings*
1985	$12,177	$6,210	$1,295	$4,672
1984	14,044	7,064	1,529	5,451
1983 (3 months) ...	3,642	1,909	381	1,352

Revenues in 1985 were about 4% greater than in 1983. However, gross margins declined moderately, and operating costs increased moderately. The latter reflected higher costs incurred with respect to computerized systems for inventory location and control and in other areas of costs relating to customer service.

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*
1985	$107,662	$19,865	$1,593	$86,204
1984	84,161	11,802	1,342	71,017
1983	64,903	8,018	3,544	53,341

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. See Note 13 to the accompanying financial statements. Total interest and dividend income has increased as the amount of investments has increased. Tax-exempt interest income increased significantly from $9,677,000 in 1983 to $23,896,000 in 1984 and to $36,579,000 in 1985. The increases resulted from increased investment in Washington Public Power Supply System bonds.

Realized Investment Gain

This part of the discussion in past years has included a recitation that a significant component of Berkshire's net earnings has historically resulted from 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.

In 1985, realized investment gain was unusually high because of the sale by Berkshire subsidiaries to Philip Morris Company, in response to a tender offer at a large premium over the then prevailing market price, of their significant investment in General Foods Corporation. That transaction contributed about two thirds of the 1985 realized investment gain. See also Note 15 to the Consolidated Financial Statements.

Liquidity and Capital Resources

Berkshire maintains liquidity beyond industry norms. But, the amount of cash and temporary cash investments held by Berkshire at year-end 1985 was abnormally high, even for Berkshire, because of significant commitments that then existed against those funds. In March, 1985, Berkshire committed itself to purchase for $517,500,000 cash, the three million shares of Capital Cities that it purchased just a few days after 1985 year-end. Further, the Scott Fetzer merger, effected with cash, occurred early in January, 1986. An unaudited pro forma balance sheet of Berkshire is presented in Note 18 to the Consolidated Financial Statements herein. It reflects what Berkshire's financial condition would have been if those two transactions would have occurred at year-end instead of occurring, as they did, just after year-end.

That pro forma balance sheet reflects continuing significant capital strength and liquidity. Berkshire's financial strength and liquidity enabled it to respond quickly to the opportunity to acquire Scott Fetzer. The sale of the General Foods stock made funds available that otherwise would have been required from other of Berkshire's resources; it also permitted Berkshire to cancel, on October 18, 1985, its $175 million line-of-credit arrangements with banks.

Berkshire's equity capital, as reflected in its year-end consolidated balance sheets, has increased $1,157,847,000 in the past three years, from $727,483,000 at the beginning of 1983, to $1,885,330,000 at the end of 1985. Berkshire's obligations continue to include those of a fiduciary nature, to policyholders of its insurance subsidiaries, to savers of Blue Chip trading stamps, and to others. Management expects Berkshire to maintain significant margin of safety for meeting those obligations.

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. This is not expected to change appreciably as the result of the Scott Fetzer merger.

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.

The 1985 Annual Report of Wesco Financial Corporation included the following letter to Wesco stockholders from the Chairman of the Company.

WESCO FINANCIAL CORPORATION
LETTER TO SHAREHOLDERS

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 1985 decreased to $8,347,000 ($1.17 per share) from $10,060,000 ($1.42 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 $51,541,000 ($7.24 per share) from $23,656,000 ($3.32 per share) in the previous year.

A highly unusual capital gain, of a not-likely-to-recur type, from disposition of General Foods stock caused most of the net income in 1985. The table below gives particulars.

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

	Year Ended			
	December 31, 1985		December 31, 1984	
	Amount	Per Wesco Share	Amount	Per Wesco Share
"Normal" net operating income (loss) of:				
Mutual Savings	$ 3,342	$ .47	$ 3,476	$ .49
Precision Steel businesses	2,010	.28	2,034	.29
Wesco-Financial Insurance business—				
Underwriting	(1,584)	(.22)	—	—
Investment activity	1,225	.17		
	(359)	(.05)		
All other "normal" net operating income[2]	3,354	.47	4,550	.64
	8,347	1.17	10,060	1.42
Fluctuation in market value of GNMA futures contract	1,671	.24	458	.06
Net gains on sales of securities[3]	41,523	5.83	13,138	1.84
Wesco consolidated net income	$51,541	$7.24	$23,656	$3.32

[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 and insurance subsidiaries.

