Berkshire Hathaway Inc.

1987
ANNUAL REPORT TO THE STOCKHOLDERS

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

	1967	1972	1977	1982	1987
Revenues of consolidated companies:					
Sales and service revenues	$ 39,056	$ 27,742	$203,752	$ 306,564	$1,332,840
Insurance premiums earned	—	59,627	143,087	152,945	824,895
Interest and dividend income	296	6,785	16,796	58,003	163,341
Earnings data:					
Before realized investment gain	$ 1,007	$ 11,116	$ 23,472	$ 31,497	$ 214,746
Realized investment gain	100	1,010	6,921	14,877	19,806
Net earnings	$ 1,107	$ 12,126	$ 30,393	$ 46,374	$ 234,552
Year-end data:					
Total assets	$ 37,995	$176,109	$646,678	$1,514,431	$5,379,735
Term debt and other borrowings	2,629	9,641	55,104	169,947	132,165
Minority shareholders' interest	—	—	47,926	101,177	45,871
Stockholders' equity — total	30,161	68,295	206,735	727,483	2,841,659
Shares of common stock outstanding — in thousands	985	980	1,038	987	1,147
Shareholders' equity per outstanding share	$ 30.62	$ 69.69	$ 199.17	$ 737.06	$ 2,477.47

Data is shown as previously reported, except that data for 1972 reflects insurance subsidiaries on a consolidated basis consistent with the presentation practice for later years. The 1987 fiscal year ended on December 31. The 1967 fiscal year ended on September 30. Other years ended on the Saturday nearest December 31.

BERKSHIRE HATHAWAY INC.

1987 ANNUAL REPORT

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BERKSHIRE HATHAWAY INC.

OWNER-RELATED BUSINESS PRINCIPLES

Reproduced from the Chairman's letter in 1983 Annual Report

- 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 "wish list" 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 managers: 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.

Business Activities

Berkshire Hathaway Inc. is a holding company owning subsidiaries engaged in a number of diverse business activities. The most important of these is the property and casualty insurance business conducted nationwide on both a direct and reinsurance basis through a number of subsidiaries collectively referred to in this report as the Berkshire Hathaway Insurance Group. Business activities conducted by other subsidiaries include publication and distribution of encyclopedias and related educational and instructional material (World Book and Childcraft products), manufacture and marketing of home cleaning systems and related accessories (sold principally under the Kirby name), manufacture and sale of boxed chocolates and other confectionery products (See's Candies), publication of a daily and Sunday newspaper in upstate New York (the Buffalo News), retailing of home furnishings (the Nebraska Furniture Mart) and manufacture and distribution of uniforms (The Fechheimer Brothers Company). Wesco Financial Corporation, a publicly traded and 80.1% owned subsidiary of Berkshire, owns a California chartered savings and loan company (Mutual Savings and Loan Association, Pasadena, California), a property and casualty insurer (which is included in the Berkshire Hathaway Insurance Group) and a steel service center business.

Significant amounts of income are generated by investment activity that centers in the Berkshire Hathaway Insurance Group. Equity investments generally are made in the stocks of a limited number of companies. Very significant equity investments at present include ownership of approximately 42% of the outstanding capital stock of GEICO Corporation, approximately 18% of the capital stock of Capital Cities/ABC, Inc., $700,000,000 face amount of 9% convertible preferred stock of Salomon Inc having approximately 12% of the total voting power of that company and approximately 13% of the capital stock of The Washington Post Company. Much about these four companies is available to the public, including considerable information released from time to time by the companies themselves.

Operating decisions for the various Berkshire subsidiary businesses are made by managers of the business units. Investment decisions and all other capital allocation decisions are made for Berkshire and its subsidiaries by Warren E. Buffett, in consultation with Charles T. Munger. Mr. Buffett is Chairman and Mr. Munger is Vice Chairman of Berkshire's Board of Directors. Additionally, Mr. Munger is Chairman of Wesco's Board of Directors.

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BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 1987 was $464 million, or 19.5%. Over the last 23 years (that is, since present management took over), our per-share book value has grown from $19.46 to $2,477.47, or at a rate of 23.1% compounded annually.

What counts, of course, is the rate of gain in per-share business value, not book value. In many cases, a corporation's book value and business value are almost totally unrelated. For example, just before they went bankrupt, LTV and Baldwin-United published yearend audits showing their book values to be $652 million and $397 million, respectively. Conversely, Belridge Oil was sold to Shell in 1979 for $3.6 billion although its book value was only $177 million.

At Berkshire, however, the two valuations have tracked rather closely, with the growth rate in business value over the last decade moderately outpacing the growth rate in book value. This good news continued in 1987.

Our premium of business value to book value has widened for two simple reasons: We own some remarkable businesses and they are run by even more remarkable managers.

You have a right to question that second assertion. After all, CEOs seldom tell their shareholders that they have assembled a bunch of turkeys to run things. Their reluctance to do so makes for some strange annual reports. Oftentimes, in his shareholders' letter, a CEO will go on for pages detailing corporate performance that is woefully inadequate. He will nonetheless end with a warm paragraph describing his managerial comrades as "our most precious asset." Such comments sometimes make you wonder what the other assets can possibly be.

At Berkshire, however, my appraisal of our operating managers is, if anything, understated. To understand why, first take a look at page 7, where we show the earnings (on an historical-cost accounting basis) of our seven largest non-financial units: Buffalo News, Fechheimer, Kirby, Nebraska Furniture Mart, Scott Fetzer Manufacturing Group, See's Candies, and World Book. In 1987, these seven business units had combined operating earnings before interest and taxes of $180 million.

By itself, this figure says nothing about economic performance. To evaluate that, we must know how much total capital — debt and equity — was needed to produce these earnings. Debt plays an insignificant role at our seven units: Their net interest expense in 1987 was only $2 million. Thus, pre-tax earnings on the equity capital employed by these businesses amounted to $178 million. And this equity — again on an historical-cost basis — was only $175 million.

If these seven business units had operated as a single company, their 1987 *after*-tax earnings would have been approximately $100 million — a return of about 57% on equity capital. You'll seldom see such a percentage anywhere, let alone at large, diversified companies with nominal leverage. Here's a benchmark: In its 1988 Investor's Guide issue, Fortune reported that among the 500 largest industrial companies and 500 largest service companies, only six had averaged a return on equity of over 30% during the previous decade. The best performer among the 1000 was Commerce Clearing House at 40.2%.

Of course, the returns that Berkshire earns from these seven units are not as high as their underlying returns because, in aggregate, we bought the businesses at a substantial premium to underlying equity capital. Overall, these operations are carried on our books at about $222 million above the historical accounting values of the underlying assets. However, the managers of the units should be judged by the returns they achieve on the underlying assets; what we pay for a business does not affect the amount of capital its manager has to work with. (If, to become a shareholder and part owner of Commerce Clearing House, you pay, say, six times book value, that does not change CCH's return on equity.)

Three important inferences can be drawn from the figures I have cited. First, the current business value of these seven units is far above their historical book value and also far above the value at which they are carried on Berkshire's balance sheet. Second, because so little capital is required to run these businesses, they can grow while concurrently making almost all of their earnings available for deployment in new opportunities. Third, these businesses are run by truly extraordinary managers. The Blumkins, the Heldmans, Chuck Huggins, Stan Lipsey, and Ralph Schey all meld unusual talent, energy and character to achieve exceptional financial results.

For good reasons, we had very high expectations when we joined with these managers. In every case, however, our experience has greatly exceeded those expectations. We have received far more than we deserve, but we are willing to accept such inequities. (We subscribe to the view Jack Benny expressed upon receiving an acting award: "I don't deserve this, but then, I have arthritis and I don't deserve that either.")

Beyond the Sainted Seven, we have our other major unit, insurance, which I believe also has a business value well above the net assets employed in it. However, appraising the business value of a property-casualty insurance company is a decidedly imprecise process. The industry is volatile, reported earnings oftentimes are seriously inaccurate, and recent changes in the Tax Code will severely hurt future profitability. Despite these problems, we like the business and it will almost certainly remain our largest operation. Under Mike Goldberg's management, the insurance business should treat us well over time.

With managers like ours, my partner, Charlie Munger, and I have little to do with operations. In fact, it is probably fair to say that if we did more, less would be accomplished. We have no corporate meetings, no corporate budgets, and no performance reviews (though our managers, of course, oftentimes find such procedures useful at their operating units). After all, what can we tell the Blumkins about home furnishings, or the Heldmans about uniforms?

Our major contribution to the operations of our subsidiaries is applause. But it is not the indiscriminate applause of a Pollyanna. Rather it is informed applause based upon the two long careers we have spent intensively observing business performance and managerial behavior. Charlie and I have seen so much of the ordinary in business that we can truly appreciate a virtuoso performance. Only one response to the 1987 performance of our operating managers is appropriate: sustained, deafening applause.

Sources of Reported Earnings

The table on the following page shows the major sources of Berkshire's reported earnings. In the table, amortization of Goodwill and other major purchase-price accounting adjustments are not charged against the specific businesses to which they apply but, instead, are aggregated and shown separately. In effect, this procedure presents the earnings of our businesses as they would have been reported had we not purchased them. In appendixes to my letters in the 1983 and 1986 annual reports, I explained why this form of presentation seems to us to be more useful to investors and managers than the standard GAAP presentation, which makes purchase-price adjustments on a business-by-business basis. The total net earnings we show in the table are, of course, identical to the GAAP figures in our audited financial statements.

In the Business Segment Data on pages 36-38 and in the Management's Discussion section on pages 40-44 you will find much additional information about our businesses. In these sections you will also find our segment earnings reported on a GAAP basis. I urge you to read that material, as well as Charlie Munger's letter to Wesco shareholders, describing the various businesses of that subsidiary, which starts on page 45.

	(000s omitted)			
	Pre-Tax Earnings		Berkshire's Share of Net Earnings (after taxes and minority interests)	
	1987	1986	1987	1986
Operating Earnings:				
Insurance Group:				
Underwriting	$(55,429)	$(55,844)	$(20,696)	$(29,864)
Net Investment Income	152,483	107,143	136,658	96,440
Buffalo News	39,410	34,736	21,304	16,918
Fechheimer (Acquired 6/3/86)	13,332	8,400	6,580	3,792
Kirby	22,408	20,218	12,891	10,508
Nebraska Furniture Mart	16,837	17,685	7,554	7,192
Scott Fetzer Mfg. Group	30,591	25,358	17,555	13,354
See's Candies	31,693	30,347	17,363	15,176
Wesco — other than Insurance	6,209	5,542	4,978	5,550
World Book	25,745	21,978	15,136	11,670
Amortization of Goodwill	(2,862)	(2,555)	(2,862)	(2,555)
Other Purchase-Price Accounting Adjustments	(5,546)	(10,033)	(6,544)	(11,031)
Interest on Debt and Pre-Payment Penalty	(11,474)	(23,891)	(5,905)	(12,213)
Shareholder-Designated Contributions	(4,938)	(3,997)	(2,963)	(2,158)
Other	22,460	20,770	13,696	8,685
Operating Earnings	280,919	195,857	214,745	131,464
Sales of Securities	27,319	216,242	19,807	150,897
Total Earnings — All Entities	$308,238	$412,099	$234,552	$282,361

Gypsy Rose Lee announced on one of her later birthdays: "I have everything I had last year; it's just that it's all two inches lower." As the table shows, during 1987 almost all of our businesses aged in a more upbeat way.

There's not a lot new to report about these businesses — and that's good, not bad. Severe change and exceptional returns usually don't mix. Most investors, of course, behave as if just the opposite were true. That is, they usually confer the highest price-earnings ratios on exotic-sounding businesses that hold out the promise of feverish change. That prospect lets investors fantasize about future profitability rather than face today's business realities. For such investor-dreamers, any blind date is preferable to one with the girl next door, no matter how desirable she may be.

Experience, however, indicates that the best business returns are usually achieved by companies that are doing something quite similar today to what they were doing five or ten years ago. That is no argument for managerial complacency. Businesses always have opportunities to improve service, product lines, manufacturing techniques, and the like, and obviously these opportunities should be seized. But a business that constantly encounters major change also encounters many chances for major error. Furthermore, economic terrain that is forever shifting violently is ground on which it is difficult to build a fortress-like business franchise. Such a franchise is usually the key to sustained high returns.

The Fortune study I mentioned earlier supports our view. Only 25 of the 1,000 companies met two tests of economic excellence — an average return on equity of over 20% in the ten years, 1977 through 1986, and no year worse than 15%. These business superstars were also stock market superstars: During the decade, 24 of the 25 outperformed the S&P 500.

The Fortune champs may surprise you in two respects. First, most use very little leverage compared to their interest-paying capacity. Really good businesses usually don't need to borrow. Second, except for one company that is "high-tech" and several others that manufacture ethical drugs, the companies are in businesses that, on balance, seem rather mundane. Most sell non-sexy products or services in much the same manner as they did ten years ago (though in larger quantities now, or at higher prices, or both). The record of these 25 companies confirms that making the most of an already strong business franchise, or concentrating on a single winning business theme, is what usually produces exceptional economics.

Berkshire's experience has been similar. Our managers have produced extraordinary results by doing rather ordinary things – but doing them exceptionally well. Our managers protect their franchises, they control costs, they search for new products and markets that build on their existing strengths and they don't get diverted. They work exceptionally hard at the details of their businesses, and it shows.

Here's an update:

• Agatha Christie, whose husband was an archaeologist, said that was the perfect profession for one's spouse: "The older you become, the more interested they are in you." It is students of business management, not archaeologists, who should be interested in Mrs. B (Rose Blumkin), the 94-year-old chairman of Nebraska Furniture Mart.

Fifty years ago Mrs. B started the business with $500, and today NFM is far and away the largest home furnishings store in the country. Mrs. B continues to work seven days a week at the job from the opening of each business day until the close. She buys, she sells, she manages – and she runs rings around the competition. It's clear to me that she's gathering speed and may well reach her full potential in another five or ten years. Therefore, I've persuaded the Board to scrap our mandatory-retirement-at-100 policy. (And it's about time: With every passing year, this policy has seemed sillier to me.)

Net sales of NFM were $142.6 million in 1987, up 8% from 1986. There's nothing like this store in the country, and there's nothing like the family Mrs. B has produced to carry on: Her son Louie, and his three boys, Ron, Irv and Steve, possess the business instincts, integrity and drive of Mrs. B. They work as a team and, strong as each is individually, the whole is far greater than the sum of the parts.

The superb job done by the Blumkins benefits us as owners, but even more dramatically benefits NFM's customers. They saved about $30 million in 1987 by buying from NFM. In other words, the goods they bought would have cost that much more if purchased elsewhere.

You'll enjoy an anonymous letter I received last August: "Sorry to see Berkshire profits fall in the second quarter. One way you may gain back part of your lost. (sic) Check the pricing at The Furniture Mart. You will find that they are leaving 10% to 20% on the table. This additional profit on $140 million of sells (sic) is $28 million. Not small change in anyone's pocket! Check out other furniture, carpet, appliance and T.V. dealers. Your raising prices to a reasonable profit will help. Thank you. /signed/ A Competitor."

NFM will continue to grow and prosper by following Mrs. B's maxim: "Sell cheap and tell the truth."

• Among dominant papers of its size or larger, the Buffalo News continues to be the national leader in two important ways: (1) its weekday and Sunday penetration rate (the percentage of households in the paper's primary market area that purchase it); and (2) its "news-hole" percentage (the portion of the paper devoted to news).

It may not be coincidence that one newspaper leads in both categories: an exceptionally "news-rich" product makes for broad audience appeal, which in turn leads to high penetration. Of course, quantity must be matched by quality. This not only means good reporting and good writing; it means freshness and relevance. To be indispensable, a paper must promptly tell its readers many things they want to know but won't otherwise learn until much later, if ever.

At the News, we put out seven fresh editions every 24 hours, each one extensively changed in content. Here's a small example that may surprise you: We redo the obituary page in every edition of the News, or seven times a day. Any obituary added runs through the next six editions until the publishing cycle has been completed.

It's vital, of course, for a newspaper to cover national and international news well and in depth. But it is also vital for it to do what only a local newspaper can: promptly and extensively chronicle the personally-important, otherwise-unreported details of community life. Doing this job well requires a very broad range of news — and that means lots of space, intelligently used.

Our news hole was about 50% in 1987, just as it has been year after year. If we were to cut it to a more typical 40%, we would save approximately $4 million annually in newsprint costs. That interests us not at all — and it won't interest us even if, for one reason or another, our profit margins should significantly shrink.

Charlie and I do not believe in flexible operating budgets, as in "Non-direct expenses can be X if revenues are Y, but must be reduced if revenues are Y — 5%." Should we really cut our news hole at the Buffalo News, or the quality of product and service at See's, simply because profits are down during a given year or quarter? Or, conversely, should we add a staff economist, a corporate strategist, an institutional advertising campaign or something else that does Berkshire no good simply because the money currently is rolling in?

That makes no sense to us. We neither understand the adding of unneeded people or activities because profits are booming, nor the cutting of essential people or activities because profitability is shrinking. That kind of yo-yo approach is neither business-like nor humane. Our goal is to do what makes sense for Berkshire's customers and employees at all times, and never to add the unneeded. ("But what about the corporate jet?" you rudely ask. Well, occasionally a man must rise above principle.)