[3] The 1985 figure includes a $34,363,000 ($4.83 per share) gain realized by Wesco on the sale of its General Foods Corporation common stock to Philip Morris Company in connection with the latter's publicly announced tender offer. See "Net Gains on Sales of Securities" below.

This supplementary breakdown of earnings differs somewhat from that used in audited financial statements which follow standard accounting convention. The supplementary breakdown is furnished because it is considered useful to shareholders.

Mutual Savings

Mutual Savings' "normal" net operating income of $3,342,000 in 1985 represented a decrease of 4% from the $3,476,000 figure the previous year.

Separate balance sheets of Mutual Savings at yearend 1984 and 1985 are set forth at the end of this annual report. They show (1) total savings accounts rising to $269 million from $228 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, (4) a loan portfolio (mostly real estate mortgages) of about $83 million at the end of 1985, down 12% from the $95 million at the end of 1984, and (5) favorable effects of securities gains and other unusual gains and fluctuations, which caused net worth to decline only $4 million in 1985 despite payment of a dividend of $14 million to the parent corporation.

The loan portfolio at the end of 1985, although containing almost no risk of loss from defaults, bore a fixed average interest rate of only 7.60%, 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. However, as the loan payoff pace intensified and interest rates declined sharply in 1985, the unrealized depreciation in the loan portfolio became approximately offset by unrealized appreciation in Mutual Savings' interest-bearing securities and preferred stocks.

As pointed out in footnote 13 to the accompanying financial statements, the book value of Wesco's equity in Mutual Savings ($57.6 million at December 31, 1985) overstates the amount realizable, after taxes, from sale or liquidation at book value. If all Mutual Savings' assets, net of liabilities, were to be sold, even pursuant to a plan of complete liquidation, for the $57.6 million in book value reported under applicable accounting convention, the parent corporation would receive much less than $57.6 million after substantial income taxation imposed because about $47 million of what is designated shareholders' equity for accounting purposes is considered bad debt reserves for most tax purposes.

There is, however, a buried plus value in Mutual Savings. The foreclosed property on hand (mostly 22 largely oceanfront acres in Santa Barbara) has become worth over a long holding period much more than its $1.5 million balance sheet carrying cost. Reasonable, community-sensitive development of this property has been delayed over 10 years in the course of administration of land-use laws. But we are optimistic that an end to the delay is near and that the Santa Barbara and Montecito communities will be very pleased with the development now likely to go forward. This development will contain 32 houses interspersed with large open areas. Mutual Savings plans to make the development first rate in every respect, and unique in the quality of its landscaping.

Balancing all merits and demerits, Mutual Savings, as it has been managed under present conditions by the writer and others, is no jewel of a business from the shareholders' point of view. Mutual Savings' good points are: (1) high asset quality and sound balance sheet; (2) a maturity match of interest-bearing assets and liabilities which makes risk of insolvency near zero, whatever happens to interest rates; and (3) a deserved reputation for high quality service to account holders, achieved at below-average cost to the institution in an efficient one-large-office operation, as distinguished from a many-small-branch-offices operation. Mutual Savings' bad points are: (1) all recent growth in savings accounts, considered on an incremental effects basis, has been loss business because interest and other costs incurred exceed income obtained by employing proceeds in short-term interest-bearing assets; (2) a burdensome position under the FSLIC account-insurance system causes payments of ever-higher amounts into the system to help bail out more venturesome savings and loan associations which become insolvent, with the payments being required despite the fact that Mutual Savings imposes almost no risk on FSLIC; (3) "normal" net operating income is below an acceptable rate of return on present book value of shareholders' equity, with such return reaching an acceptable level over recent years only with help from securities gains and other unusual items; (4) it would not be easy to leave the savings and loan business, should this course of action ever be desired, without a large income tax burden of a type not applied to corporations other than savings and loan associations; (5) the regulatory structure of the savings and loan business creates a competitive situation in which it is hard to make respectable profits through careful operations; and (6) management has not yet found an acceptable remedy for any of the previously listed bad points, despite years of trying.

Moreover, comparisons of post-1984 financial results for Mutual Savings with results for many other and more typical savings and loan associations in California leave Mutual Savings looking inferior, to put it mildly. As interest rates went down these other associations, which have greater financial leverage and operated less fearfully than Mutual Savings during former high-interest periods, came to have loan and investment portfolios which (1) now are worth more on average than book value and (2) now produce a high return on book value of shareholders' equity, after deduction of operating expenses and interest to account holders at present rates. Any Wesco shareholder who thinks Mutual Savings has any expertise in predicting and profiting from interest rate changes can look at the 1985 record and despair.

Despite the fact that some other savings and loan associations did much better after 1984 than Mutual Savings, and are now much better poised to report good figures for 1986, we plan to continue operating only in ways acceptable in our own judgment, anticipating as a consequence widely fluctuating and sometimes inadequate returns. In the future, however, Mutual Savings will make and purchase more loans. Now that Mutual Savings' old mortgage loans have declined in amount and increased in market value (the market value increase being caused both by a decline in generally prevailing interest rates and by a shortening of remaining loan life), new loans will be added as seems wise, with a target that 60% of assets be in housing-related loans. The first new direct loan in some time, an adjustable rate mortgage with no cap on future interest rate changes but with an extremely low "spread" for the lender, will shortly be closed. We are not at all excited by our prospects as we now make housing loans of this type, but we wish to get some renewal of direct mortgage lending under way.

With assets not employed in direct real-estate lending, Mutual Savings continues not only to make payments to FSLIC far in excess of fair charges for risks imposed on FSLIC but also to employ a large part of total assets in short-term loans to the Federal Home Loan Bank. These practices are pro-social but will continue to reduce profits.

Mutual Savings also continues to support the Federal Home Loan Bank Board in its efforts to change the present rules of the savings and loan business to augment average soundness of FSLIC-insured associations. We retain our opinion that the present rules, despite some improvement in 1985 through wise efforts of the Federal Home Loan Bank Board, are unsound, from the country's point of view. Too much latitude is allowed financial "swingers" to grow as they gamble, through use of account guarantees from FSLIC, an agency of the U.S. Government, while they offer whatever it takes in interest rates to attract more accounts.

With money being the ultimate fungible commodity, it seems to us that the rules create a super-competitive, commodity-type business, in which (1) economic law probably destines most careful associations, like other fungible-commodity dealers, to realize very modest returns on shareholders' equity over extended time periods, yet (2) good financial results can nonetheless usually be reported in each near-term period by managers-in-charge through aggressive deposit-expanding, lending and investing measures which increase risk, while (3) the importance and rewards of managers, who usually have little downside risk as owners, are tied mostly to institutional size and recently reported numbers. With managers mostly being non-owners, a sort of Gresham's law of competitive-yet-deposit-insured banking, "bad loans drive out good," tends to work with extra force as managers fear being left out of whatever activity allows competing managers to report high profits while bidding high for deposits. We see no reason for assuming that ethical, intelligent managers in the savings and loan industry are immune from effects similar to those which caused similar managers of all major U.S. banks to place significant portions of assets in now-regretted foreign loans, rather than stand apart from the crowd. If our diagnosis is correct, a lot of serious trouble lies ahead (perhaps far ahead) for U.S. savings and loan associations.

While present rules and practices have a positive side in causing satisfaction of almost 100% of demand for those housing loans which are sound at the prevailing interest rate, this accomplishment is accompanied by much unsound housing and other lending and by much unsound investment in "junk bonds" and other assets unsuitable for highly leveraged, federally insured, deposit-taking institutions. The system design in place would probably be a flunking design in an engineering course, where the emphasis would be on preserving the integrity of an essential system by a margin of safety, by being content with rules which (1) caused satisfaction of, say, only 95% of requests for sound credit extension and (2) forced more conservative conduct on banks and savings and loan associations.

The present design, we think, would probably also be a flunking design in a surgery course, where the wise practice is to remove some healthy cells along with cancerous cells, based on margin-of-safety principles. We hope we are wrong about the present design of the savings and loan system, but we fear increased, widespread adversity, ultimately reaching housing borrowers and would-be housing borrowers, whose interests we consider important. Any such adversity would probably be followed by changes in the rules. No doubt, our judgment as to the probable temporary nature of present savings and loan industry structure and practices has helped deter us from direct lending of a conventional sort which otherwise would have occurred. Our attitude, right or wrong, during recent tumultuous changes in the savings and loan industry, has been roughly that of the French grandfather who replied when asked what he did in the great revolution: "I got through." We also think something good could eventually happen to Mutual Savings because future trouble in the savings and loan business may create opportunities worth seizing.

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, the company 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 $2,010,000 to "normal" net operating income in 1985, down 1% compared with $2,034,000 in 1984. Such a modest decrease in 1985 profit was achieved in spite of decreased sales (down 7% to $51,124,000).

Under the skilled 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.