Although the News' revenues have grown only moderately since 1984, superb management by Stan Lipsey, its publisher, has produced excellent profit growth. For several years, I have incorrectly predicted that profit margins at the News would fall. This year I will not let you down: Margins will, without question, shrink in 1988 and profit may fall as well. Skyrocketing newsprint costs will be the major cause.

• Fechheimer Bros. Company is another of our family businesses — and, like the Blumkins, what a family. Three generations of Heldmans have for decades consistently built the sales and profits of this manufacturer and distributor of uniforms. In the year that Berkshire acquired its controlling interest in Fechheimer — 1986 — profits were a record. The Heldmans didn't slow down after that. Last year earnings increased substantially and the outlook is good for 1988.

There's nothing magic about the uniform business; the only magic is in the Heldmans. Bob, George, Gary, Roger and Fred know the business inside and out, and they have fun running it. We are fortunate to be in partnership with them.

• Chuck Huggins continues to set new records at See's, just as he has ever since we put him in charge on the day of our purchase some 16 years ago. In 1987, volume hit a new high at slightly under 25 million pounds. For the second year in a row, moreover, same-store sales, measured in pounds, were virtually unchanged. In case you are wondering, that represents improvement: In each of the previous six years, same-store sales had fallen.

Although we had a particularly strong 1986 Christmas season, we racked up better store-for-store comparisons in the 1987 Christmas season than at any other time of the year. Thus, the seasonal factor at See's becomes even more extreme. In 1987, about 85% of our profit was earned during December.

Candy stores are fun to visit, but most have not been fun for their owners. From what we can learn, practically no one besides See's has made significant profits in recent years from the operation of candy shops. Clearly, Chuck's record at See's is not due to a rising industry tide. Rather, it is a one-of-a-kind performance.

His achievement requires an excellent product — which we have — but it also requires genuine affection for the customer. Chuck is 100% customer-oriented, and his attitude sets the tone for the rest of the See's organization.

Here's an example of Chuck in action: At See's we regularly add new pieces of candy to our mix and also cull a few to keep our product line at about 100 varieties. Last spring we selected 14 items for elimination. Two, it turned out, were badly missed by our customers, who wasted no time in letting us know what they thought of our judgment: "A pox on all in See's who participated in the abominable decision . . .;" "May your new truffles melt in transit, may they sour in people's mouths, may your costs go up and your profits go down . . .;" "We are investigating the possibility of obtaining a mandatory injunction requiring you to supply . . ." You get the picture. In all, we received many hundreds of letters.

Chuck not only reintroduced the pieces, he turned this miscue into an opportunity. Each person who had written got a complete and honest explanation in return. Said Chuck's letter: "Fortunately, when I make poor decisions, good things often happen as a result . . ." And with the letter went a special gift certificate.

See's increased prices only slightly in the last two years. In 1988 we have raised prices somewhat more, though still moderately. To date, sales have been weak and it may be difficult for See's to improve its earnings this year.

- World Book, Kirby, and the Scott Fetzer Manufacturing Group are all under the management of Ralph Schey. And what a lucky thing for us that they are. I told you last year that Scott Fetzer performance in 1986 had far exceeded the expectations that Charlie and I had at the time of our purchase. Results in 1987 were even better. Pre-tax earnings rose 10% while average capital employed declined significantly.

Ralph's mastery of the 19 businesses for which he is responsible is truly amazing, and he has also attracted some outstanding managers to run them. We would love to find a few additional units that could be put under Ralph's wing.

The businesses of Scott Fetzer are too numerous to describe in detail. Let's just update you on one of our favorites: At the end of 1987, World Book introduced its most dramatically-revised edition since 1962. The number of color photos was increased from 14,000 to 24,000; over 6,000 articles were revised; 840 new contributors were added. Charlie and I recommend this product to you and your family, as we do World Book's products for younger children, Childcraft and Early World of Learning.

In 1987, World Book unit sales in the United States increased for the fifth consecutive year. International sales and profits also grew substantially. The outlook is good for Scott Fetzer operations in aggregate, and for World Book in particular.

Insurance Operations

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

	Yearly Change in Premiums Written (%)	*Statutory Combined Ratio After Policyholder Dividends*	*Yearly Change in Incurred Losses (%)*	*Inflation Rate Measured by GNP Deflator (%)*
1981	3.8	106.0	6.5	9.6
1982	4.4	109.8	8.4	6.4
1983	4.6	112.0	6.8	3.8
1984	9.2	117.9	16.9	3.7
1985	22.1	116.3	16.1	3.2
1986 (Rev.)	22.2	108.0	13.5	2.6
1987 (Est.)	8.7	104.7	6.8	3.0

Source: Best's Insurance Management Reports

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. When the investment income that an insurer earns from holding on to policyholders' funds ("the float") is taken into account, a combined ratio in the 107-111 range typically produces an overall breakeven result, exclusive of earnings on the funds provided by shareholders.

The math of the insurance business, encapsulated by the table, is not very complicated. In years when the industry's annual gain in revenues (premiums) pokes along at 4% or 5%, underwriting losses are sure to mount. That is not because auto accidents, fires, windstorms and the like are occurring more frequently, nor has it lately been the fault of general inflation. Today, social and judicial inflation are the major culprits; the cost of entering a courtroom has simply ballooned. Part of the jump in cost arises from skyrocketing verdicts, and part from the tendency of judges and juries to expand the coverage of insurance policies beyond that contemplated by the insurer when the policies were written. Seeing no let-up in either trend, we continue to believe that the industry's revenues must grow at about 10% annually for it to just hold its own in terms of profitability, even though general inflation may be running at a considerably lower rate.

The strong revenue gains of 1985-87 almost guaranteed the industry an excellent underwriting performance in 1987 and, indeed, it was a banner year. But the news soured as the quarters rolled by: Best's estimates that year-over-year volume increases were 12.9%, 11.1%, 5.7%, and 5.6%. In 1988, the revenue gain is certain to be far below our 10% "equilibrium" figure. Clearly, the party is over.

However, earnings will not immediately sink. A lag factor exists in this industry: Because most policies are written for a one-year term, higher or lower insurance prices do not have their full impact on earnings until many months after they go into effect. Thus, to resume our metaphor, when the party ends and the bar is closed, you are allowed to finish your drink. If results are not hurt by a major natural catastrophe, we predict a small climb for the industry's combined ratio in 1988, followed by several years of larger increases.

The insurance industry is cursed with a set of dismal economic characteristics that make for a poor long-term outlook: hundreds of competitors, ease of entry, and a product that cannot be differentiated in any meaningful way. In such a commodity-like business, only a very low-cost operator or someone operating in a protected, and usually small, niche can sustain high profitability levels.

When shortages exist, however, even commodity businesses flourish. The insurance industry enjoyed that kind of climate for a while but it is now gone. One of the ironies of capitalism is that most managers in commodity industries abhor shortage conditions — even though those are the only circumstances permitting them good returns. Whenever shortages appear, the typical manager simply can't wait to expand capacity and thereby plug the hole through which money is showering upon him. This is precisely what insurance managers did in 1985-87, confirming again Disraeli's observation: "What we learn from history is that we do not learn from history."

At Berkshire, we work to escape the industry's commodity economics in two ways. First, we differentiate our product by our financial strength, which exceeds that of all others in the industry. This strength, however, is limited in its usefulness. It means nothing in the personal insurance field: The buyer of an auto or homeowners policy is going to get his claim paid even if his insurer fails (as many have). It often means nothing in the commercial insurance arena: When times are good, many major corporate purchasers of insurance and their brokers pay scant attention to the insurer's ability to perform under the more adverse conditions that may exist, say, five years later when a complicated claim is finally resolved. (Out of sight, out of mind — and, later on, maybe out-of-pocket.)

Periodically, however, buyers remember Ben Franklin's observation that it is hard for an empty sack to stand upright and recognize their need to buy promises only from insurers that have enduring financial strength. It is then that we have a major competitive advantage. When a buyer really focuses on whether a $10 million claim can be easily paid by his insurer five or ten years down the road, and when he takes into account the possibility that poor underwriting conditions may then coincide with depressed financial markets and defaults by reinsurers, he will find only a few companies he can trust. Among those, Berkshire will lead the pack.

Our second method of differentiating ourselves is the total indifference to volume that we maintain. In 1989, we will be perfectly willing to write five times as much business as we write in 1988 — or only one-fifth as much. We hope, of course, that conditions will allow us large volume. But we cannot control market prices. If they are unsatisfactory, we will simply do very little business. No other major insurer acts with equal restraint.

Three conditions that prevail in insurance, but not in most businesses, allow us our flexibility. First, market share is not an important determinant of profitability: In this business, in contrast to the newspaper or grocery businesses, the economic rule is not survival of the fattest. Second, in many sectors of insurance, including most of those in which we operate, distribution channels are not proprietary and can be easily entered: Small volume this year does not preclude huge volume next year. Third, idle capacity — which in this industry largely means people — does not result in intolerable costs. In a way that industries such as printing or steel cannot, we can operate at quarter-speed much of the time and still enjoy long-term prosperity.

We follow a price-based-on-exposure, not-on-competition policy because it makes sense for our shareholders. But we're happy to report that it is also pro-social. This policy means that we are always available, given prices that we believe are adequate, to write huge volumes of almost any type of property-casualty insurance. Many other insurers follow an in-and-out approach. When they are "out" — because of mounting losses, capital inadequacy, or whatever — we are available. Of course, when others are panting to do business we are also available — but at such times we often find ourselves priced above the market. In effect, we supply insurance buyers and brokers with a large reservoir of standby capacity.

One story from mid-1987 illustrates some consequences of our pricing policy: One of the largest family-owned insurance brokers in the country is headed by a fellow who has long been a shareholder of Berkshire. This man handles a number of large risks that are candidates for placement with our New York office. Naturally, he does the best he can for his clients. And, just as naturally, when the insurance market softened dramatically in 1987 he found prices at other insurers lower than we were willing to offer. His reaction was, first, to place all of his business elsewhere and, second, to buy more stock in Berkshire. Had we been really competitive, he said, we would have gotten his insurance business but he would not have bought our stock.

Berkshire's underwriting experience was excellent in 1987, in part because of the lag factor discussed earlier. Our combined ratio (on a statutory basis and excluding structured settlements and financial reinsurance) was 105. Although the ratio was somewhat less favorable than in 1986, when it was 103, our profitability improved materially in 1987 because we had the use of far more float. This trend will continue to run in our favor: Our ratio of float to premium volume will increase very significantly during the next few years. Thus, Berkshire's insurance profits are quite likely to improve during 1988 and 1989, even though we expect our combined ratio to rise.

Our insurance business has also made some important non-financial gains during the last few years. Mike Goldberg, its manager, has assembled a group of talented professionals to write larger risks and unusual coverages. His operation is now well equipped to handle the lines of business that will occasionally offer us major opportunities.

Our loss reserve development, detailed on pages 41-42, looks better this year than it has previously. But we write lots of "long-tail" business — that is, policies generating claims that often take many years to resolve. Examples would be product liability, or directors and officers liability coverages. With a business mix like this, one year of reserve development tells you very little.

You should be very suspicious of any earnings figures reported by insurers (including our own, as we have unfortunately proved to you in the past). The record of the last decade shows that a great many of our best-known insurers have reported earnings to shareholders that later proved to be wildly erroneous. In most cases, these errors were totally innocent: The unpredictability of our legal system makes it impossible for even the most conscientious insurer to come close to judging the eventual cost of long-tail claims.

Nevertheless, auditors annually certify the numbers given them by management and in their opinions unqualifiedly state that these figures "present fairly" the financial position of their clients. The auditors use this reassuring language even though they know from long and painful experience that the numbers so certified are likely to differ dramatically from the true earnings of the period. Despite this history of error, investors understandably rely upon auditors' opinions. After all, a declaration saying that "the statements present fairly" hardly sounds equivocal to the non-accountant.

The wording in the auditor's standard opinion letter is scheduled to change next year. The new language represents improvement, but falls far short of describing the limitations of a casualty-insurer audit. If it is to depict the true state of affairs, we believe the standard opinion letter to shareholders of a property-casualty company should read something like: "We have relied upon representations of management in respect to the liabilities shown for losses and loss adjustment expenses, the estimate of which, in turn, very materially affects the earnings and financial condition herein reported. We can express no opinion about the accuracy of these figures. Subject to that important reservation, in our opinion, etc."

If lawsuits develop in respect to wildly inaccurate financial statements (which they do), auditors will definitely say something of that sort in court anyway. Why should they not be forthright about their role and its limitations from the outset?

We want to emphasize that we are not faulting auditors for their inability to accurately assess loss reserves (and therefore earnings). We fault them only for failing to publicly acknowledge that they can't do this job.

From all appearances, the innocent mistakes that are constantly made in reserving are accompanied by others that are deliberate. Various charlatans have enriched themselves at the expense of the investing public by exploiting, first, the inability of auditors to evaluate reserve figures and, second, the auditors' willingness to confidently certify those figures as if they had the expertise to do so. We will continue to see such chicanery in the future. Where "earnings" can be created by the stroke of a pen, the dishonest will gather. For them, long-tail insurance is heaven. The audit wording we suggest would at least serve to put investors on guard against these predators.

The taxes that insurance companies pay — which increased materially, though on a delayed basis, upon enactment of the Tax Reform Act of 1986 — took a further turn for the worse at the end of 1987. We detailed the 1986 changes in last year's report. We also commented on the irony of a statute that substantially increased 1987 reported earnings for insurers even as it materially reduced both their long-term earnings potential and their business value. At Berkshire, the temporarily-helpful "fresh start" adjustment inflated 1987 earnings by $8.2 million.

In our opinion, the 1986 Act was the most important economic event affecting the insurance industry over the past decade. The 1987 Bill further reduced the intercorporate dividends-received credit from 80% to 70%, effective January 1, 1988, except for cases in which the taxpayer owns at least 20% of an investee.

Investors who have owned stocks or bonds through corporate intermediaries other than qualified investment companies have always been disadvantaged in comparison to those owning the same securities directly. The penalty applying to indirect ownership was greatly increased by the 1986 Tax Bill and, to a lesser extent, by the 1987 Bill, particularly in instances where the intermediary is an insurance company. We have no way of offsetting this increased level of taxation. It simply means that a given set of pre-tax investment returns will now translate into much poorer after-tax results for our shareholders.

All in all, we expect to do well in the insurance business, though our record is sure to be uneven. The immediate outlook is for substantially lower volume but reasonable earnings improvement. The decline in premium volume will accelerate after our quota-share agreement with Fireman's Fund expires in 1989. At some point, likely to be at least a few years away, we may see some major opportunities, for which we are now much better prepared than we were in 1985.

Marketable Securities — Permanent Holdings

Whenever Charlie and I buy common stocks for Berkshire's insurance companies (leaving aside arbitrage purchases, discussed later) we approach the transaction as if we were buying into a private business. We look at the economic prospects of the business, the people in charge of running it, and the price we must pay. We do not have in mind any time or price for sale. Indeed, we are willing to hold a stock indefinitely so long as we expect the business to increase in intrinsic value at a satisfactory rate. When investing, we view ourselves as business analysts — not as market analysts, not as macroeconomic analysts, and not even as security analysts.

Our approach makes an active trading market useful, since it periodically presents us with mouth-watering opportunities. But by no means is it essential: a prolonged suspension of trading in the securities we hold would not bother us any more than does the lack of daily quotations on World Book or Fechheimer. Eventually, our economic fate will be determined by the economic fate of the business we own, whether our ownership is partial or total.

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him or to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, *you're* the patsy."

Ben's Mr. Market allegory may seem out-of-date in today's investment world, in which most professionals and academicians talk of efficient markets, dynamic hedging and betas. Their interest in such matters is understandable, since techniques shrouded in mysterly clearly have value to the purveyor of investment advice. After all, what witch doctor has ever achieved fame and fortune by simply advising "Take two aspirins"?

The value of market esoterica to the consumer of investment advice is a different story. In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets. Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind.

Following Ben's teachings, Charlie and I let our marketable equities tell us by their operating results — not by their daily, or even yearly, price quotations — whether our investments are successful. The market may ignore business success for a while, but eventually will confirm it. As Ben said: "In the short run, the market is a voting machine but in the long run it is a weighing machine." The speed at which a business's success is recognized, furthermore, is not that important as long as the company's intrinsic value is increasing at a satisfactory rate. In fact, delayed recognition can be an advantage: It may give us the chance to buy more of a good thing at a bargain price.

Sometimes, of course, the market may judge a business to be more valuable than the underlying facts would indicate it is. In such a case, we will sell our holdings. Sometimes, also, we will sell a security that is fairly valued or even undervalued because we require funds for a still more undervalued investment or one we believe we understand better.

We need to emphasize, however, that we do not sell holdings just because they have appreciated or because we have held them for a long time. (Of Wall Street maxims the most foolish may be "You can't go broke taking a profit.") We are quite content to hold any security indefinitely, so long as the prospective return on equity capital of the underlying business is satisfactory, management is competent and honest, and the market does not overvalue the business.

However, our insurance companies own three marketable common stocks that we would not sell even though they became far overpriced in the market. In effect, we view these investments exactly like our successful controlled businesses — a permanent part of Berkshire rather than merchandise to be disposed of once Mr. Market offers us a sufficiently high price. To that, I will add one qualifier: These stocks are held by our insurance companies and we would, if absolutely necessary, sell portions of our holdings to pay extraordinary insurance losses. We intend, however, to manage our affairs so that sales are never required.

A determination to have and to hold, which Charlie and I share, obviously involves a mixture of personal and financial considerations. To some, our stand may seem highly eccentric. (Charlie and I have long followed David Oglivy's advice: "Develop your eccentricities while you are young. That way, when you get old, people won't think you're going ga-ga.") Certainly, in the transaction-fixated Wall Street of recent years, our posture must seem odd: To many in that arena, both companies and stocks are seen only as raw material for trades.

Our attitude, however, fits our personalities and the way we want to live our lives. Churchill once said, "You shape your houses and then they shape you." We know the manner in which we wish to be shaped. For that reason, we would rather achieve a return of X while associating with people whom we strongly like and admire than realize 110% of X by exchanging these relationships for uninteresting or unpleasant ones. And we will never find people we like and admire more than some of the main participants at the three companies — our permanent holdings — shown below:

No. of Shares		*Cost*	*Market*
		(000s omitted)	
3,000,000	Capital Cities/ABC, Inc.	$517,500	$1,035,000
6,850,000	GEICO Corporation	45,713	756,925
1,727,765	The Washington Post Company	9,731	323,092

We really don't see many fundamental differences between the purchase of a controlled business and the purchase of marketable holdings such as these. In each case we try to buy into businesses with favorable long-term economics. Our goal is to find an outstanding business at a sensible price, not a mediocre business at a bargain price. Charlie and I have found that making silk purses out of silk is the best that we can do; with sow's ears, we fail.

(It must be noted that your Chairman, always a quick study, required only 20 years to recognize how important it was to buy good businesses. In the interim, I searched for "bargains" — and had the misfortune to find some. My punishment was an education in the economics of short-line farm implement manufacturers, third-place department stores, and New England textile manufacturers.)

Of course, Charlie and I may misread the fundamental economics of a business. When that happens, we will encounter problems whether that business is a wholly-owned subsidiary or a marketable security, although it is usually far easier to exit from the latter. (Indeed, businesses can be misread: Witness the European reporter who, after being sent to this country to profile Andrew Carnegie, cabled his editor, "My God, you'll never believe the sort of money there is in running libraries.")

In making both control purchases and stock purchases, we try to buy not only good businesses, but ones run by high-grade, talented and likeable managers. If we make a mistake about the managers we link up with, the controlled company offers a certain advantage because we have the power to effect change. In practice, however, this advantage is somewhat illusory: Management changes, like marital changes, are painful, time-consuming and chancy. In any event, at our three marketable-but-permanent holdings, this point is moot: With Tom Murphy and Dan Burke at Cap Cities, Bill Snyder and Lou Simpson at GEICO, and Kay Graham and Dick Simmons at The Washington Post, we simply couldn't be in better hands.

I would say that the controlled company offers two main advantages. First, when we control a company we get to allocate capital, whereas we are likely to have little or nothing to say about this process with marketable holdings. This point can be important because the heads of many companies are not skilled in capital allocation. Their inadequacy is not surprising. Most bosses rise to the top because they have excelled in an area such as marketing, production, engineering, administration – or, sometimes, institutional politics.

Once they become CEOs, they face new responsibilities. They now must make capital allocation decisions, a critical job that they may have never tackled and that is not easily mastered. To stretch the point, it's as if the final step for a highly-talented musician was not to perform at Carnegie Hall but, instead, to be named Chairman of the Federal Reserve.

The lack of skill that many CEOs have at capital allocation is no small matter: After ten years on the job, a CEO whose company annually retains earnings equal to 10% of net worth will have been responsible for the deployment of more than 60% of all the capital at work in the business.

CEOs who recognize their lack of capital-allocation skills (which not all do) will often try to compensate by turning to their staffs, management consultants, or investment bankers. Charlie and I have frequently observed the consequences of such "help." On balance, we feel it is more likely to accentuate the capital-allocation problem than to solve it.

In the end, plenty of unintelligent capital allocation takes place in corporate America. (That's why you hear so much about "restructuring.") Berkshire, however, has been fortunate. At the companies that are our major non-controlled holdings, capital has generally been well-deployed and, in some cases, brilliantly so.

The second advantage of a controlled company over a marketable security has to do with taxes. Berkshire, as a corporate holder, absorbs some significant tax costs through the ownership of partial positions that we do not when our ownership is 80% or greater. Such tax disadvantages have long been with us, but changes in the tax code caused them to increase significantly during the past year. As a consequence, a given business result can now deliver Berkshire financial results that are as much as 50% better if they come from an 80%-or-greater holding rather than from a lesser holding.

The disadvantages of owning marketable securities are sometimes offset by a huge advantage: Occasionally the stock market offers us the chance to buy non-controlling pieces of extraordinary businesses at truly ridiculous prices – dramatically below those commanded in negotiated transactions that transfer control. For example, we purchased our Washington Post stock in 1973 at $5.63 per share, and per-share operating earnings in 1987 after taxes were $10.30. Similarly, our GEICO stock was purchased in 1976, 1979 and 1980 at an average of $6.67 per share, and after-tax operating earnings per share last year were $9.01. In cases such as these, Mr. Market has proven to be a mighty good friend.

An interesting accounting irony overlays a comparison of the reported financial results of our controlled companies with those of the permanent minority holdings listed above. As you can see, those three stocks have a market value of over $2 billion. Yet they produced only $11 million in reported after-tax earnings for Berkshire in 1987.

Accounting rules dictate that we take into income only the dividends these companies pay us — which are little more than nominal — rather than our share of their earnings, which in 1987 amounted to well over $100 million. On the other hand, accounting rules provide that the carrying value of these three holdings — owned, as they are, by insurance companies — must be recorded on our balance sheet at current market prices. The result: GAAP accounting lets us reflect in our net worth the up-to-date underlying values of the businesses we partially own, but does not let us reflect their underlying earnings in our income account.

In the case of our controlled companies, just the opposite is true. Here, we show full earnings in our income account but never change asset values on our balance sheet, no matter how much the value of a business might have increased since we purchased it.

Our mental approach to this accounting schizophrenia is to ignore GAAP figures and to focus solely on the future earning power of both our controlled and non-controlled businesses. Using this approach, we establish our own ideas of business value, keeping these independent from both the accounting values shown on our books for controlled companies and the values placed by a sometimes-foolish market on our partially-owned companies. It is this business value that we hope to increase at a reasonable (or, preferably, unreasonable) rate in the years ahead.

Marketable Securities — Other

In addition to our three permanent common stock holdings, we hold large quantities of marketable securities in our insurance companies. In selecting these, we can choose among five major categories: (1) long-term common stock investments, (2) medium-term fixed-income securities, (3) long-term fixed-income securities, (4) short-term cash equivalents, and (5) short-term arbitrage commitments.

We have no particular bias when it comes to choosing from these categories. We just continuously search among them for the highest after-tax returns as measured by "mathematical expectation," limiting ourselves always to investment alternatives we think we understand. Our criteria have nothing to do with maximizing immediately reportable earnings; our goal, rather, is to maximize eventual net worth.

• Let's look first at common stocks. During 1987 the stock market was an area of much excitement but little net movement: The Dow advanced 2.3% for the year. You are aware, of course, of the roller coaster ride that produced this minor change. Mr. Market was on a manic rampage until October and then experienced a sudden, massive seizure.

We have "professional" investors, those who manage many billions, to thank for most of this turmoil. Instead of focusing on what businesses will do in the years ahead, many prestigious money managers now focus on what they expect other money managers to do in the days ahead. For them, stocks are merely tokens in a game, like the thimble and flatiron in Monopoly.

An extreme example of what their attitude leads to is "portfolio insurance," a money-management strategy that many leading investment advisors embraced in 1986-1987. This strategy — which is simply an exotically-labeled version of the small speculator's stop-loss order — dictates that ever-increasing portions of a stock portfolio, or their index-future equivalents, be sold as prices decline. The strategy says nothing else matters: A downtick of a given magnitude automatically produces a huge sell order. According to the Brady Report, $60 billion to $90 billion of equities were poised on this hair trigger in mid-October of 1987.

If you've thought that investment advisors were hired to invest, you may be bewildered by this technique. After buying a farm, would a rational owner next order his real estate agent to start selling off pieces of it whenever a neighboring property was sold at a lower price? Or would you sell your house to whatever bidder was available at 9:31 on some morning merely because at 9:30 a similar house sold for less than it would have brought on the previous day?

Moves like that, however, are what portfolio insurance tells a pension fund or university to make when it owns a portion of enterprises such as Ford or General Electric. The less these companies are being valued at, says this approach, the more vigorously they should be sold. As a "logical" corollary, the approach commands the institutions to repurchase these companies — *I'm not making this up* — once their prices have rebounded significantly. Considering that huge sums are controlled by managers following such Alice-in-Wonderland practices, is it any surprise that markets sometimes behave in aberrational fashion?

Many commentators, however, have drawn an incorrect conclusion upon observing recent events: They are fond of saying that the small investor has no chance in a market now dominated by the erratic behavior of the big boys. This conclusion is dead wrong: Such markets are ideal for any investor — small or large — so long as he sticks to his investment knitting. Volatility caused by money managers who speculate irrationally with huge sums will offer the true investor more chances to make intelligent investment moves. He can be hurt by such volatility only if he is forced, by either financial or psychological pressures, to sell at untoward times.

At Berkshire, we have found little to do in stocks during the past few years. During the break in October, a few stocks fell to prices that interested us, but we were unable to make meaningful purchases before they rebounded. At yearend 1987 we had no major common stock investments (that is, over $50 million) other than those we consider permanent or arbitrage holdings. However, Mr. Market will offer us opportunities — you can be sure of that — and, when he does, we will be willing and able to participate.

• In the meantime, our major parking place for money is medium-term tax-exempt bonds, whose limited virtues I explained in last year's annual report. Though we both bought and sold some of these bonds in 1987, our position changed little overall, holding around $900 million. A large portion of our bonds are "grandfathered" under the Tax Reform Act of 1986, which means they are fully tax-exempt. Bonds currently purchased by insurance companies are not.

As an alternative to short-term cash equivalents, our medium-term tax-exempts have — so far — served us well. They have produced substantial extra income for us and are currently worth a bit above our cost. Regardless of their market price, we are ready to dispose of our bonds whenever something better comes along.

• We continue to have an aversion to long-term bonds (and may be making a serious mistake by not disliking medium-term bonds as well). Bonds are no better than the currency in which they are denominated, and nothing we have seen in the past year — or past decade — makes us enthusiastic about the long-term future of U.S. currency.

Our enormous trade deficit is causing various forms of "claim checks" — U.S. government and corporate bonds, bank deposits, etc. — to pile up in the hands of foreigners at a distressing rate. By default, our government has adopted an approach to its finances patterned on that of Blanche DuBois, of *A Streetcar Named Desire,* who said, "I have always depended on the kindness of strangers." In this case, of course, the "strangers" are relying on the integrity of our claim checks although the plunging dollar has already made that proposition expensive for them.

The faith that foreigners are placing in us may be misfounded. When the claim checks outstanding grow sufficiently numerous and when the issuing party can unilaterally determine their purchasing power, the pressure on the issuer to dilute their value by inflating the currency becomes almost irresistible. For the debtor government, the weapon of inflation is the economic equivalent of the "H" bomb, and that is why very few countries have been allowed to swamp the world with debt denominated in their own currency. Our past, relatively good record for fiscal integrity has let us break this rule, but the generosity accorded us is likely to intensify, rather than relieve, the eventual pressure on us to inflate. If we do succumb to that pressure, it won't be just the foreign holders of our claim checks who will suffer. It will be all of us as well.

Of course, the U.S. may take steps to stem our trade deficit well before our position as a net debtor gets out of hand. (In that respect, the falling dollar will help, though unfortunately it will hurt in other ways.) Nevertheless, our government's behavior in this test of its mettle is apt to be consistent with its Scarlett O'Hara approach generally: "I'll think about it tomorrow." And, almost inevitably, procrastination in facing up to fiscal problems will have inflationary consequences.

Both the timing and the sweep of those consequences are unpredictable. But our inability to quantify or time the risk does not mean we should ignore it. While recognizing the possibility that we may be wrong and that present interest rates may adequately compensate for the inflationary risk, we retain a general fear of long-term bonds.

We are, however, willing to invest a moderate portion of our funds in this category if we think we have a significant edge in a specific security. That willingness explains our holdings of the Washington Public Power Supply Systems #1, #2 and #3 issues, discussed in our 1984 report. We added to our WPPSS position during 1987. At yearend, we had holdings with an amortized cost of $240 million and a market value of $316 million, paying us tax-exempt income of $34 million annually.

• We continued to do well in arbitrage last year, though — or perhaps because — we operated on a very limited scale. We enter into only a few arbitrage commitments each year and restrict ourselves to large transactions that have been publicly announced. We do not participate in situations in which green-mailers are attempting to put a target company "in play."

We have practiced arbitrage on an opportunistic basis for decades and, to date, our results have been quite good. Though we've never made an exact calculation, I believe that overall we have averaged annual pre-tax returns of at least 25% from arbitrage. I'm quite sure we did better than that in 1987. But it should be emphasized that a really bad experience or two — such as many arbitrage operations suffered in late 1987 — could change the figures dramatically.

Our only $50 million-plus arbitrage position at yearend 1987 was 1,096,200 shares of Allegis, with a cost of $76 million and a market value of $78 million.

• We had two other large holdings at yearend that do not fit precisely into any of our five categories. One was various Texaco, Inc. bonds with short maturities, all purchased after Texaco went into bankruptcy. Were it not for the extraordinarily strong capital position of our insurance companies, it would be inappropriate for us to buy defaulted bonds. At prices prevailing after Texaco's bankruptcy filing, however, we regarded these issues as by far the most attractive bond investment available to us.

On a worst-case basis with respect to the Pennzoil litigation, we felt the bonds were likely to be worth about what we paid for them. Given a sensible settlement, which seemed likely, we expected the bonds to be worth considerably more. At yearend our Texaco bonds were carried on our books at $104 million and had a market value of $119 million.

By far our largest — and most publicized — investment in 1987 was a $700 million purchase of Salomon Inc 9% preferred stock. This preferred is convertible after three years into Salomon common stock at $38 per share and, if not converted, will be redeemed ratably over five years beginning October 31, 1995. From most standpoints, this commitment fits into the medium-term fixed-income securities category. In addition, we have an interesting conversion possibility.

We, of course, have no special insights regarding the direction or future profitability of investment banking. By their nature, the economics of this industry are far less predictable than those of most other industries in which we have major commitments. This unpredictability is one of the reasons why our participation is in the form of a convertible preferred.

What we do have a strong feeling about is the ability and integrity of John Gutfreund, CEO of Salomon Inc. Charlie and I like, admire and trust John. We first got to know him in 1976 when he played a key role in GEICO's escape from near-bankruptcy. Several times since, we have seen John steer clients away from transactions that would have been unwise, but that the client clearly wanted to make — even though his advice provided no fee to Salomon and acquiescence would have delivered a large fee. Such service-above-self behavior is far from automatic in Wall Street.

For the reasons Charlie outlines on page 50, at yearend we valued our Salomon investment at 98% of par, $14 million less than our cost. However, we believe there is a reasonable likelihood that a leading, high-quality capital-raising and market-making operation can average good returns on equity. If so, our conversion right will eventually prove to be valuable.

Two further comments about our investments in marketable securities are appropriate. First, we give you our usual warning: Our holdings have changed since yearend and will continue to do so without notice.

The second comment is related: During 1987, as in some earlier years, there was speculation in the press from time to time about our purchase or sale of various securities. These stories were sometimes true, sometimes partially true, and other times completely untrue. Interestingly, there has been no correlation between the size and prestige of the publication and the accuracy of the report. One dead-wrong rumor was given considerable prominence by a major national magazine, and another leading publication misled its readers by writing about an arbitrage position as if it were a long-term investment commitment. (In not naming names, I am observing the old warning that it's not wise to pick fights with people who buy ink by the barrel.)

You should understand that we simply don't comment in any way on rumors, whether they are true or false. If we were to deny the incorrect reports and refuse comment on the correct ones, we would in effect be commenting on all.

In a world in which big investment ideas are both limited and valuable, we have no interest in telling potential competitors what we are doing except to the extent required by law. We certainly don't expect others to tell us of their investment ideas. Nor would we expect a media company to disclose news of acquisitions it was privately pursuing or a journalist to tell his competitors about stories on which he is working or sources he is using.

I find it uncomfortable when friends or acquaintances mention that they are buying X because it has been reported — incorrectly — that Berkshire is a buyer. However, I do not set them straight. If they want to participate in whatever Berkshire actually is buying, they can always purchase Berkshire stock. But perhaps that is too simple. Usually, I suspect, they find it more exciting to buy what is being talked about. Whether that strategy is more profitable is another question.

Financing

Shortly after yearend, Berkshire sold two issues of debentures, totaling $250 million. Both issues mature in 2018 and will be retired at an even pace through sinking fund operations that begin in 1999. Our overall interest cost, after allowing for expenses of issuance, is slightly over 10%. Salomon was our investment banker, and its service was excellent.

Despite our pessimistic views about inflation, our taste for debt is quite limited. To be sure, it is likely that Berkshire could improve its return on equity by moving to a much higher, though still conventional, debt-to-business-value ratio. It's even more likely that we could handle such a ratio, without problems, under economic conditions far worse than any that have prevailed since the early 1930s.