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 $9,140,000 to 1985 sales at a profit margin 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 available liquid assets.

Wesco-Financial Insurance Company

A new business was added to the Wesco group in 1985, in co-venture with Wesco's 80% owner and ultimate parent corporation, Berkshire Hathaway Inc.

With the enthusiastic approval of all Wesco's directors, including substantial Wesco shareholders in the Peters and Caspers families, without whose approval such action would not have been taken, Wesco invested $45,000,000 in cash equivalents in a newly organized, wholly owned, Nebraska-chartered insurance company, Wesco-Financial Insurance Company ("Wes-FIC").

The new subsidiary, Wes-FIC, then reinsured, through another Berkshire Hathaway insurance company subsidiary as intermediary-without-profit, 2% of the entire book of insurance business of the long-established Fireman's Fund Corp. (listed on the NYSE).

Wes-FIC thereby assumed the benefits and burdens of Fireman's Fund's prices, costs and losses under a contract covering all insurance premiums earned by Fireman's Fund during a four-year period commencing September 1, 1985. The arrangement puts Wes-FIC in almost exactly the position it would have been in if it, instead of Fireman's Fund, had directly written 2% of the business. Differences in results should occur only from the investment side of insurance, as Wes-FIC, instead of Fireman's Fund, invests funds from "float" generated. Wes-FIC's share of premiums earned in 1986 is expected to be over $60 million.

Wes-FIC's separate financial statements, covering the brief period of its existence, September 1, 1985, to December 31, 1985, are included on pages 29 and 30 of this Annual Report, and show that Wes-FIC experienced a small 1985 reduction in net worth, from $45,000,000 to $44,676,000.

We do not consider this four-month result to have significant predictive value with respect to the future. The price of insurance is rising, with price increases not yet fully reflected in 1985 numbers. Moreover, the financial statements are of questionable accuracy and could be wrong in either direction. It is in the nature of even the finest casualty insurance businesses that in keeping their accounts they must estimate and deduct all future costs and losses from premiums already earned. Uncertainties inherent in this undertaking make financial statements more mere "best honest guesses" than is typically the case with accounts of non-insurance-writing corporations. And the reinsurance portion of the casualty insurance business, because it contains one or more extra links in the loss-reporting chain, usually creates more accounting uncertainty than the non-reinsurance portion. Finally, Wes-FIC's initial financial statements have a disadvantage in that the period covered is short, making any use of the reported past cost-price ratio extra dubious as an indicator of any probable future cost-price ratio, due to the small size of the sample forming a base for projection.

It is entirely too soon to forecast future results for Wes-FIC, but Wesco hopes for: (1) a reasonable return on its investment over the four years of the Fireman's Fund reinsurance contract, and (2) possible future reinsurance contracts with other insurers.

Wesco has high regard for John Byrne, newly appointed CEO and also a large shareholder and stock-option holder of Fireman's Fund. Mr. Byrne was an outstanding insurance company manager in his previous position as CEO of GEICO CORPORATION (38%-owned, but not controlled, by Berkshire Hathaway), which improved enormously during his stewardship. Fireman's Fund's insurance business is intrinsically more cyclical and less-advantaged than GEICO's core insurance business, which has lower distribution costs from a different, "direct-writing" distribution system. Thus Fireman's Fund's business will almost surely be much more difficult to improve permanently than was the case at GEICO. However, Mr. Byrne and other Fireman's Fund executives know all this very well, and, with improvement less spectacular than previous improvement at GEICO, Fireman's Fund and Wes-FIC could both prosper.

Industry-wide conditions, as well as managerial excellence, affect Wes-FIC's prospects under the reinsurance contract with Fireman's Fund. Large premium increases now going into effect throughout the casualty insurance business could provide some welcome tailwind effects, instead of the headwind effects of the period just ended, which was one of the worst in history.

We are pleased with our relationship with Fireman's Fund, which has a long and distinguished record, going all the way back to superb performance after the great San Francisco earthquake and fire, and which is affiliated with the even longer established American Express Company, one of the premier corporations in the United States.

However, Wesco's optimism about quality of Fireman's Fund, quality of this reinsurance contract, and possible short-term, industry-wide cyclical improvement, is tempered by a larger and longer view of the reinsurance business. That business has the defect of being too attractive-looking to new entrants for its own good and therefore will always tend to be more or less the opposite of, say, the old business of gathering and rendering dead horses, which tended to contain few and prosperous participants.