But we do not wish it to be only likely that we can meet our obligations; we wish that to be certain. Thus we adhere to policies — both in regard to debt and all other matters — that will allow us to achieve acceptable long-term results under extraordinarily adverse conditions, rather than optimal results under a normal range of conditions.

Good business or investment decisions will eventually produce quite satisfactory economic results, with no aid from leverage. Therefore, it seems to us to be both foolish and improper to risk what is important (including, necessarily, the welfare of innocent bystanders such as policyholders and employees) for some extra returns that are relatively unimportant. This view is not the product of either our advancing age or prosperity: Our opinions about debt have remained constant.

However, we are not phobic about borrowing. (We're far from believing that there is no fate worse than debt.) We are willing to borrow an amount that we believe — on a worst-case basis — will pose no threat to Berkshire's well-being. Analyzing what that amount might be, we can look to some

important strengths that would serve us well if major problems should engulf our economy: Berkshire's earnings come from many diverse and well-entrenched businesses; these businesses seldom require much capital investment; what debt we have is structured well; and we maintain major holdings of liquid assets. Clearly, we could be comfortable with a higher debt-to-business-value ratio than we now have.

One further aspect of our debt policy deserves comment: Unlike many in the business world, we prefer to finance in anticipation of need rather than in reaction to it. A business obtains the best financial results possible by managing both sides of its balance sheet well. This means obtaining the highest-possible return on assets and the lowest-possible cost on liabilities. It would be convenient if opportunities for intelligent action on both fronts coincided. However, reason tells us that just the opposite is likely to be the case: Tight money conditions, which translate into high costs for liabilities, will create the best opportunities for acquisitions, and cheap money will cause assets to be bid to the sky. Our conclusion: Action on the liability side should sometimes be taken independent of any action on the asset side.

Alas, what is "tight" and "cheap" money is far from clear at any particular time. We have no ability to forecast interest rates and — maintaining our usual open-minded spirit — believe that no one else can. Therefore, we simply borrow when conditions seem non-oppressive and hope that we will later find intelligent expansion or acquisition opportunities, which — as we have said — are most likely to pop up when conditions in the debt market are clearly oppressive. Our basic principle is that if you want to shoot rare, fast-moving elephants, you should always carry a loaded gun.

Our fund-first, buy-or-expand-later policy almost always penalizes near-term earnings. For example, we are now earning about 6½% on the $250 million we recently raised at 10%, a disparity that is currently costing us about $160,000 per week. This negative spread is unimportant to us and will not cause us to stretch for either acquisitions or higher-yielding short-term instruments. If we find the right sort of business elephant within the next five years or so, the wait will have been worthwhile.

Miscellaneous

We hope to buy more businesses that are similar to the ones we have, and we can use some help. If you have a business that fits the following criteria, call me or, preferably, write.

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 "turnaround" 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 issuing stock when we receive as much in intrinsic business value as we give. We invite potential sellers to check us out by contacting people with whom we have done business in the past. For the right business — and the right people — we can provide a good home.

On the other hand, we frequently get approached about acquisitions that don't come close to meeting our tests: new ventures, turnarounds, 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 comparable to those we hold in Cap Cities and Salomon. We have a special interest in purchasing convertible preferreds as a long-term investment, as we did at Salomon.

* * *

And now a bit of *deja vu*. Most of Berkshire's major stockholders received their shares at yearend 1969 in a liquidating distribution from Buffett Partnership, Ltd. Some of these former partners will remember that in 1962 I encountered severe managerial problems at Dempster Mill Manufacturing Co., a pump and farm implement manufacturing company that BPL controlled.

At that time, like now, I went to Charlie with problems that were too tough for me to solve. Charlie suggested the solution might lie in a California friend of his, Harry Bottle, whose special knack was never forgetting the fundamental. I met Harry in Los Angeles on April 17, 1962, and on April 23 he was in Beatrice, Nebraska, running Dempster. Our problems disappeared almost immediately. In my 1962 annual letter to partners, I named Harry "Man of the Year."

Fade to 24 years later: The scene is K & W Products, a small Berkshire subsidiary that produces automotive compounds. For years K & W did well, but in 1985-86 it stumbled badly, as it pursued the unattainable to the neglect of the achievable. Charlie, who oversees K & W, knew there was no need to consult me. Instead, he called Harry, now 68 years old, made him CEO, and sat back to await the inevitable. He didn't wait long. In 1987 K & W's profits set a record, up more than 300% from 1986. And, as profits went up, capital employed went down: K & W's investment in accounts receivable and inventories has decreased 20%.

If we run into another managerial problem ten or twenty years down the road, you know whose phone will ring.

* * *

About 97.2% of all eligible shares participated in Berkshire's 1987 shareholder-designated contributions program. Contributions made through the program were $4.9 million, and 2,050 charities were recipients.

A recent survey reported that about 50% of major American companies match charitable contributions made by directors (sometimes by a factor of three to one). In effect, these representatives of the owners direct funds to their favorite charities, and never consult the owners as to their charitable preferences. (I wonder how they would feel if the process were reversed and shareholders could invade the directors' pockets for charities favored by the shareholders.) When A takes money from B to give to C and A is a legislator, the process is called taxation. But when A is an officer or director of a corporation, it is called philanthropy. We continue to believe that contributions, aside from those with quite clear direct benefits to the company, should reflect the charitable preferences of owners rather than those of officers and directors.

We urge new shareholders to read the description of our shareholder-designated contributions program that appears on pages 54 and 55. If you wish to participate in future programs, we strongly urge that you immediately make sure 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, 1988 will be ineligible for the 1988 program.

* * *

Last year we again had about 450 shareholders at our annual meeting. The 60 or so questions they asked were, as always, excellent. At many companies, the annual meeting is a waste of time because exhibitionists turn it into a sideshow. Ours, however, is different. It is informative for shareholders and fun for us. (At Berkshire's meetings, the exhibitionists are on the dais.)

This year our meeting will be on May 23, 1988 in Omaha, and we hope that you come. The meeting provides the forum for you to ask any owner-related questions you may have, and we will keep answering until all (except those dealing with portfolio activities or other proprietary information) have been dealt with.

Last year we rented two buses — for $100 — to take shareholders interested in the trip to the Furniture Mart. Your actions demonstrated your good judgment: You snapped up about $40,000 of bargains. Mrs. B regards this expense/sales ratio as on the high side and attributes it to my chronic inattention to costs and generally sloppy managerial practices. But, gracious as always, she has offered me another chance and we will again have buses available following the meeting. Mrs. B says you must beat last year's sales figures, and I have told her she won't be disappointed.

Warren E. Buffett
Chairman of the Board

February 29, 1988

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March 8, 1988

To the Board of Directors and Stockholders
Berkshire Hathaway Inc.

We have examined the consolidated balance sheets of Berkshire Hathaway Inc. and consolidated subsidiaries as of December 31, 1987 and 1986, and the related consolidated statements of earnings and changes in financial position for each of the three fiscal years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries as of December 31, 1987 and 1986, and the results of their operations and the changes in their financial position for each of the three fiscal years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Touche Ross International

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
CONSOLIDATED BALANCE SHEETS
(dollars in thousands except per share amounts)

	December 31, 1987	December 31, 1986
ASSETS		
Cash and temporary cash investments	$ 154,933	$ 292,473
Investments, other than investments in affiliates:		
Obligations with fixed maturities, at cost (market value: 1987 — $2,046,534, 1986 — $1,274,342)	1,940,714	1,124,389
Marketable equity securities	2,328,766	1,871,933
Accounts receivable from customers, agents and others	273,855	434,703
Inventories	154,288	159,660
Properties and equipment	200,643	212,211
Goodwill of acquired businesses	124,195	126,957
Other assets	202,341	219,329
	$5,379,735	$4,441,655
LIABILITIES AND STOCKHOLDERS' EQUITY		
Losses and loss adjustment expenses	$1,260,422	$ 860,228
Unearned premiums	341,344	414,986
Accounts payable, accruals and other liabilities	252,353	236,157
Income taxes	505,921	414,275
Term debt and other borrowings	132,165	94,923
	2,492,205	2,020,569
Minority shareholders' interests	45,871	43,289
Stockholders' equity:		
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	1,104,123	874,813
Retained earnings	1,614,221	1,379,669
	2,882,597	2,418,735
Less common stock in treasury, at cost (228,274 shares)	40,938	40,938
Total stockholders' equity	2,841,659	2,377,797
	$5,379,735	$4,441,655

See accompanying Notes to Consolidated Financial Statements

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

	Fiscal Year Ended		
	December 31,		*Dec. 28,*
	1987	*1986*	*1985*
Income items:			
Sales and service revenues	$1,332,840	$1,225,290	$ 508,764
Insurance premiums earned	824,895	823,884	317,059
Interest and dividend income	163,341	118,429	107,662
Other	16,598	9,062	6,379
	2,337,674	2,176,665	939,864
Cost and expense items:			
Cost of products and services sold	705,203	651,717	285,925
Insurance losses and loss adjustment expenses	661,146	655,758	280,249
Insurance underwriting expenses	219,178	223,970	81,040
Selling, general and administrative expenses	459,617	425,562	150,423
Interest and financing costs	11,474	23,892	14,415
	2,056,618	1,980,899	812,052
Earnings from operations including minority interest in consolidated subsidiaries, before applicable income taxes and before realized investment gain	281,056	195,766	127,812
Income taxes applicable to above	60,154	59,152	31,271
	220,902	136,614	96,541
Minority interest applicable to above	6,156	5,150	3,593
Earnings before realized investment gain	214,746	131,464	92,948
Realized investment gain, net	19,806	150,897	342,867
Net earnings	$ 234,552	$ 282,361	$ 435,815
Average shares outstanding	1,146,909	1,146,909	1,146,909
Per share:			
Earnings before realized investment gain	$ 187.24	$ 114.62	$ 81.04
Net earnings	204.51	246.19	379.99

See accompanying Notes to Consolidated Financial Statements

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

	Fiscal Year Ended		
	December 31,		*Dec. 28,*
	1987	*1986*	*1985*
Consolidated assets at beginning of year	$4,441,655	$3,180,718	$2,035,203
Changes during the year resulted from:			
Net earnings	234,552	282,361	435,815
Net increase in losses, loss adjustment expenses and unearned premiums of insurance subsidiaries	326,552	634,469	348,348
Net increase (decrease) in other consolidated liabilities arising from operations	(11,995)	(76,999)	109,779
Increases essentially from operations	549,109	839,831	893,942
Net increase in unrealized appreciation included in carrying value of marketable equity securities	349,147	291,811	248,810
Repayment of debt	(12,833)	(69,097)	(9,298)
Additional borrowings	50,075	—	—
Net increase in minority interests	2,582	5,682	12,061
Obligations to which assets of purchased businesses were subject, when acquired:			
Term debt and other borrowings	—	46,141	—
Other liabilities	—	146,569	—
Total increases	938,080	1,260,937	1,145,515
Consolidated assets at end of year	$5,379,735	$4,441,655	$3,180,718

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Consolidated Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1987

(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 its subsidiaries except as indicated in the immediately following paragraph. Consolidated subsidiaries include companies engaged in a number of diverse businesses. See Note 15.

(b) Unconsolidated Subsidiaries

Berkshire subsidiaries not consolidated include Mutual Savings and Loan Association ("Mutual Savings") and Scott Fetzer Financial Group, Inc. ("SFFG"). Mutual Savings is a California chartered savings and loan institution, 80.1% indirectly owned by Berkshire. SFFG, formerly World Book Finance, Inc., acquired by Berkshire on January 6, 1986, is indirectly wholly owned by Berkshire. SFFG provides financing to purchasers of World Book and Kirby products. These companies are not consolidated because of the nature of their businesses. Berkshire's investment in these subsidiaries is accounted for by the equity method.

Statement of Financial Accounting Standards No. 94, issued in October, 1987, requires, effective for financial statements for fiscal years ending after December 15, 1988, consolidation of all majority owned subsidiaries unless control is temporary or does not rest with the majority owner. If these requirements were applied as of December 31, 1987, Berkshire's total consolidated assets and liabilities would each be greater by approximately $475,000. Consolidated net earnings and stockholders' equity would be unchanged from that reported herein.

(c) Accounting Period

In 1986, Berkshire adopted the calendar year as its annual accounting period. For years prior to 1986, Berkshire used a 52-53 week accounting period that ended on the Saturday nearest December 31. With the exception of See's Candies, who continues to employ a 52-53 week year ending with respect to December 31, all of Berkshire's significant subsidiaries employed the calendar year for 1987 and for prior years.

(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 — common stocks and preferred stocks without fixed maturities — held by members of the Berkshire Hathaway Insurance Group are carried at market value.

Investments in marketable equity securities held by non-insurance subsidiaries are carried at the lower of their 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.

(e) Goodwill and Negative Goodwill of Acquired Businesses

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

(1) Significant Accounting Policies and Practices *(Continued)*

(f) Insurance Premium Acquisition Costs

For financial reporting purposes, certain 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 recoverability of premium acquisition costs is determined without regard to investment income.

(g) Losses and Loss Adjustment Expenses

Liability for losses and loss adjustment expenses is determined on the basis of estimates of unpaid amounts with respect to both reported and incurred but not reported losses. Provisions are intended to cover ultimate payment amounts, less amounts recoverable on account of reinsurance, except that provisions for periodic payment obligations ("structured settlements") are established at discounted present value of expected ultimate payment amounts.

Present value of expected ultimate payment amounts for structured settlements was determined for financial reporting purposes to be $66,285 as of December 31, 1987 and $52,029 as of December 31, 1986 applying, as present value discount rates, the market interest rates at contract inception dates — the weighted average of which was 10.9% as of December 31, 1987. Present value of liabilities for structured settlements was determined for statutory and tax reporting purposes to be $110,010 and $83,968, respectively as of December 31, 1987 and 1986, applying discount rates prescribed by insurance regulatory authority — 5% for contracts incepting in 1987 and 7% for those incepting prior thereto.

(h) 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 unearned premiums ceded to reinsurers.

Policyholder dividends incurred with respect to participating policies are reflected in the accompanying Consolidated Statements of Earnings as a deduction from earned premiums.

(j) Income Taxes

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 Company's consolidated federal income tax returns, giving rise to recognition in the financial statements of deferred and prepaid income taxes.

The liability for income taxes in the Consolidated Balance Sheets also includes taxes deemed applicable to unrealized appreciation included in carrying value of marketable equity securities. Such taxes were applied at a rate of 34% relative to increases in unrealized appreciation during 1987 and at the rate of 28% relative to such appreciation that arose in years prior to 1987.

In December 1987, the Financial Accounting Standards Board issued Statement No. 96 which requires a change in accounting for income taxes. This Statement must be implemented no later than 1989. Uncertainties exist with respect to the most appropriate means of implementing the changes, and Berkshire management has not determined precisely when or how it will accomplish the newly prescribed methods. Berkshire management believes that if the changed methods were applied to its December 31, 1987 data, its consolidated stockholders' equity might be reduced by as much as $67,000. That net effect is the proximate result of recognizing changed income tax rates, particularly in computing income taxes deemed applicable to unrealized appreciation of marketable equity securities.

Notes to Consolidated Financial Statements *(Continued)*
(dollars in thousands except per share amounts)

(2) Pro Forma Data

The Scott & Fetzer Company, acquired January 6, 1986, and The Fechheimer Brothers Company, acquired in June, 1986 were each acquired for cash in transactions accounted for as purchases of assets. The following sets forth on an unaudited pro forma basis certain Consolidated Statement of Earnings information for 1985, as if those businesses were acquired at the beginning of 1985.

Total income items	$1,709,893
Net earnings	$ 447,817
Net earnings per share	$ 390.46

Similar information developed on a pro forma basis for 1986, as if those businesses were acquired at the very beginning of the year, would not materially differ from that reflected in the accompanying Consolidated Statement of Earnings for 1986.

(3) Investment in Cumulative Convertible Preferred Stock of Salomon Inc

On October 1, 1987 consolidated subsidiaries of Berkshire purchased 674,000 shares of a new issue of 9% Cumulative Convertible Preferred Stock of Salomon Inc ("Salomon") at a cost of one thousand dollars per share and $674,000 in the aggregate. That investment is reflected in Berkshire's consolidated investment in obligations with fixed maturities as of December 31, 1987. As part of the same purchase transaction and upon the same terms a subsidiary of Mutual Savings, an unconsolidated subsidiary of Berkshire, purchased 26,000 of these Salomon preferred shares. Each share of the issue is entitled to 26.31579 votes on all matters submitted to a vote of stockholders of Salomon, with the preferred shares voting together as one class with the common shares of Salomon. Based on the number of shares outstanding immediately after the transaction, the voting rights of the preferred shares represented approximately 12% of the voting rights of the class. On October 31, 1990, each preferred share becomes convertible into 26.31579 fully paid common shares of Salomon. Annually on each October 31, commencing in 1995, Salomon will redeem at cost 140,000 of the shares (or such fewer number as then outstanding).

(4) Investments in Marketable Equity Securities

Aggregate data with respect to the consolidated investment in marketable equity securities is shown below as of the dates indicated. See Note 1(d) as to methods applied to determine carrying value of these securities.

	December 31, 1987			
	Cost	*Unrealized Gain*	*Market*	*Carrying Value*
Common stock of:				
Capital Cities/ABC, Inc.	$517,500	$ 517,500	$1,035,000	$1,026,375
GEICO Corporation	45,713	711,212	756,925	756,925
The Washington Post Company	9,731	313,361	323,092	323,092
All other marketable equity securities	191,832	30,601	222,433	222,374
	$764,776	$1,572,674	$2,337,450	$2,328,766

	December 31, 1986			
	Cost	*Unrealized Gain*	*Market*	*Carrying Value*
Common stock of:				
Capital Cities/ABC, Inc.	$517,500	$ 286,875	$ 804,375	$ 799,594
GEICO Corporation	45,713	629,012	674,725	674,725
The Washington Post Company	9,731	259,800	269,531	269,531
All other marketable equity securities	84,145	43,938	128,083	128,083
	$657,089	$1,219,625	$1,876,714	$1,871,933

At December 31, 1987, unrealized gains were net of unrealized losses of $3,940. There were no unrealized losses at December 31, 1986.

(5) Investment in shares of Capital Cities/ABC, Inc.

The 3,000,000 common shares of Capital Cities/ABC, Inc. ("Capital Cities") reflected in the preceding note possessed approximately 18.5% of the voting rights of all Capital Cities shares outstanding at December 31, 1987. 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 governs 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.

(6) Investment in GEICO Corporation

Subsidiaries of Berkshire, at both December 31, 1987 and at December 31, 1986, owned 6,850,000 shares of common stock of GEICO Corporation. The shares possessed approximately 42% of the voting rights of all GEICO shares outstanding at December 31, 1987, but Berkshire maintains an independent proxy arrangement for voting of the shares as required by Order of GEICO's domiciliary insurance supervisory authority. The Order, dating from Berkshire subsidiaries' major purchase of the shares in 1976, 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. Because the Order 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.

(7) Accounts Receivable

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

	Dec. 31, 1987	*Dec. 31, 1986*
Trade accounts receivable, net of allowances for doubtful accounts	$142,733	$128,800
Agents' balances and premiums in course of collection	80,976	116,415
Reinsurance recoverable on loss payments	902	2,056
Investment income due and accrued	43,975	42,188
Amounts due from sale of securities	5,269	145,244
	$273,855	$434,703

Notes to Consolidated Financial Statements *(Continued)*
(dollars in thousands except per share amounts)

(8) Investment in Mutual Savings and Loan Association

Mutual Savings is wholly owned by Wesco Financial Corporation, an 80.1% beneficially owned subsidiary of Berkshire. Summarized consolidated financial information of Mutual Savings is as follows:

Balance Sheet Data	*December 31,* 1987		1986
Assets			
Cash and marketable securities	$173,396		$253,828
Convertible Preferred Stock of Salomon Inc	26,000		—
Loans receivable, net	139,427		78,613
Other assets	8,733		9,759
	$347,556		$342,200
Liabilities and Shareholder's Equity			
Savings accounts	$287,126		$282,441
Other liabilities	3,871		4,996
Shareholder's equity, substantially restricted	56,559		54,763
	$347,556		$342,200
Earnings Statement Data	*1987*	*1986*	*1985*
Total revenues	$26,576	$25,140	$38,798
Net income	$ 1,796	$ 4,684	$ 9,330

Berkshire's carrying value, in other assets, for the investment in Mutual Savings was $30,240 at December 31, 1987. That figure represents Berkshire's 80.1% share of Mutual Savings' shareholder's equity less $15,062 unamortized negative goodwill.

(9) Investment in Scott Fetzer Financial Group, Inc.

Scott Fetzer Financial Group, Inc. ("SFFG") was acquired by Berkshire in its January 6, 1986 acquisition of The Scott & Fetzer Company. SFFG and its subsidiaries provide consumer financing, principally for World Book and Kirby products. Berkshire's investment in SFFG, is reflected in other assets in the Consolidated Balance Sheets. Summarized financial information of SFFG is as follows:

Balance Sheet Data	*December 31,* 1987	1986
Assets		
Cash and cash equivalents	$ 42,244	$ 43,572
Finance receivables, net of allowance for credit losses	164,949	170,289
Other assets	6,222	5,514
	$213,415	$219,375
Liabilities and Shareholder's Equity		
Accounts payable and other liabilities	$ 13,424	$ 13,472
Term debt	157,721	165,247
Shareholder's equity	42,270	40,656
	$213,415	$219,375
Earnings Statement Data	*1987*	*1986*
Total revenues	$44,286	$37,233
Net income	$ 4,614	$ 5,367

Berkshire has agreed with SFFG among other things, that Berkshire will (1) cause SFFG's quarterly consolidated net income to be at least a minimum amount (by payment to SFFG of a facilitating fee, if required), (2) cause SFFG to maintain not less than a specified amount represented by shareholder's equity plus debt to Berkshire and Berkshire affiliates, and (3) continue, directly or indirectly, to own all of the capital stock of SFFG. The agreement was made to accommodate the continuing financing needs of SFFG. There has been no requirement to-date for payment by Berkshire to SFFG of any facilitating fees, nor is any such need contemplated.

(10) Income Taxes

The liability for income taxes as reflected in the accompanying Consolidated Balance Sheets represents estimates of liabilities as follows:

	Dec. 31, 1987	*Dec. 31, 1986*
Payable currently	$ 33,854	$ 10,999
Deferred, relating to unrealized appreciation of marketable equity securities	459,707	339,869
Deferred, net of prepaid, arising from timing differences	12,360	63,407
	$505,921	$414,275

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

	1987	*1986*	*1985*
Applicable to			
Operating earnings	$ 60,154	$ 59,152	$ 31,271
Realized investment gain	8,085	66,956	140,946
	$ 68,239	$126,108	$172,217
These taxes are comprised of:			
Federal	$ 54,982	$112,313	$158,603
State	11,866	12,845	13,593
Foreign	1,391	950	21
	$ 68,239	$126,108	$172,217
Taxes payable currently	$119,286	$106,107	$137,689
Increase (decrease) in net deferred taxes	(51,047)	20,001	34,528
	$ 68,239	$126,108	$172,217

The increase (decrease) in net deferred taxes represent the tax effects of timing differences as follows:

Applicable to	*1987*	*1986*	*1985*
Deferred insurance premium acquisition costs	$ (13,577)	$ 12,778	$ 20,207
Structured settlements and portfolio reinsurance liabilities	4,714	2,255	7,640
Discounting of loss and loss adjustment expense reserves	(37,692)	—	—
Deferred gross profit on installment sales	(8,745)	(2,836)	—
Other, net	4,253	7,804	6,681
	$ (51,047)	$ 20,001	$ 34,528

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

	1987	*1986*	*1985*
Net earnings including minority interest, before applicable income taxes	$309,211	$414,533	$620,035
Hypothetical amounts applicable to above computed at the Federal statutory rate (40% in 1987 and 46% in 1986 and 1985)	$123,684	$190,685	$285,216
Decreases resulting from:			
Tax-exempt interest income	(39,692)	(33,112)	(16,826)
Dividends received deduction	(9,498)	(6,963)	(13,340)
Rate differentials relating to realized investment gains	(3,079)	(31,878)	(86,828)
Fresh start adjustment related to discounting of loss and loss adjustment expense reserves	(8,241)*	—	—
State income taxes, less Federal income tax benefit	7,120	6,937	7,340
Net other differences	(2,055)	439	(3,345)
Total income taxes	$ 68,239	$126,108	$172,217

**Consolidated income tax expense for the year ended December 31, 1987 was reduced by $8,241 as the result of the recomputation on a discounted basis, for income tax reporting purposes, of insurance subsidiaries loss and loss expense reserves as of January 1, 1987 (the so-called "fresh start" adjustment).*

Notes to Consolidated Financial Statements *(Continued)*
(dollars in thousands except per share amounts)

(11) Term Debt and Other Borrowings

Outstanding term debt of the Parent Company at December 31, 1987, amounted to $63,565. Such amount includes $50,000 borrowed on November 3, 1987 and repayable in full on November 3, 1988. Outstanding term debt of consolidated subsidiaries at December 31, 1987 amounted to $68,600. Included is a $25,000 issue of 9½% Notes payable $2,500 annually through 1998, and $25,000 of 10⅛% Notes maturing in 1991.

Covenants of various borrowing Agreements, to which the Company or its subsidiaries are parties, are not materially restrictive.

Principal payments on borrowings outstanding at December 31, 1987 are required during the succeeding five years as follows:

Year	Amount
1988	$57,295
1989	5,159
1990	5,116
1991	30,107
1992	5,129

Berkshire issued a total of $250,000 face amount of debentures during January, 1988. These debentures bear interest at per annum rates of 9¾% ($100,000) and 10% ($150,000) and are redeemable through operation of sinking funds which call for annual repayments of $12,500 beginning in 1999. Final maturity of the obligations is January, 2018. Proceeds of the borrowings were contributed to equity capital of insurance subsidiaries.

(12) Stockholders' Equity

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

	Net Unrealized Appreciation	*Retained Earnings*
Balance at December 29, 1984	$ 486,953	$ 661,493
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)	
Increase in minority shareholders' interest in net unrealized appreciation	(7)	
Net earnings 1985		435,815
Balance at December 28, 1985	664,707	1,097,308
Increase during 1986 in unrealized appreciation included in carrying value of marketable equity securities	291,804	
Change during 1986 in deemed applicable income taxes	(81,705)	
Decrease in minority shareholders' interest in net unrealized appreciation	7	
Net earnings 1986		282,361
Balance at December 31, 1986	874,813	1,379,669
Increase during 1987 in unrealized appreciation included in carrying value of marketable equity securities	349,147	
Change during 1987 in deemed applicable income taxes	(119,837)	
Net earnings 1987		234,552
Balance at December 31, 1987	$1,104,123	$1,614,221

(13) Interest and Dividend Income

Consolidated interest and dividend income for each of the past three years was comprised of the following:

	1987	*1986*	*1985*
Dividends:			
Capital Cities/ABC, Inc.	$ 600	$ 600	$ —
GEICO Corporation	9,316	7,398	6,850
General Foods Corporation	—	—	7,727
Salomon Inc	15,165	—	—
The Washington Post Company	2,212	1,935	1,726
All Others	5,058	7,875	17,815
Total dividends	32,351	17,808	34,118
Interest substantially exempt from Federal income taxes	102,210	71,982	36,579
Other interest	28,780	28,639	36,965
Interest and dividend income	$163,341	$118,429	$107,662

(14) Quarterly Data

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

1987	*1st Quarter*	*2nd Quarter*	*3rd Quarter*	*4th Quarter*
Income items	$607,670	$560,145	$551,387	$618,472
Earnings before realized investment gain	57,219	45,880	49,239	62,408
Realized investment gain	3,255	360	11,917	4,274
Net earnings	$ 60,474	$ 46,240	$ 61,156	$ 66,682
Per outstanding share:				
Earnings before realized investment gain	$ 49.89	$ 40.00	$ 42.93	$ 54.42
Net earnings	52.73	40.31	53.32	58.15

1986	*1st Quarter*	*2nd Quarter*	*3rd Quarter*	*4th Quarter*
Income items	$542,229	$496,307	$533,710	$604,419
Earnings before realized investment gain	39,437	28,421	33,320	30,286
Realized investment gain	46,832	94,756	2,761	6,548
Net earnings	$ 86,269	$123,177	$ 36,081	$ 36,834
Per outstanding share:				
Earnings before realized investment gain	$ 34.39	$ 24.78	$ 29.05	$ 26.40
Net earnings	75.22	107.40	31.46	32.11

Revenues and earnings from marketing of World Book products are concentrated in the first quarter. See's Candy sales peak at Easter and more notably so in the fourth quarter when more than one-half of annual revenues for that business are normally recorded. Holiday advertising revenues also tend to increase fourth quarter earnings recorded for the Buffalo News. A non-seasonal factor that may influence Berkshire's interim consolidated financial statements is that estimation error, inherent to the process of determining liabilities for unpaid losses of insurance subsidiaries, can be relatively more significant to results of interim periods than to results for a full year.

Variations in amount and timing of realized securities gains or losses cause significant variations in periodic net earnings.

Notes to Consolidated Financial Statements *(Continued)*
(dollars in thousands except per share amounts)

(15) Business Segment Data

Berkshire's principal business segments are briefly described at page 4 of this report. The tables below reflect data for those segments for each of the three most recent years.

Revenues

	1987	1986	1985
Insurance	$ 977,890	$ 931,379	$412,481
Candy	157,391	151,861	145,103
Newspaper	122,955	114,267	107,864
Retailing of home furnishings	145,997	135,501	123,292
Encyclopedias, other reference materials	325,772	285,356	—
Home cleaning systems	129,678	126,812	—
Revenues not identified with segments	477,991	431,489	151,124
	$2,337,674	$2,176,665	$939,864

Operating Profit Before Taxes

	1987	1986	1985
Insurance	$ 97,054	$ 51,299	$ 50,987
Candy	30,718	29,373	28,014
Newspaper	38,811	34,137	29,322
Retailing of home furnishings	16,328	17,176	12,177
Encyclopedias, other reference materials	25,494	20,534	—
Home cleaning systems	23,325	20,019	—
Pre-tax operating profits not identified with segments	69,118	53,864	27,458
Corporate expenses	(3,380)	(2,748)	(1,725)
Shareholder designated contributions	(4,938)	(3,997)	(4,006)
Interest expense	(11,474)	(23,891)	(14,415)
	$281,056	$195,766	$127,812

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 following page. Realized investment gains are not reflected.

Capital Expenditures

	1987	1986	1985
Insurance	$ 804	$ 607	$ 623
Candy	4,758	4,138	3,756
Newspaper	1,266	764	3,602
Retailing of home furnishings	3,103	3,771	1,665
Encyclopedias, other reference materials	376	307	—
Home cleaning systems	1,320	1,562	—
Other	5,722	8,447	2,077
	$17,349	$19,596	$11,723

Expenditures which were part of business acquisitions are excluded.

(15) Business Segment Data *(continued)*

Depreciation and Amortization of Tangible Assets

	1987	*1986*	*1985*
Insurance	$ 648	$ 545	$ 531
Candy	3,200	2,956	2,613
Newspaper	2,909	2,899	2,762
Retailing of home furnishings	1,515	1,243	1,098
Encyclopedias, other reference materials	770	836	—
Home cleaning systems	2,627	2,647	—
Other	14,625	14,597	2,588
	$ 26,294	$ 25,723	$ 9,592

Amortization of Intangible Assets

	1987	*1986*	*1985*
Candy	$ 975	$ 975	$ 975
Newspaper	599	599	599
Retailing of home furnishings	509	509	509
Encyclopedias, other reference materials	162	162	—
Home cleaning systems	65	65	—
Other	552	245	(608)
	$ 2,862	$ 2,555	$ 1,475

Identifiable Assets At Year-End

	1987	*1986*	*1985*
Insurance	$4,519,664	$3,533,669	$2,627,957
Candy	64,742	68,856	68,129
Newspaper	54,326	58,735	59,822
Retailing of home furnishings	71,461	64,946	64,617
Encyclopedias, other reference materials	80,318	76,893	—
Home cleaning systems	46,191	46,777	—
Other	543,033	591,779	360,193
	$5,379,735	$4,441,655	$3,180,718

The totals set out above include amounts representing unamortized goodwill, as follows:

	1987	*1986*	*1985*
Candy	$ 31,573	$ 32,548	$ 33,523
Newspaper	21,108	21,708	22,307
Retailing of home furnishings	18,280	18,789	19,298
Encyclopedias, other reference materials	6,171	6,333	—
Home cleaning systems	2,464	2,529	—
Other	44,599	45,050	41
	$124,195	$ 126,957	$ 75,169

Notes to Consolidated Financial Statements *(Continued)*
(dollars in thousands except per share amounts)

(15) Business Segment Data *(continued)*

Revenues of the Insurance Segment

	1987	*1986*	*1985*
Premiums written	$751,253	$1,009,430	$497,400
Premiums earned:			
Primary or direct insurance	$441,635	$ 463,117	$184,333
Reinsurance assumed excluding structured settlements and portfolio reinsurance	372,763	344,385	82,877
Subtotal	814,398	807,502	267,210
Structured settlements and portfolio reinsurance	10,497	16,382	49,849
Total premiums earned	824,895	823,884	317,059
Investment income	152,995	107,495	95,422
	$977,890	$ 931,379	$412,481

Insurance Segment Operating Profit Before Taxes

	1987	*1986*	*1985*
Underwriting gain (loss):			
Primary or direct insurance operations	$ (2,715)	$ 3,538	$ (8,147)
Reinsurance assumed excluding structured settlements and portfolio reinsurance	(27,745)	(49,355)	(29,973)
Subtotal	(30,460)	(45,817)	(38,120)
Structured settlements and portfolio reinsurance	(24,969)	(10,027)	(6,110)
Total underwriting (loss)	(55,429)	(55,844)	(44,230)
Net investment income	152,483	107,143	95,217
	$ 97,054	$ 51,299	$ 50,987

(16) Dividend Restrictions — Insurance Subsidiaries

Payments of dividends by Insurance Group members are restricted by insurance statutes and regulations. In 1988 Berkshire can receive up to approximately $278,000 as its proportionate share of dividends paid by Insurance Group members without prior regulatory approval.