Troubles, losses, and insolvencies can come fast as the apparent attractions of the reinsurance business, including its seductive receive-pay-in-advance aspects, lure new entrants and encourage expansions by old occupants. The business was a disaster area in recent years, adversely affected by prices which would have been too low in a stable world, plus inflation, new judicial notions tending to augment insurance coverage beyond limits contemplated when policies were issued, and not-minor degradation of commercial behavior.

No doubt recent commercial behavior degradation, particularly noticeable in the reinsurance business on both sides of the purchase counter, was accelerated by general hardship, demonstrating once again the wisdom of Poor Richard's Almanac: "It is hard for an empty sack to stand upright."

Insurance company subsidiaries of Wesco's parent corporation, Berkshire Hathaway, long active in reinsurance, did continue proper commercial behavior during the recent period of industry-wide problems, but financial results from reinsurance were terrible. Thus Wesco shareholders are being led not only into an extra-hazardous place but also by people who met severe reverses on the last trip.

Is there any reasonable hope for Wesco shareholders that its reinsurance business, whatever its short-term merits, will provide an advantageous long-term journey? Yes, one reason for long-term optimism is present. With recent defaults by reinsurers causing everyone to worry more about quality in promisors, Wes-FIC and Berkshire Hathaway expect that their old-fashioned, engineering-type attitudes and financial practices will help create for Wes-FIC an unusual, commercially-useful reputation for issuing trustworthy promises in one or more markets or submarkets wherein most buyers will accept nothing less. Thus, the absence of federal insurance for reinsurance liabilities may create for Wes-FIC a reputation-based competitive advantage which is denied to Mutual Savings by FSLIC's support of all Mutual Savings' competitors through insuring their accounts.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, decreased to $3,354,000 in 1985 from $4,550,000 in 1984. Sources were (1) rents ($2,219,000 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 $41,523,000 in 1985 from $13,138,000 in 1984.

The 1985 figure includes a big after-tax gain ($34,363,000) from sale of General Foods stock to Philip Morris Company. This gain contained a large amount of windfall profit. When Wesco made its investment in General Foods stock several years ago, because General Foods' executives seemed sensible and the stock was available in the market at a conservative price relative to its value as a share of ownership in a presumably ever-continuing independent entity, it was unprecedented and virtually inconceivable that a corporation the size of General Foods would ever be "bear-hugged" into selling out at an immense premium over the then prevailing market price for its stock. But that is what happened, wholly unpredicted by Wesco, in 1985 as old taboos eroded and the great American takeover game swept into new areas.

Bowery Savings Bank

In 1985 Wesco, in another co-venture with its parent corporation, approved by Wesco's directors in the same manner as the Wes-FIC co-venture, joined a group which invested $100,000,000 cash in a newly organized, New York-chartered savings bank. The new bank then took over the name, assets and liabilities of the insolvent Bowery Savings Bank in the city of New York. The takeover received (1) much needed assistance from FDIC, the federal agency, akin to FSLIC, which insures deposits in banks, and (2) the blessing of New York bank regulators. Wesco invested $9,000,000, other Berkshire Hathaway subsidiaries invested $12,384,000, and other unrelated investors invested the balance of the $100,000,000.

The terms of the FDIC assistance, which include income-assistance payments over many years to the newly organized bank, are extremely complex but can be fairly summarized as far from adequate to assure that the investors will make a profit. This is as it should be when $100 million buys a highly-leveraged residual equity position in a $5 billion bank, albeit one with many sick assets.

Any minority-position investment with such extreme financial leverage (in effect buying with a 2% down payment), involving a troubled company in a demanding environment, can fairly be called a venture-capital type investment for Wesco. In our judgment, the prospect for gain justified the risk of loss. The investment involves a small portion (about 5%) of Wesco's consolidated net worth. We consider it financially conservative to risk 3½% of Wesco's net worth, which is roughly the after-tax exposure involved, if we believe a hundred similar bets would, in aggregate, be almost sure to work out successfully.

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 slow pace of acquisition of additional businesses because few are found available, despite constant search, at prices deemed rational from the standpoint of Wesco shareholders.

As indicated in Note 3 to the accompanying financial statements, the aggregate market value of Wesco's marketable equity securities was higher than their aggregate cost at December 31, 1985 by about $5 million, down sharply from about $13 million one year earlier.