Combined stockholder's equity of insurance subsidiaries, determined pursuant to statutory accounting rules (Statutory Surplus as Regards Policyholders), was approximately $2,800,000 and $2,100,000 at December 31, 1987 and 1986, respectively. These amounts exceeded the corresponding amounts determined on the basis of generally accepted accounting principles by approximately $400,000 at December 31, 1987 and $275,000 at December 31, 1986. The principle difference is represented by deferred income tax liabilities established for financial reporting purposes but ignored for statutory reporting purposes.

BERKSHIRE HATHAWAY INC.
PARENT COMPANY — 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

	December 31, 1987	December 31, 1986
Assets		
Cash and invested cash	$ 4,711	$ 9,151
Investment in subsidiaries (including unrealized appreciation of marketable equity securities owned by insurance subsidiaries, net of taxes, amounting to $1,104,123 and $874,813 at Dec. 31, 1987 and 1986 respectively)	2,914,556	2,393,873
Other assets	6,297	2,102
	$2,925,564	$2,405,126
Liabilities and Stockholders' Equity		
Accounts payable and accrued expenses	$ 2,523	$ 2,244
Term debt and other borrowings	63,565	16,949
Income taxes	17,817	8,136
	83,905	27,329
Stockholders' equity (See Consolidated Balance Sheets)	2,841,659	2,377,797
	$2,925,564	$2,405,126

Statements of Earnings

	1987	1986	1985
Income items:			
From subsidiaries:			
Interest	$ 186	$ 299	$ 507
Dividends	164,010	427,546	86,094
Undistributed earnings	72,611	(134,773)	355,396
	236,807	293,072	441,997
Interest and dividends — other investments	1,686	1,263	1,276
Other income	598	4	2,904
Income tax credit	962	8,207	4,529
	240,053	302,546	450,706
Cost and expense items:			
Corporate administration	3,380	2,748	1,725
Shareholder Designated Contributions*	—	867	805
Textile business expenses**	—	1,474	1,850
Interest expense	2,121	15,096	10,511
	5,501	20,185	14,891
Net earnings	$234,552	$282,361	$435,815

Shareholder designated contributions were made by wholly-owned subsidiaries in full in 1987 and in major part in 1986 and 1985.

***The parent company operated a textile products manufacturing and marketing business that was discontinued at the end of 1985. Gross profit from sale of textile products is reflected above in other income for 1985. Textile business expenses reflected for 1985 represent administrative and selling expenses of the business. Textile business expenses for 1986 represent costs associated with abandonment of the business, net of rental income received from leasing portions of the real properties previously used in the business. In 1987 the properties were contributed to a wholly-owned subsidiary formed to conduct the rental activities.*

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

Results of Operations

Note 15 to the Consolidated Financial Statements (the "Segment Note"), at pages 36 to 38 should be referenced in connection with this discussion.

The Segment Note reflects, among other information, operating profit before taxes for each of the past three years for each significant Berkshire business segment. A meaningful portion of the Insurance Group's investment income is largely free of Federal income taxes. Federal capital gains tax rates (34% in 1987 vs. 28% in 1986 and 1985) applicable to realized securities gains differ from rates applicable to ordinary income (40% in 1987 vs. 46% in 1986 and 1985). After-tax net earnings are disaggregated in the following table, thus reflecting results after giving effect to these differing rates of applicable income taxes.

	After-Tax Earnings (Costs) 000s Omitted		
	1987	*1986*	*1985*
Insurance	$115,962	$ 66,576	$ 56,147
Manufacturing, merchandising and services	109,681	80,743	47,184
Interest and financing costs	(5,905)	(12,213)	(7,288)
Other unallocated corporate costs	(4,992)	(3,642)	(3,095)
Earnings before realized investment gain	214,746	131,464	92,948
Realized investment gain	19,806	150,897	342,867
Net earnings	$234,552	$282,361	$435,815

Insurance

The figures shown above for the Insurance segment reflect the following:

	1987	*1986*	*1985*
Underwriting gains (losses):			
Primary or Direct Insurance Operations	$ (2,715)	$ 3,538	$ (8,147)
Reinsurance Assumed, excluding Structured Settlements and Portfolio Reinsurance	(27,745)	(49,355)	(29,973)
Structured Settlements and Portfolio Reinsurance	(24,969)	(10,027)	(6,110)
Underwriting loss — pretax	(55,429)	(55,844)	(44,230)
Applicable income tax credit	34,461*	25,688	20,346
Applicable minority interest	309	292	315
After-tax underwriting loss	(20,659)	(29,864)	(23,569)
After-tax net investment income	136,621	96,440	79,716
Net earnings	$115,962	$ 66,576	$ 56,147

**The "fresh start" credit (discussed elsewhere herein) accounted for approximately $8 million of the Insurance Group's 1987 income tax credit applicable to underwriting losses.*

Discussions of underwriting results which follow deal with specified subsegments of Berkshire's insurance business. One such subsegment is described as "Primary or direct insurance operations". That term includes those operations where insurance policies are issued to named insureds that are directly subject to the risks insured against. The term is used to distinguish such business from that of reinsurance assumed activities that involve insuring other insurers.

Insurance (continued)

Primary or Direct Insurance Underwriting

A summary follows of the combined underwriting results, determined on the basis of generally accepted accounting principles ("GAAP"), of the Berkshire Hathaway Insurance Group's primary or direct insurance operations. Dollars are in thousands.

	1987		*1986*		*1985*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Premiums written	$412,748		$594,607		$269,057	
Premiums earned	441,635	100.0	463,117	100.0	184,333	100.0
Losses and loss expenses	338,575	76.7	347,468	75.0	140,029	76.0
Underwriting expenses	105,775	23.9	112,111	24.2	52,451	28.4
Total losses and expenses	444,350	100.6	459,579	99.2	192,480	104.4
Underwriting gain (loss) — pre-tax	$ (2,715)		$ 3,538		$ (8,147)	

Price competition intensified during 1987 in the property/casualty insurance industry. This resulted in considerably fewer risk acceptances in Berkshire's primary or direct insurance operations in 1987 as compared with 1986. The extraordinary growth in earned premiums that occurred in 1986 resulted from an increased number of risks underwritten at notably higher premium rates. Premiums written by this subsegment declined in the most recent year by about 30% from the prior year. Changes in written premium foretell changes in earned premium, and premiums earned in 1988 by this subsegment are virtually certain to decline substantially from 1987/86 levels. The underwriting expense ratios shown above of 23.9% for 1987 and 24.2% for 1986 were well below the comparable 28.4% ratio for 1985 principally because a greater portion of the premiums earned in the most recent two years represented those earned with respect to policies issued by the Group's Special Risks and Commercial Casualty divisions. These are usually large-premium policies with commission rates considerably below those that prevail for small-premium policies.

Summarized below is loss and loss expense data for this business.

	000s Omitted		
	1987	*1986*	*1985*
Unpaid losses and loss expenses at beginning of year	$429,505	$209,236	$164,776
Incurred losses recorded:			
Current year occurrences	348,010	331,463	139,966
All prior years' occurrences	(9,435)	16,005	63
	338,575	347,468	140,029
Payments with respect to:			
Current year occurrences	44,856	53,086	35,419
All prior years' occurrences	95,147	74,113	60,150
	140,003	127,199	95,569
Unpaid losses and loss expenses at end of year	$628,077	$429,505	$209,236

Reflected in the 1987 underwriting results of the primary or direct insurance operations is favorable loss development of $9,435,000. The favorable loss development recorded in 1987 was slightly over 2% of the unpaid losses and loss expenses at the beginning of the year. In contrast, adverse loss development recorded in 1986 represented about 8% of the outstanding loss reserves at the beginning of that year. The amount of "development" recorded in a given year is a recognition of estimation error in the beginning-of-the-year stated liability. Additional information will become available and events will subsequently occur that will influence the loss amounts incurred and ultimately recorded with respect to the prior years' occurrences. Thus, one-year development data does not speak to the question of adequacy of an insurer's loss reserving practices. However, such data is useful in that it reveals the effect on reported income of any given year of the estimation error recognized in that year.

Management's Discussion *(continued)*
Insurance (continued)

Reinsurance Assumed, excluding Structured Settlements and Portfolio Reinsurance

The combined underwriting results, determined on a GAAP basis, with respect to the reinsurance assumed business, other than structured settlements and portfolio reinsurance, are summarized in the following table, with dollars in thousands.

	1987		*1986*		*1985*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Premiums written	$328,011		$398,446		$178,502	
Premiums earned	372,763	100.0	344,385	100.0	82,877	100.0
Losses and loss expenses	287,638	77.2	282,563	82.0	85,670	103.4
Underwriting expenses	112,870	30.2	111,177	32.3	27,180	32.8
Total losses and expenses	400,508	107.4	393,740	114.3	112,850	136.2
Underwriting (loss) — pre-tax	$(27,745)		$(49,355)		$(29,973)	

Premiums earned by this subsegment in each of the past three years were principally derived from major quota share reinsurance contracts. One of the contracts is a four year, 7% quota share treaty with Fireman's Fund Insurance Companies, effective until September 1, 1989. Earned premiums from this contract were $254 million, $233 million and $70 million respectively, in 1987, 1986, and 1985. Another major quota share reinsurance contract has been in force for the past two years, from which earned premiums were approximately $88 million in 1987 and $85 million in 1986. That contract expired at the end of 1987, was not renewed and unearned premiums of $27,924,000 were returned with respect thereto as of December 31, 1987. Berkshire remains liable for future payments against its quota share of losses incurred during 1987 and 1986 in that reinsured book of business.

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

	000s Omitted		
	1987	*1986*	*1985*
Unpaid losses and loss expenses at beginning of year	$319,989	$114,191	$ 47,867
Incurred losses recorded:			
Current year occurrences	283,151	261,554	66,228
All prior years' occurrences	4,487	21,009	19,442
	287,638	282,563	85,670
Payments with respect to:			
Current year occurrences	45,201	43,711	5,155
All prior years' occurrences	74,328	33,054	14,191
	119,529	76,765	19,346
Unpaid losses and loss expenses at end of year	$488,098	$319,989	$114,191

Insignificant amounts of either favorable or adverse loss development have been recorded to date with respect to the major quota share reinsurance contracts. Adverse development of $4,487,000, as shown above for 1987, was recorded principally with respect to surety reinsurance loss occurrences in 1985 and 1986.

Insurance (continued)

Structured Settlements and Portfolio Reinsurance

Analyses of loss developments for the Structured Settlements and Portfolio Reinsurance business are not meaningful because, at inception of these contracts, it is predictable that subsequent underwriting losses will result in varying amounts that are reasonably estimable. Acceptance of the business nevertheless occurs after appraisal on a proposal-by-proposal basis of the value of funds expected to be generated thereby.

Insurance Segment Investment Income

Net investment income earned by the Insurance Group for each of the past three years is summarized and reduced to after-tax income, in thousands of dollars, in the following table:

	Income Before Taxes	*Applicable Income Taxes*	*Applicable Minority Interest*	*Income After Taxes*
1987	$152,483	$13,670	$2,192	$136,621
1986	107,143	9,094	1,609	96,440
1985	95,217	15,257	244	79,716

Manufacturing, merchandising and services

Results of operations for the past three years of Berkshire's diverse non-insurance businesses are summarized in the following table, in thousands of dollars:

	1987	*1986*	*1985*
Revenues	$1,359,784	$1,245,286	$527,383
Costs and expenses	1,155,990	1,070,183	430,412
Earnings before income taxes	203,794	175,103	96,971
Applicable income taxes	(89,497)	(90,180)	(45,818)
Applicable minority interest	(4,616)	(4,180)	(3,969)
Net earnings	$ 109,681	$ 80,743	$ 47,184

Revenues of Berkshire's group of non-insurance businesses, on a combined basis, increased approximately 9% in 1987 over 1986, after more than doubling in 1986 over 1985. The latter resulted from the addition to the group in 1986 of the Scott Fetzer and Fechheimer businesses. Combined earnings before income taxes increased approximately 16% in 1987 over 1986. Such figures do not reflect any charge or apportionment of Berkshire corporate expenses, nor contributions made pursuant to the shareholder designated contribution program, nor for interest expense, consistent with the presentation in the Segment Note.

Reference to the Segment Note will reveal that 1987 revenues increased over 1986 for each of five non-insurance business segments indentified in that Note, with the increases ranging from 2.3% for the home cleaning systems segment to 14.2% for the World Book operations. Pre-tax profits of each of these segments also increased in 1987, with the exception of the Nebraska Furniture Mart where lower gross margins were realized in 1987 than in 1986, causing that segments pretax profits to decline slightly.

As shown above, aggregate after tax earnings of the Group were enhanced in 1987 by application of lower rates of income taxes than in 1986. This reflects provisions of the 1986 Tax Reform Act. But, provisions of that Act also accelerated approximately $9 million of World Book's otherwise deferred income taxes, relating to unrealized gross profit on installment sales, into current income taxes.

Interest and Financing Costs

Interest and financing costs decreased approximately $12.4 million, before income tax effect, in 1987 versus 1986. This principally resulted from the fact that Berkshire incurred interest expense with respect to $60 million face amount of 12¾% debentures outstanding from 1980 until December 1986 when such debt obligations were called for prepayment. A call premium cost of approximately $5.3 million was incurred in 1986 with respect to prepayment, as described in the prior year report.

Management's Discussion *(continued)*

Realized Investment Gain

Realized investment gain has been an element of Berkshire's net earnings for each of the past several years. The amount of this gain — recorded by Berkshire when appreciated securities are sold — tends to fluctuate significantly from period to period. The varying effect upon Berkshire's consolidated net earnings is evident on the face of the Consolidated Statements of Earnings. The amount of realized investment gain for any period has no predictive value, and variations in amount from period to period have no practical analytical value, given the preexistence of substantial unrealized price appreciation in Berkshire's consolidated investment portfolio.

Liquidity and Capital Resources

Berkshire's Consolidated Balance Sheet as of December 31, 1987 reflects continuing capital strength. Berkshire shareholders' equity has increased from approximately $1.3 billion at December 31, 1984 to approximately $2.8 billion at December 31, 1987. In that three-year period, realized and unrealized securities gains increased equity capital by approximately $1.1 billion, and reinvested earnings, other than realized securities gains, were approximately $400 million. Significantly increased liabilities over the three year period arose from increased funds held for the benefit of Berkshire Hathaway Insurance Group policyholders — unpaid losses, loss adjustment expenses and unearned insurance premiums. Their total increased approximately $1.3 billion during the three years. Berkshire's financial practices are directed so as to continuously provide wide margins of safety, in the form of significant financial strength and ample liquidity, in support of the Company's financial obligations. The capital strength of the Berkshire Hathaway Insurance Group is significantly higher than normal in the property and casualty insurance industry. This strength, reflected in the Group's ratios of premiums to surplus (0.27:1, 0.48:1 and 0.30:1 for 1987, 1986 and 1985, respectively), is useful as a marketing tool, in that members of the Group are thereby meaningfully distinguished from their competitors. The aggregate-premium to aggregate-surplus ratio for the industry for all recent years has approximated 1.9:1.

During 1987, Standard & Poor's Corporation increased the credit rating it has assigned to the Company's long-term debt to AA+, the second highest rating it assigns that category of obligations. In January, 1988 Berkshire issued $250,000,000 face amount of 30 year debentures, redeemable through sinking funds commencing in 1999. Proceeds from the issue were contributed to the equity capital of the Insurance Group. Final maturity of the obligations, which bear interest at approximately 10% per annum, is in January, 2018. It seems probable that Berkshire will be unable to employ the funds in the near term to return amounts equal to or in excess of their cost. However, the enhanced liquidity that resulted from the borrowings improved the Company's ability to respond to future business acquisition opportunities as they arise.

The 1987 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 1987 increased to $16,612,000 ($2.33 per share) from $11,934,000 ($1.68 per share) in the previous year.

Consolidated net income (i.e., after unusual operating losses and all net gains from sales of securities) decreased to $15,213,000 ($2.14 per share) from $16,524,000 ($2.32 per share) in the previous year.

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, 1987		December 31, 1986	
	Amount	Per Wesco Share	Amount	Per Wesco Share
"Normal" net operating income (loss) of:				
Mutual Savings	$ 2,895	$ .41	$ 2,159	$ .30
Precision Steel's businesses	2,450	.34	1,701	.24
Wesco-Financial insurance business —				
Underwriting	(1,394)	(.19)	(1,469)	(.21)
Investment activity	10,853	1.52	8,084	1.14
	9,459	1.33	6,615	.93
All other "normal" net operating income(2)	1,808	.25	1,459	.21
	16,612	2.33	11,934	1.68
Writeoff by Mutual Savings of prepaid FSLIC insurance premiums(3)	(1,935)	(.27)	—	—
Flood loss at Precision Steel	(672)	(.09)	—	—
Net gains on sales of securities	1,208	.17	4,590	.64
Wesco consolidated net income	$15,213	$2.14	$16,524	$2.32

(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) Necessitated by the Federal Home Loan Bank's elimination of the savings and loan industry's nearly $1-billion secondary insurance reserve, consisting of deposit insurance premiums prepaid to FSLIC, the U.S agency which insures accounts in savings and loan associations.

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 $2,895,000 in 1987 represented an increase of 34% from the $2,159,000 figure the previous year.

However, this "normal" figure of $2,895,000 for Mutual Savings' 1987 earnings is created by ignoring as abnormal an after-tax charge of $1,935,000 from writeoff of prepayments of deposit-insurance premiums. The premiums had been prepaid in previous years to FSLIC, the U.S. agency which insures accounts in savings and loan associations. Since FSLIC has been grievously impaired by widespread failure of insured associations and continues to be insolvent, and since its long-term source of support is collection of premiums which the savings and loan industry is *compelled* to pay, it may well be questioned whether FSLIC-related charges far in excess of past experience should on that account now be excluded from the "normal" as we do in this explanatory letter. Mutual Savings' position, relative to FSLIC, is like that of the owner of a concrete pier, mostly underwater, compelled to buy fire insurance on a pooled-rate basis with a group of oily-rag collectors, many of whom have already had but not reported their fires, with the result that no provision for such fires has yet been made in pooled-basis premium rates. Such an owner probably has not yet had his last unpleasant surprise from his insurance costs. Even so, we chose "unusual" classification for the FSLIC special charge in 1987, because it is not certain to be repeated.

Separate balance sheets of Mutual Savings at yearend 1986 and 1987 are set forth at the end of this annual report. They show (1) total savings accounts rising to $287 million from $282 million the year before, (2) a very high ratio of shareholders' equity to savings account liabilities (probably the highest for any mature U.S. savings and loan association), (3) a substantial portion of savings account liabilities offset by cash equivalents and marketable securities, and (4) a loan portfolio (mostly real estate mortgages) of about $139 million at the end of 1987, up 76% from the $79 million at the end of 1986.

The loan portfolio at the end of 1987, although containing almost no risk of loss from defaults, bore an average interest rate of only 8.38%, probably near the lowest among U.S. savings and loan associations, but up sharply from 7.48% at the end of 1986. There is now no significant unrealized depreciation in the loan portfolio, while unrealized appreciation in Mutual Savings' interest-bearing securities and preferred stocks at December 31, 1987 was about $9 million.

As pointed out in Note 10 to the accompanying financial statements, the book value of Wesco's equity in Mutual Savings ($56.6 million at December 31, 1987) 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, for the $56.6 million reported as book value, the parent corporation would receive much less than $56.6 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.

Mutual Savings has not only a buried plus value in unrealized appreciation of securities, but also a buried plus value in real estate. 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 $2.0 million balance sheet carrying cost. Reasonable, community-sensitive development of this property has been delayed over 12 years in the course of administration of land-use laws. But, miraculous to report, grading is now actually under way on the property for an authorized development into 31 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.

The buried plus value in real estate is limited by the small number of houses allowed (31) and by the fact that only a minority of such houses (11) will have any significant ocean view. Additional limitation will come from prospective high cost of private streets, sewage and utility improvements and connections, and landscaping. And, most important of all, various charges and burdens, including heavy archaeological obligations imposed by governmental bodies, will drastically reduce our potential recovery from what it would have been had the zoning and development climate of the early 1970s continued into 1988.

Mutual Savings is now a "qualified thrift lender" under the Federal regulatory definition requiring 60% of assets in various housing-related categories. Substantially all loans receivable have either short expected lives or bear interest rates which fluctuate with the market to 25% per annum or more.

While the "spread" between Mutual Savings' average interest rates paid on savings and received on loans remains too low to provide respectable profits, such spread is improving. Moreover, the disadvantage from inadequate spread continues to be offset to a considerable degree by the effect of various forms of tax-advantaged investment, primarily preferred stock. The negative side of this tax-advantaged antidote to inadequate interest rate margin on loans is the risk that preferred stock, with its fixed dividend and long life, will decline in value and not provide enough income to cover Mutual Savings' interest costs, if the general level of interest rates should sharply rise. In view of this risk, Mutual Savings' total commitment to preferred stock is kept conservative, relative to the amount of its net worth.

All in all, Mutual Savings continues to be a mediocre business, albeit one which is both (1) improving slightly and (2) expected to produce an average return of at least 10% per annum on the after-tax proceeds which could be realized from its liquidation. And, of course, we are making needed loans in our community while we try to behave as if there were no federal deposit-insurance system. Such an institution may find a bigger role as the years go by.

Precision Steel

The businesses of Wesco's Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, contributed $2,450,000 to "normal" net operating income in 1987, up 44% compared with $1,701,000 in 1986. The increase in 1987

profit occurred in spite of only a modest increase in revenues (up 5% to $54,843,000).

The "normal" net operating income figure does not include the adverse effect of an after-tax charge of $672,000 from a flood loss following a severe rainstorm in August, during which nine inches of rain fell in a twenty-four hour period. We consider such a flood a once-in-a-hundred-years type of occurrence, and have no hesitation as we exclude the item from "usual" results in our explanatory letter.

Under the skilled leadership of David Hillstrom, Precision Steel's businesses in 1987 provided an extraordinary return even without taking into account the financial leverage put into Wesco's consolidated picture incident to their acquisition.

The good financial results have an underlying reason. 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-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 in 1985 invested $45 million in cash equivalents in a newly organized, wholly owned insurance company, Wesco-Financial Insurance Company ("Wes-FIC"). Another $45 million was invested in 1986 and 1987.

The new subsidiary, Wes-FIC, has 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 1987 exceeded $73 million.

Wes-FIC's net income for 1987 was $9,468,000, versus $6,967,000 for 1986. The net income figures included securities gains, net of income taxes, of $9,000 in 1987 and $352,000 in 1986. Wes-FIC's 1987 net income benefitted by about

$1 million because of an unusual adjustment to its income tax provision caused by the Tax Reform Act of 1986.

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. Wesco shareholders should remain aware, not only of the inherent imperfections of Wes-FIC's accounting, but also of the inherent cyclicality of its business.

However, 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.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, increased to $1,808,000 in 1987 from $1,459,000 in 1986. Sources were (1) rents ($2,272,000 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, decreased to $1,208,000 in 1987 from $4,590,000 in 1986.

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 were extremely complex but can be fairly summarized as far from adequate to assure that the investors would 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 problems.

The investment continued to be carried at cost in Wesco's accompanying year-end financial statements, but it was sold, as part of a friendly acquisition of Bowery

by a large and reputable company, on January 31, 1988, at an after-tax profit for Wesco of about $5 million.

Richard Ravitch was the organizing leader in the group which revitalized Bowery Savings Bank, acted as its CEO and negotiated its sale. We take this opportunity to doff our hat to him for a job well done. We have similar admiration for our other co-investors, particularly the Tisch family and Richard Rosenthal. Mr. Rosenthal was a former Salomon partner (see below) who died in a tragic air crash in the midcourse of our venture.

Salomon Inc

On October 1, 1987 Wesco and certain of its wholly owned subsidiaries purchased 100,000 newly issued shares of Series A Cumulative Convertible Preferred Stock, without par value, of Salomon Inc ("Salomon"), at a cost of $100 million. Salomon's primary business is transacted by its subsidiary, Salomon Brothers, a leading securities firm. Our investment was part of a $700 million transaction in which other subsidiaries of Berkshire Hathaway Inc., Wesco's parent, invested $600 million. Principal terms of the transaction include the following: (1) the new preferred stock will pay dividends at the annual rate of 9%; (2) each preferred share, purchased at a cost of $1,000, will be convertible into 26.31579 shares of Salomon common stock on or after October 31, 1990, or earlier if certain extraordinary events occur; and (3) the preferred stock is subject to mandatory redemption provisions requiring the retirement, at $1,000 per share plus accrued dividends, of 20% of the issue on each October 31, beginning in 1995, so long as any shares of preferred stock remain outstanding.

At the stated conversion price of the preferred stock, a profit (subject to certain procedural requirements) will be realizable whenever, after October 31, 1990, the common stock of Salomon (listed NYSE) trades at over $38 per share. At the time of our commitment to buy the new preferred, the common stock of Salomon was selling in the low 30s. However, shortly after the ink dried on Wesco's new stock certificates, the October 19, 1987 "Black Monday" stock market crash occurred, which caused temporary but substantial operating losses plus a lowered credit rating at Salomon. Although Salomon, among securities firms, suffered only its rough share of the general debacle, its common stock at one time after the crash traded as low as 16⅝.

Fortunately, as the conversion privilege we had bargained for declined in value along with the price of Salomon common stock, interest rates also declined, which made our fixed 9% annual preferred stock dividend more valuable. We believe that, all factors considered, at December 31, 1987 our $100 million investment in preferred stock of Salomon was still worth about $98 million.

We much admire the way Salomon and its leader, John Gutfreund, are adjusting operations to cope with new and adverse conditions. They seem ahead of the game to us, compared with competitors, and they work from the sound base of an honored name, affixed to an organization deep in talent and known for hard work.

Berkshire Hathaway's Chairman, Warren Buffett, and the undersigned joined the board of Salomon on October 28, 1987, and are very pleased with the new association.

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 on the accompanying consolidated balance sheet, the aggregate market value of Wesco's marketable equity securities was higher than their aggregate carrying value at December 31, 1987 by about $6 million, down significantly from about $13 million one year earlier. The consolidated aggregate market value of all marketable securities, including bonds and other fixed-income securities, exceeded aggregate carrying value by about $12 million. As earlier noted, about $9 million of this unrealized appreciation lies within the savings and loan subsidiary.

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 ($4,850,000 at 9.25% fixed) against this real estate now exceeding its depreciated carrying value ($3,164,000) in Wesco's balance sheet at December 31, 1987, 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 99% 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 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 15% in 1985-87, was dependent to a very large extent on securities gains, irregular by nature. This recent ratio is almost certain to continue to decline, probably sharply, as it did in 1987. Neither possible future acquisitions of other businesses nor possible future securities gains appear likely to help much in the short term. The business acquisition game continues to be crowded with optimistic players who usually force prices for low-leverage acquirers like Wesco to levels where return-on-investment prospects are modest. And future securities gains are likely to prove harder to come by for very simple reasons. 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, early in 1988, even easier than it was early in 1986, to predict less desirable future results. It is also easy for any sophisticated Wesco shareholder, reviewing either (1) this virtual reprint of last year's letter or (2) Wesco's marketable securities disclosed herein, to diagnose (correctly) that the decision-makers are now even more dry of good ideas than they were two years earlier.

The considerable, and higher than desired, liquidity of Wesco's consolidated financial position as this is written does not result from our forecast that business conditions are about to worsen, or that interest rates are about to rise, or that common stock prices are about to fall. Wesco's condition results, instead, from our simply not finding opportunities for more aggressive use of capital with which we are comfortable.

Wesco continues to try 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, our approach is being applied to no great base position. Wesco has only a tiny fraction of its total intrinsic value in businesses with enough commercial advantage in place to assure permanent high future returns on capital employed. In contrast, Berkshire Hathaway, Wesco's parent corporation, has a larger proportion of its intrinsic value in durable high-return businesses.

Some historical explanation for the current situation becomes appropriate here. When Wesco's parent corporation acquired control, Wesco's activities were almost entirely limited to holding (1) some surplus cash, plus (2) a multi-branch savings and loan association which had many very long-term, fixed-rate mortgages, offset by interest-bearing demand deposits. The acquisition of this intrinsically disadvantageous position was unwisely made, alternative opportunities considered, because the acquirer was overly influenced by a price considered to be moderately below liquidating value. Under such circumstances, acquisitions have a way of producing, on average, for acquirers who are not quick-turn operators, low to moderate long-term results. This happens because any advantage from a starting "bargain" gets

swamped by effects from change-resistant mediocrity in the purchased business. Such normal effects have not been completely avoided at Wesco, despite some successful activities, including recent investment in General Foods.

Over the long term, a corporation like Wesco, with no significant proportion of intrinsic value in great businesses, is like a tortoise in a race of hares. And, as noted above, this particular tortoise faces the race with an unoriginal and conservative approach.

However, there are respectable precedents for our approach. The novelist Hardy, who believed that the natural outcome of ambition was getting clobbered, advocated the logical preventative of aiming low. And people known for outcomes far too good to have been expected by Hardy have mined a branch of the same vein. Consider this statement from Newton: "If I have seen further than other men, it is by standing on the shoulders of giants". And this from Mozart (as approvingly quoted by the distinguished advertising creator, David Ogilvy): "I never tried to compose anything original in my life".

It is occasionally possible for a tortoise, content to assimilate proven insights of his best predecessors, to outrun hares which seek originality or don't wish to be left out of some crowd folly which ignores the best work of the past. This happens as the tortoise stumbles on some particularly effective way to apply the best previous work, or simply avoids standard calamities. Anyway, we hope so. And so should recent purchasers of Wesco stock who have not only bet on a tortoise but also, by paying prices in the mid forties, given odds.

On January 28, 1988, Wesco increased its regular quarterly dividend from 17½ cents per share to 18½ cents per share, payable March 15, 1988, to shareholders of record as of the close of business on February 26, 1988.

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

Charles T. Munger
Chairman of the Board

February 26, 1988

BERKSHIRE HATHAWAY INC.

SHAREHOLDER-DESIGNATED CONTRIBUTIONS

The Company has conducted this program of corporate giving for seven 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
1986	$4	97.1%	3,996,820	1,934
1987	$5	97.2%	4,937,574	2,050

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

In addition to the shareholder-designated contributions summarized above, Berkshire and its subsidiaries made certain contributions pursuant to local level decisions of operating managers of the businesses.

* * *

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

	1983	1984	1985	1986	1987
Revenues of consolidated companies:					
Sales and service revenues	$ 381,674	$ 500,219	$ 508,764	$1,225,290	$1,332,840
Insurance premiums earned	152,480	140,242	317,059	823,884	824,895
Interest and dividend income	64,903	84,161	107,662	118,429	163,341
Earnings:					
Before realized investment gain	$ 48,644	$ 70,201	$ 92,948	$ 131,464	$ 214,746
Realized investment gain	63,522	78,694	342,867	150,897	19,806
Net earnings	$ 112,166	$ 148,895	$ 435,815	$ 282,361	$ 234,552
Common shares outstanding — average in thousands	1,067	1,147	1,147	1,147	1,147
Earnings per share:					
Before realized investment gain	$ 45.60	$ 61.21	$ 81.04	$ 114.62	$ 187.24
Net earnings	105.15	129.82	379.99	246.19	204.51
Year-end data:					
Total assets	$1,837,543	$2,035,203	$3,180,718	$4,441,655	$5,379,735
Term debt and other borrowings ...	128,984	127,104	117,879	94,923	132,165
Minority shareholders' interest	17,990	22,299	34,360	43,289	45,871
Stockholders' equity — total	1,119,193	1,271,761	1,885,330	2,377,797	2,841,659
Shares of common stock outstanding — in thousands	1,147	1,147	1,147	1,147	1,147
Stockholders' equity — per outstanding share	$ 975.76	$ 1,108.77	$ 1,643.71	$ 2,073.06	$ 2,477.47

Shareholder Communications

A compilation of letters taken from Berkshire Hathaway Inc. Annual Reports for the years from 1979 to 1985 is available upon request. Direct your request to the Company at 1440 Kiewit Plaza, Omaha, Nebraska 68131.

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 and Secretary

ROBERT H. BIRD, *Vice President*

MICHAEL A. GOLDBERG, *Vice President*

MARC D. HAMBURG, *Treasurer*

DANIEL J. JAKSICH, *Controller*

J. WILLIAM SCOTT, *Vice President*

GENERAL COUNSEL

STEVEN T. ATKINS

COMMON STOCK DATA

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.

Shareholders

The Company had approximately 4,900 record holders of its common stock at March 5, 1988.

Market Prices

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market through the National Association of Securities Dealers Automated Quotation ("NASDAQ")/National Market System under the symbol BKHT. The following high and low selling prices for the shares during each quarter of 1987 and 1986 were taken from quotations provided to the Company by the National Association of Securities Dealers, Inc.

1987	*High*	*Low*
First Quarter	$3,630	$2,800
Second Quarter	3,530	3,330
Third Quarter	4,220	3,420
Fourth Quarter	4,270	2,550

1986	*High*	*Low*
First Quarter	$3,250	$2,220
Second Quarter	3,160	2,640
Third Quarter	3,100	2,525
Fourth Quarter	2,925	2,620

Dividends

Berkshire has not declared a cash dividend since 1967.

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

BERKSHIRE HATHAWAY INC.

1440 Kiewit Plaza

Omaha, Nebraska 68131

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

MAY 23, 1988

TO THE STOCKHOLDERS:

Notice is hereby given that the Annual Meeting of the Stockholders of Berkshire Hathaway Inc. will be held at the Witherspoon Auditorium, Joslyn Art Museum, 2200 Dodge Street, Omaha, Nebraska, on Monday, May 23, 1988 at 9:30 o'clock in the forenoon for the following purposes:

1. To fix the number of directors at five and to elect directors.
2. To consider and act upon any other matters which may properly come before the meeting or any adjournment or adjournments thereof.

The Board of Directors has fixed the close of business on March 24, 1988 as the record date for determining the stockholders having the right to vote at this meeting or any adjournment or adjournments thereof. A list of stockholders entitled to vote at the meeting will be available for examination by any stockholder for any purpose germane to the meeting during ordinary business hours at 1401 Kiewit Plaza, Omaha, NE during the ten days prior to the meeting.

You are requested to date, sign and return the enclosed proxy which is solicited by the Board of Directors of the Corporation and will be voted as indicated in the accompanying proxy statement and proxy. A return envelope is provided which requires no postage if mailed in the United States. If mailed elsewhere, foreign postage must be affixed.