Wesco's Pasadena real estate, a full block (containing (1) about 125,000 first class net rentable square feet, including Mutual Savings' space, in a modern office building, plus (2) an additional net rentable 34,000 square feet of economically marginal space in old buildings requiring expensive improvement), has a market value substantially in excess of carrying value, demonstrated by (1) mortgage debt ($5,023,000 at 9.25% fixed) against this real estate now exceeding its depreciated carrying value ($3,158,000) in Wesco's balance sheet at December 31, 1985, and (2) substantial current net cash flow (about $1 million per year) to Wesco after debt service on the mortgage. The modern office building is 96% rented, despite a glut of vacant office space in Pasadena. We charge just-below-standard rents and run the building as a sort of first-class club for tenants we admire. With these practices, a prime location and superior parking facilities, we anticipate future increases in cash flow, but at no better rate than the rate of inflation.

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, investments, both those in the savings and loan and reinsurance subsidiaries and those held temporarily elsewhere pending sale to fund business extension, tend to be concentrated in very few places. Through this practice of concentration of investments, 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 21% in 1983-85, was dependent to a very large extent on securities gains, irregular by nature. The recent ratio is almost certain to decline, quite probably very sharply. Neither possible future acquisitions of other businesses nor possible future securities gains appear likely to cause the recent ratio to continue. The business acquisition game is now crowded with optimistic players who usually force prices for low-leverage acquirers like Wesco to levels where return-on-investment prospects are modest. And, as discussed earlier, the great contribution of 1985 securities gains to Wesco's recent return on shareholders' equity contained a big fluke element. Such fluke gain, rare in any event, tends to come to an investor like Wesco mostly as an unanticipated by-product of an obviously sound investment which does not require any fluke to work out well. Because securities generally traded lower several years ago than they do now, relative to the intrinsic values of the businesses represented by the securities, creating more obviously sound investments then than now, and because prospects for above-average returns tend to go down as assets managed go up, it is now easy to predict less desirable future results. It is also easy for any sophisticated Wesco shareholder, reviewing Wesco marketable securities disclosed in the 1985 Annual Report, to diagnose (correctly) that the decision-makers are dry of good investment ideas.

Wesco is trying more to profit from always remembering the obvious than from grasping the esoteric (including much modern "strategic planning" and "portfolio theory"). Such an approach, while it has worked fairly well on average in the past and will probably work fairly well over the long-term future, is bound to encounter periods of dullness and disadvantage as it limits action. Moreover, the approach is being applied to no great base position. Wesco is sort of scrambling through the years without owning a single business, even a small one, with enough commercial advantage in place to pretty well assure high future returns on its capital. In contrast, Berkshire Hathaway, Wesco's parent corporation, owns three such high-return businesses.

On January 23, 1986, Wesco increased its regular quarterly dividend from 15½ cents per share to 16½ cents per share, payable March 6, 1986, to shareholders of record as of the close of business on February 17, 1986.

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
Charles T. Munger
Chairman of the Board

February 13, 1986

SHAREHOLDER-DESIGNATED CONTRIBUTIONS

The Company has conducted this program of corporate giving for five years. On October 14, 1981, the Chairman sent to the shareholders a letter giving the reasons for the program. 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."

* * *

The history of contributions made pursuant to this program since its inception follows:

Year	*Specified Amount per Share*	*Percent of Eligible* Shares Participating*	*Amount Contributed*	*No. of Charities*
1981	$2	95.6%	1,783,655	675
1982	$1	95.8%	890,948	704
1983	$3	96.4%	3,066,501	1,353
1984	$3	97.2%	3,179,049	1,519
1985	$4	96.8%	4,006,260	1,724

**Shares registered in street name are not eligible to participate.*

In addition to the shareholder-designated contributions summarized above, Berkshire and its subsidiaries continue to make certain contributions pursuant to local level decisions of 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 six weeks — or until about November 30 — to respond with your designation. *Shareholders should note that replies received after that deadline are not processed.*

Shareholders should also note the fact that shares held in street name are not eligible to participate in the program. *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.
SUPPLEMENTAL INFORMATION ON THE EFFECTS OF CHANGING PRICES

(dollars in thousands except per share amounts)

This information is unaudited. 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. Berkshire's management does not use this supplementary data in any of its decision-making activities. Readers' evaluation of the data 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 1985 constant dollars. The latter is determined by the Consumer Price Index.

	Fiscal Year Ended Saturday nearest December 31				
	1985	*1984*	*1983*	*1982*	*1981*
Total revenues:					
As reported*	$ 939,864	$ 729,179	$ 602,726	$521,472	$529,234
As adjusted	939,864	755,196	650,799	581,177	626,218
Earnings from continuing operations before realized investment gain:					
Total as reported*	$ 92,948	$ 70,201	$ 48,644	$ 31,497	$ 39,723
Total as adjusted	92,948	72,706	52,524	35,103	47,002
Per share as reported*	$ 81.04	$ 61.21	$ 45.60	$ 31.93	$ 40.27
Per share as adjusted	81.04	63.39	49.24	35.59	47.65
Stockholders' equity:					
As reported*	$1,885,330	$1,271,761	$1,119,193	$727,483	$519,463
As adjusted	1,885,330	1,317,137	1,208,458	810,775	614,657
Market price per common share at year end:					
Historical amount	$ 2,430	$ 1,275	$ 1,310	$ 775	$ 560
As adjusted	2,430	1,320	1,414	864	663
Average consumer price index (1967 = 100)	322.2	311.1	298.4	289.1	272.3

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

Gain or Loss 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". Hypothetical gain results from holding of net monetary liabilities, i.e., monetary items that are liabilities in excess of monetary items that are assets, since this calculation presumes that the net liabilities can be redeemed with dollars of lower 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 1985 dollars, is as follows:

1985	$4,786
1984	6,707
1983	8,810
1982	6,991
1981	14,937

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.

BERKSHIRE HATHAWAY INC.
SHAREHOLDERS' VIEWS re. ADVISORY MATTERS

May, 1985

SOLICITATION OF VIEWS

The following was distributed to shareholders of the company prior to the company's 1985 shareholders' meeting.

ADVISORY MATTERS — NOT FOR ACTION AT ANNUAL MEETING

The Board of Directors solicits shareholders' views with respect to the matters below. No action is proposed to be taken at the Annual Meeting or at future shareholders' meetings with respect to these matters, and no proxy is solicited with respect thereto. These questions are asked solely to collect for the Board the views of shareholders.

SHAREHOLDER DESIGNATED CONTRIBUTIONS PROGRAM

In both 1983 and 1984, holders of shares of Berkshire Hathaway Inc., if the shares were registered in their name and not in nominee name, were given the opportunity to designate qualifying charities to receive a contribution from the Company at the rate of $3 per share. These contributions reduce earnings, and therefore the value of the holders' investments, by about 50% of the specified amount.

Do you favor (check one): □ Discontinuation of the program

Continuation of the program:
□ At the same $3 rate
□ At a higher ($4-7) rate
□ At a lower ($1-2) rate

DIVIDEND POLICY

For reasons discussed in the 1984 Annual Report the Company has, for some years, reinvested all of its earnings in its various businesses.

Do you favor (check one):

□ Continuation of the policy of reinvesting all earnings rather than payment of any cash dividends

□ Payment annually of cash dividends at a modest rate (5%-15% of operating earnings), with a corresponding reduction in reinvested earnings

□ Payment annually of cash dividends at rates typical of American industry (40%-50% of operating earnings), with a corresponding reduction in reinvested earnings

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TABULATION OF RESPONSES

This tabulation excludes responses of Warren E. Buffett, Susan T. Buffett, and Charles T. Munger with respect to 541,285 shares.

SHAREHOLDER DESIGNATED CONTRIBUTION PROGRAM

		Shares Represented	
Views Expressed In Favor of	*No. of Responses*	*No.*	*Percent of Responses*
Discontinuation	257	12,249	3.2%
Continuation at:			
Same $3 rate per share	948	205,141	52.7%
Higher rate	446	151,767	39.0%
Lower rate	50	13,217	3.4%
Continuation at "some" rate	23	6,532	1.7%
	1,724	388,906	100.0%

DIVIDEND POLICY

		Shares Represented	
Views Expressed In Favor of	*No. of Responses*	*No.*	*Percent of Responses*
Continuing to reinvest all earnings	1,441	342,611	87.8%
Paying modest dividend	193	33,453	8.6%
Paying "typical" dividend	149	9,218	2.4%
Paying "some" dividend	1	4,600	1.2%
	1,784	389,882	100.0%

BERKSHIRE HATHAWAY INC.
COMMON STOCK DATA

Shareholders

The Company had approximately 3,800 record holders of its common stock at March 4, 1986.