By order of the Board of Directors

J. VERNE MCKENZIE, *Secretary*

Omaha, Nebraska
March 30, 1988

We hope that you will be able to attend this meeting in person, but if you cannot be present, we ask that you please immediately execute the accompanying form of proxy and return it in the enclosed return envelope. If you plan to attend the meeting, but your shares are not registered in your own name, please be prepared at the meeting to present evidence of your beneficial ownership on March 24, 1988 of Berkshire Hathaway common shares.

BERKSHIRE HATHAWAY INC.

1440 Kiewit Plaza

Omaha, Nebraska 68131

PROXY STATEMENT
FOR ANNUAL MEETING OF STOCKHOLDERS
MAY 23, 1988

This statement is furnished in connection with the solicitation by the Board of Directors of Berkshire Hathaway Inc. (hereinafter "Berkshire" or the "Corporation") of proxies in the accompanying form for the Annual Meeting of the Stockholders to be held on Monday, May 23, 1988, and at any adjournment or adjournments thereof.

This proxy statement and the enclosed form of proxy were first sent to stockholders on or about March 30, 1988.

If the form of proxy which is enclosed herewith is executed and returned as requested, it may nevertheless be revoked at any time prior to exercise by filing an instrument revoking it or a duly executed proxy bearing a later date.

Solicitation of proxies will be made solely by mail at the Corporation's expense. The Corporation will reimburse brokerage firms, banks, trustees and others for their actual out-of-pocket expenses in forwarding proxy material to the beneficial owners of its common stock.

Issued common stock of the Corporation consists of 1,375,183 shares, par value $5 per share, of which on March 24, 1988, 228,541 shares were held by Berkshire as Treasury shares and 850 outstanding shares were held by the First National Bank of Boston as Agent for holders of unexchanged shares of Blue Chip Stamps. The remaining 1,145,792 outstanding shares are those eligible to be voted at this meeting. Holders of record thereof as of March 24, 1988 will be entitled to one vote per share.

Stockholders who send in proxies, but attend the meeting in person, may vote directly if they prefer and withdraw their proxies or may allow their proxies to be voted with the similar proxies sent in by other stockholders.

1. ELECTION OF DIRECTORS

At the meeting, the number of directors is to be fixed and a Board of Directors is to be elected, each director to hold office in accordance with the By-Laws until the next annual meeting of the stockholders, or special meeting of the stockholders held in place thereof, and until his successor is chosen and qualified. The By-Laws of the corporation provide that a board of not more than nine nor less than one director shall be elected at the annual meeting of the stockholders, by such stockholders as have the right to vote at such election, and that the number of directors for each corporate year shall be fixed by vote at the meeting at which they are elected.

When the accompanying proxy is properly executed and returned, the shares it represents will be voted in accordance with the directions indicated thereon, or if no direction is indicated the shares will be voted in favor of fixing the number of Directors at five and for the election of the five nominees identified below. The Corporation expects each of the nominees named below to be able to accept such nomination. If any nominee is unable to accept such nomination, proxies will be voted in favor of the remainder of those nominated and may be voted to fix the number of directors at such lesser number as will equal the number of nominees who are able to serve, or be voted for such substitute nominee as the present Board of Directors may designate.

Certain information with respect to nominees for election as directors is contained in the following table:

WARREN E. BUFFETT	Mr. Buffett is 57 years old, has been a director of the Corporation since 1965 and has been its Chairman and Chief Executive Officer since 1970. Mr. Buffett is a controlling person of the Corporation. He is a director of Capital Cities/ABC, Inc. which is engaged in television and radio broadcasting, publishing of newspapers and other publications, program distribution and programming for new video technologies. Also, Mr. Buffett is a director of Salomon Inc, a holding company whose operating units engage worldwide in diversified financial services including investment banking, commodities trading, and commercial financing.
KENNETH V. CHACE	Mr. Kenneth V. Chace is 71 years old. He has been a director of the Corporation since 1965. He was President of the Corporation and the chief operating officer of the textile division of the Corporation from 1965 until his retirement from these positions in 1984.
MALCOLM G. CHACE, JR.	Mr. Malcolm G. Chace, Jr., age 84, a private investor, has been a director of the Corporation since 1943. He was formerly Chairman of the Board of Directors of the Corporation.
J. VERNE MCKENZIE	Mr. McKenzie is 59 years old. He is Vice President and Secretary of the Corporation and has been a director since 1973.
CHARLES T. MUNGER	Mr. Munger, age 64, has been a director of the Corporation since 1978, serving since then as Vice-Chairman of the Corporation's Board of Directors. Mr. Munger is Chairman of the Board of Directors of Wesco Financial Corporation, approximately 80%-owned by the Corporation. Wesco is engaged through subsidiaries in the savings and loan business, in the insurance business, in the steel service center business, and in the manufacturing and distribution of tool-room specialty items. Mr. Munger is also Chairman of the Board of Directors of Daily Journal Corporation, a publisher of specialized newspapers in California. He is a director of Salomon Inc, a brief description of the businesses of which was included with information above with respect to Mr. Buffett.

There is no family relationship between any of the nominees for directors, nor between any of such nomineees and any other officer of the Corporation.

DIRECTORS MEETINGS

During 1987, the Board of Directors met on three occasions. Additionally recorded in 1987 were Directors' written consents to six actions. Except for one meeting at which neither Kenneth V. Chace nor Malcolm G. Chace, Jr. participated, all Directors participated in all actions.

There are no standing committees of the Board of Directors.

EXECUTIVE COMPENSATION

The following table shows the cash compensation for 1987 paid by the Corporation or its subsidiaries to Executive Officers of the Corporation.

Name of Individual or Number in Group	Capacities in Which Served	Cash Compensation
Warren E. Buffett	Chairman of the Board, Chief Executive Officer of Berkshire	$ 100,275
Michael A. Goldberg	Vice President of Berkshire	3,064,300
J. Verne McKenzie	Vice President, Chief Financial Officer, and Secretary of Berkshire	255,825
Charles T. Munger	Vice Chairman of the Board of Berkshire, Chairman of the Board of certain Berkshire subsidiaries	102,500
All executive officers of Berkshire (4 persons, each listed above)		$3,522,900

Directors of the Corporation who are employees of the Corporation or its subsidiaries do not receive fees for attendance at directors meetings. Other directors receive a fee of $900 for each meeting attended in person and $300 for participating in any meeting conducted by telephone connection. Directors are reimbursed for their out-of-pocket expenses incurred in attendance at meetings of directors or stockholders.

Bonus Arrangement — Mr. Goldberg

The terms of Mr. Goldberg's employment with the Corporation provide that he may receive annual bonus compensation in addition to his regular base pay. For 1987, Mr. Goldberg earned bonus compensation in the amount of $2,954,000. His bonus compensation is based upon results of certain operations of the Corporation's insurance subsidiaries for which he is responsible. The annual bonus, if any, is determined (i) in large part by the level of underwriting profits, (ii) in part by the level of investable funds generated by the insurance operations, and (iii) in part by market interest rates at which such funds could hypothetically be invested.

TERMINATION OF PENSION PLANS

The Company has terminated the non-contributory defined benefit pension plan which previously covered employees of the Corporation, including officers, meeting certain eligibility requirements. Under this plan eligible employees accrued annual retirement benefits the amounts of which were based upon earnings during years of participation. Benefits under the plan ceased to accrue to employees on October 10, 1987, and in January, 1988 assets of the Trust maintained to fund plan benefits were applied to the extent required to purchase annuities that will provide the accrued benefits. The following table sets forth information concerning such annuities for the individuals listed in the cash compensation table above, other than Mr. Munger, who is discussed separately below.

Name of Individual	Cost of Annuity	Annual Benefit*	Normal Retirement Date
Warren E. Buffett	$ 68,716	$16,587	September 1, 1995
Michael A. Goldberg	19,801	15,852	May 1, 2011
J. Verne McKenzie	101,556	21,146	January 1, 1994

* *The Annual Benefit is stated in terms of an annual amount payable in monthly installments commencing at normal retirement date and continuing for the lifetime of the annuitant. Optional forms of benefit of actuarial equivalence are available to each person.*

Mr. Munger is an employee of Blue Chip Stamps, a subsidiary of the Corporation. As such he was covered by a Blue Chip Stamps non-contributory defined benefit pension plan. Blue Chip Stamps has also terminated its pension plan, allowing covered employees to elect whether to receive an annuity providing retirement benefits under the plan, or to receive a lump-sum payment equal to the present value of the benefits. Pursuant to his election, Mr. Munger received a lump-sum payment of $101,062.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Warren E. Buffett, whose address is 1440 Kiewit Plaza, Omaha, NE 68131, a nominee for director, is the only person known to the Corporation to be the beneficial owner of more than 5% of the Corporation's common stock as of March 5, 1988. Beneficial ownership of the Corporation's common stock on such date by Mr. Buffett and by other executive officers and directors of the Corporation is shown in the following table:

Name	Amount and Nature of Beneficial Ownership	Percent of 1,147,000 Shares Outstanding
Warren E. Buffett	479,342 shares — sole investment and voting power (1)	41.79
	37,004 shares — shared investment and voting power (2)	3.23
Kenneth V. Chace	276 shares — sole investment and voting power (3)	.02
Malcolm G. Chace, Jr.	10,209 shares — sole investment and voting power (4)	.89
Michael A. Goldberg	250 shares — sole investment and voting power	.02
J. Verne McKenzie	200 shares — sole investment and voting power (5)	.02
Charles T. Munger	22,529 shares — sole investment and voting power (6)	1.97
	50 shares — shared investment and voting power (7)	.00
All executive officers and directors as a group (6 persons, each listed above)	512,806 shares — sole investment and voting power (8)	44.71
	37,054 shares — shared investment and voting power	3.23

(1) Includes 474,998 shares (41.41%) owned directly and beneficially by Mr. Buffett, and 4,344 shares (0.38%) owned by a trust of which Mr. Buffett is sole trustee but with respect to which Mr. Buffett disclaims any beneficial economic interest.

(2) Owned by Susan T. Buffett, wife of Warren E. Buffett.

(3) Does not include 431 shares (0.04%) owned by Jessie Chace, wife of Kenneth V. Chace.

(4) An additional 2,707 shares (0.24%) are held in trusts in which Malcolm G. Chace, Jr. has a beneficial economic interest, but with respect to which Mr. Chace has no investment or voting power.

(5) Does not include 175 shares (0.01%) owned by Janet McKenzie, wife of J. Verne McKenzie.

(6) Includes 22,435 shares (1.96%) owned directly and beneficially by Mr. Munger, and 94 shares (0.01%) owned by a trust of which Mr. Munger is sole trustee but with respect to which Mr. Munger disclaims any beneficial economic interest.

(7) Owned by a charitable foundation of which Mr. Munger is a Trustee.

(8) Does not include shares enumerated in (3), (4) and (5) above, which aggregate 3,313 shares (0.29%).

2. OTHER MATTERS

As of the date of this statement your management knows of no business which will be presented to the meeting which is not referred to in the accompanying notice, other than the approval of the minutes of the last stockholders' meeting, which action will not be construed as approval or disapproval of any of the matters referred to in such minutes. As to other business, if any, which may properly come before the meeting, it is intended that proxies, properly executed and returned, unless authority is withheld on the returned form of proxy, will be voted in respect thereof at the discretion of the persons voting the proxies.

Touche Ross & Co. served as the Corporation's independent public accountants for 1987. Representatives from Touche Ross & Co. will be present at the annual meeting of stockholders, will be given the opportunity to make a statement if they so desire, and will be available to respond to any appropriate questions. The Corporation has not selected auditors for the current year, since its normal practice is for the Board of Directors to make such selection after mid-year.

ANNUAL REPORT

The Annual Report to the Stockholders for 1987 accompanies this proxy statement, but is not deemed a part of the proxy soliciting material.

A copy of the 1987 Form 10-K report to the Securities and Exchange Commission, excluding exhibits, will be mailed to stockholders without charge upon written request to: J. Verne McKenzie, Secretary, Berkshire Hathaway Inc., 1440 Kiewit Plaza, Omaha, Nebraska 68131. Such requests must set forth a good-faith representation that the requesting party was either a holder of record or a beneficial owner of common stock of the Corporation on March 24, 1988. Exhibits to the Form 10-K will be mailed upon similar request and payment of specified fees.

PROPOSALS OF STOCKHOLDERS

Any stockholder proposal intended to be considered for inclusion in the proxy statement for presentation at the 1989 Annual Meeting must be received by the Corporation by December 1, 1988. The proposal must be in accordance with the provisions of Rule 14a-8 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934. It is suggested the proposal be submitted by certified mail — return receipt requested.

By order of the Board of Directors

J. VERNE MCKENZIE, *Secretary*

Omaha, Nebraska
March 30, 1988

BERKSHIRE HATHAWAY INC.
1440 KIEWIT PLAZA
OMAHA, NEBRASKA 68131
TELEPHONE (402) 346-1400

WARREN E. BUFFETT, CHAIRMAN

August 5, 1988

To the Shareholders of Berkshire Hathaway Inc.:

It is likely that in a few months Berkshire shares will be traded on the New York Stock Exchange. Our move there would be made possible by a new listing rule that the Exchange's Board of Governors has passed and asked the SEC to approve. If that approval is forthcoming, we expect to apply for a listing, which we believe will be granted.

Up to now, the Exchange has required newly-listed companies to have a minimum of 2,000 shareholders who each own 100 shares or more. The purpose of this rule is to insure that NYSE-listed companies enjoy the broad investor interest that facilitates an orderly market. The 100-share standard corresponds to the trading unit ("round lot") for all common stocks now listed on the Exchange.

Because Berkshire has relatively few shares outstanding (1,146,642), it does not have the number of 100-share-or-more holders that the Exchange has required. A ten-share holding of Berkshire, however, represents a significant investment commitment. In fact, ten Berkshire shares have a value greater than that of 100 shares of any NYSE-listed stock. The Exchange, therefore, is willing to have Berkshire shares trade in ten-share "round lots."

The Exchange's proposed rule simply changes the 2,000 shareholder minimum from one measured by holders of 100 shares or more to one measured by holders of a round lot or more. Berkshire can easily meet this amended test.

Charlie Munger, Berkshire's Vice Chairman, and I are delighted at the prospect of listing, since we believe this move will benefit our shareholders. We have two criteria by which we judge what marketplace would be best for Berkshire stock. First, we hope for the stock to consistently trade at a price rationally related to its intrinsic business value. If it does, the investment result achieved by each shareholder will approximate Berkshire's business result during his period of ownership.

Such an outcome is far from automatic. Many stocks swing between levels of severe undervaluation and overvaluation. When this happens, owners are rewarded or penalized in a manner wildly at variance with how the business has performed during their period of ownership. We want to avoid such capricious results. Our goal is to have our shareholder-partners profit from the achievements of the business rather than from the foolish behavior of their co-owners.

Consistently rational prices are produced by rational owners, both current and prospective. All of our policies and communications are designed to attract the business-oriented long-term owner and to filter out possible buyers whose focus is short-term and market-oriented. To date we have been successful in this attempt, and Berkshire shares have consistently sold in an unusually narrow range around intrinsic business value. We do not believe that a NYSE listing will improve or diminish Berkshire's prospects for consistently selling at an appropriate price; the quality of our shareholders will produce a good result whatever the marketplace.

But we do believe that the listing will reduce transaction costs for Berkshire's shareholders — and that is important. Though we want to attract shareholders who will stay around for a long time, we also want to minimize the costs incurred by shareholders when they enter or exit. In the long run, the aggregate pre-tax rewards to our owners will equal the business gains achieved by the company less the transaction costs imposed by the marketplace — that is, commissions charged by brokers plus the net realized spreads of market-makers. Overall, we believe these transaction costs will be reduced materially by a NYSE listing.

As we pointed out in the 1984 Annual Report, transaction costs are very heavy for active stocks, often amounting to 10% or more of the earnings of a public company. In effect, these costs act as a hefty tax on owners, albeit one based on individual decisions to "change chairs" and one that is paid to the financial community rather than to Washington. Our policies and your investment attitude have reduced this "tax" on Berkshire owners to what we believe is the lowest level among large public companies. A NYSE listing should further reduce this cost for Berkshire's owners by narrowing the market-maker's spread.

Under NYSE rules we must have at least two independent directors. Among the Board of Directors you elected in May, only Malcolm Chace, Jr. meets their test of independence.

But from this deficiency comes a good result. Charlie and I are pleased to inform you that Walter Scott, Jr., CEO of Peter Kiewit Sons', Inc. has joined the Berkshire board. PKS is one of the remarkable business stories of our time. The company, which is employee-owned, has a long-term financial record so good that I'm not going to recite it for fear of stirring unrest among our shareholders. Throughout his lifetime, Pete Kiewit ran the company as a strict meritocracy and it was in this tradition that he picked Walter to succeed him upon his death. Walter instinctively thinks like an owner and he will feel at home on the Berkshire board.

One final comment: *You should clearly understand that we are not seeking a NYSE listing for the purpose of achieving a higher valuation on Berkshire shares. Berkshire should sell, and we hope will sell, on the NYSE at prices similar to those it would have commanded in the over-the-counter market, given similar economic circumstances.* The NYSE listing should not induce you to buy or sell; it simply should cut your costs somewhat should you decide to do either.

Warren E. Buffett

Chairman of the Board