Market Prices

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market and price quotations are reported through the National Association of Securities Dealers Automated Quotation System ("NASDAQ") under the symbol BKHT. On April 16, 1985, Berkshire was entered in NASDAQ's National Market System ("NMS"). Thus, the following information includes bid quotations for 1984 and for 1985 (through April 16) which represent prices between dealers which do not include retail markup, markdown or commission. They do not represent actual transactions. Quotations subsequent to Berkshire's entry into the NMS are high and low selling prices.

1985	*High*	*Low*	1984	*High*	*Low*
First Quarter	$1,930	$1,275	First Quarter	$1,360	$1,240
Second Quarter	2,160	1,725	Second Quarter	1,345	1,220
Third Quarter	2,235	2,005	Third Quarter	1,305	1,230
Fourth Quarter	2,730	2,075	Fourth Quarter	1,305	1,265

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.

(96)

BERKSHIRE HATHAWAY INC.
Selected Financial Data for the Past Five Years
(dollars in thousands — except per share amounts)

	1981	1982	1983	1984	1985
Revenues of consolidated companies					
Insurance premiums earned	$ 159,013	$ 152,945	$ 152,480	$ 140,242	$ 317,059
Sales and service revenues	312,105	306,564	381,674	500,219	508,764
Interest and dividend income	54,035	58,003	64,903	84,161	107,662
Earnings					
Before realized investment gain	$ 39,723	$ 31,497	$ 48,644	$ 70,201	$ 92,948
Realized investment gain	22,881	14,877	63,522	78,694	342,867
Net earnings	$ 62,604	$ 46,374	$ 112,166	$ 148,895	$ 435,815
Common shares outstanding — average in thousands	986	987	1,067	1,147	1,147
Earnings per share					
Before realized investment gain	$ 40.27	$ 31.93	$ 45.60	$ 61.21	$ 81.04
Net earnings	63.47	47.01	105.15	129.82	379.99
Year-end data					
Total assets	$1,199,837	$1,514,431	$1,837,543	$2,035,203	$3,180,718
Term debt and other borrowings ...	130,192	169,947	128,984	127,104	117,879
Minority shareholders' interest	81,762	101,177	17,990	22,299	34,360
Stockholders' equity — total	519,463	727,483	1,119,193	1,271,761	1,885,330
Shares of common stock outstanding — in thousands	987	987	1,147	1,147	1,147
Stockholders' equity per outstanding share	$ 526.57	$ 737.43	$ 975.83	$ 1,108.77	$ 1,643.71

Next Page 99 98 start

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

INSURANCE GROUP

Thomas A. Bolt	President	Cypress Insurance Company 1017 South Fair Oaks Ave., Pasadena, CA 91105
Joseph W. Elliott	President	Cornhusker Casualty Company 9140 West Dodge Road, Omaha, NE 68114
Steven Gluckstern	General Manager	Reinsurance Division National Indemnity Company/Columbia Insurance Company 2 Penn Center Plaza, Suite 1400, Philadelphia, PA 19102
Robert A. Lauridsen	President	Redwood Fire & Casualty Company 1111 Bayhill Drive, Suite 180, San Bruno, CA 94066
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 V. Taylor	President	Kansas Fire & Casualty Company 400 Kansas Avenue, Topeka, KS 66601
Donald F. Wurster	General Manager	Structured Settlements/Loss Portfolio Assumptions/Large Risks National Indemnity Company/Columbia Insurance Company 3024 Harney Street, Omaha, NE 68131

OTHER OPERATIONS

Louie Blumkin	President	Nebraska Furniture Mart, Inc. 700 South 72 Street, Omaha, NE 68114
Harold R. Dettmann	President	Mutual Savings & Loan Association 315 East Colorado Blvd., Pasadena, CA 91109
Page E. Golsan, III	President	K & W Products Division 8319 So. Allport Avenue, Santa Fe Springs, CA 90670
David G. Hillstrom	President	Precision Steel Warehouse, Inc. 3500 North Wolf Road, Franklin Park, IL 60131
Charles N. Huggins	President	See's Candy Shops, Incorporated 210 El Camino Real, South San Francisco, CA 94080
Donald A. Koeppel	President	Blue Chip Stamps 5801 South Eastern Avenue, Los Angeles, CA 90040
Bernard C. Kyrouac	President	Associated Retail Stores, Inc. 50-01 Northern Boulevard, Long Island City, NY 11101
Stanford Lipsey	Publisher	Buffalo News One News Plaza, Buffalo, NY 14240

BERKSHIRE HATHAWAY INC.
Executive Offices — 1440 Kiewit Plaza, Omaha, Nebraska 68131