Berkshire Hathaway Inc.

1989
ANNUAL REPORT

BERKSHIRE HATHAWAY INC. and its subsidiaries engage in a number of diverse business activities. The most important of these is the property and casualty insurance and reinsurance business conducted nationwide through a number of subsidiaries. Investment portfolios of insurance subsidiaries include meaningful ownership percentages of other publicly traded companies.

Additionally, Berkshire Hathaway publishes the *Buffalo News*, a daily and Sunday newspaper circulated in upstate New York, and a number of Berkshire subsidiaries conduct substantial business activities unrelated to the insurance business. These include: the manufacture and distribution of *Fechheimer Bros.* uniforms, of *Kirby* home cleaning systems and of *See's* fine chocolate candy; also, the publication and distribution of *World Book* encyclopedias and other reference materials; the retailing of home furnishings and the retailing of fine jewelry. A savings and loan business is conducted in Pasadena, California by a subsidiary of Wesco Financial Corporation, a publicly traded and 80.1% owned subsidiary of Berkshire. The Scott Fetzer Financial Group, 100% owned by Berkshire, provides financing for buyers of *World Book* and *Kirby* products.

Operating decisions for the various Berkshire business units are made by unit managers. 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.

BERKSHIRE HATHAWAY INC.

1989 ANNUAL REPORT

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Certain **OWNER-RELATED BUSINESS PRINCIPLES** were included in the Chairman's letter* to Shareholders of Berkshire Hathaway Inc. in the 1983 Annual Report. Because the material remains topical, it is reproduced on this and the following page.

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

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

- In line with this owner-orientation, our directors are major shareholders of Berkshire Hathaway. In the case of at least four, 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.")

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• 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.

BERKSHIRE HATHAWAY INC.

Selected Financial Data at Five Year Intervals
(dollars in thousands, except per share amounts)

	1964	1969	1974	1979	1984	1989
Revenues:						
Sales and service revenues	$ 49,983	$ 40,427	$ 32,592	$ 286,493	$ 496,971	$ 1,526,459
Insurance premiums earned	—	25,258	60,574	181,949	140,242	394,279
Investment income, insurance group	—	2,017	7,916	24,747	69,281	250,723
Realized investment gain (loss)	—	5,722	(1,908)	10,769	114,136	223,810
Total revenues	$ 49,983	$ 73,424	$ 100,384	$ 560,381	$ 861,388	$2,483,892
Earnings (loss):						
Before realized investment gain	$ (2,824)	$ 3,863	$ 8,383	$ 35,921	$ 70,201	$ 299,902
Realized investment gain (loss)	—	4,090	(1,340)	6,896	78,694	147,575
Net earnings (loss)	$ (2,824)	$ 7,953	$ 7,043	$ 42,817	$ 148,895	$ 447,477
Earnings (loss) per share:						
Before realized investment gain	$ (2.41)	$ 3.92	$ 8.56	$ 34.97	$ 61.21	$ 262.46
Realized investment gain (loss)	—	4.15	(1.37)	6.71	68.61	127.55
Net earnings (loss)	$ (2.41)	$ 8.07	$ 7.19	$ 41.68	$ 129.82	$ 390.01
Year-end data:						
Total assets	$ 27,887	$ 95,746	$ 216,214	$ 1,433,863	$2,297,516	$ 9,459,594
Term debt and other borrowings	2,500	7,419	21,830	134,416	127,104	1,007,516
Shareholders' equity	22,139	43,918	88,199	344,962	1,271,761	4,925,126
Common shares outstanding, in thousands	1,138	980	980	1,027	1,147	1,146
Shareholders' equity per outstanding share	$ 19.46	$ 44.83	$ 90.04	$ 335.85	$ 1,108.77	$ 4,296.01

The 1964 fiscal year was the 52 week period ended October 3, 1964. The years 1969, 1974, 1979 and 1984 were fiscal years that ended on Saturday nearest December 31. Data are presented in conformity with 1989 consolidation and accounting practices; accordingly, certain prior year data have been restated.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 1989 was $1.515 billion, or 44.4%. Over the last 25 years (that is, since present management took over) our per-share book value has grown from $19.46 to $4,296.01, or at a rate of 23.8% compounded annually.

What counts, however, is intrinsic value — the figure indicating what all of our constituent businesses are rationally worth. With perfect foresight, this number can be calculated by taking all future cash flows of a business — in and out — and discounting them at prevailing interest rates. So valued, all businesses, from manufacturers of buggy whips to operators of cellular phones, become economic equals.

Back when Berkshire's book value was $19.46, intrinsic value was somewhat less because the book value was entirely tied up in a textile business not worth the figure at which it was carried. Now most of our businesses are worth far more than their carrying values. This agreeable evolution from a discount to a premium means that Berkshire's intrinsic business value has compounded at a rate that somewhat exceeds our 23.8% annual growth in book value.

The rear-view mirror is one thing; the windshield is another. A large portion of our book value is represented by equity securities that, with minor exceptions, are carried on our balance sheet at current market values. At yearend these securities were valued at higher prices, relative to their own intrinsic business values, than has been the case in the past. One reason is the buoyant 1989 stock market. More important, the virtues of these businesses have been widely recognized. Whereas once their stock prices were inappropriately low, they are not now.

We will keep most of our major holdings, regardless of how they are priced relative to intrinsic business value. This 'til-death-do-us-part attitude, combined with the full prices these holdings command, means that they cannot be expected to push up Berkshire's value in the future as sharply as in the past. In other words, our performance to date has benefited from a double-dip: (1) the exceptional gains in intrinsic value that our portfolio companies have achieved; (2) the additional bonus we realized as the market appropriately "corrected" the prices of these companies, raising their valuations in relation to those of the average business. We will continue to benefit from good gains in business value that we feel confident our portfolio companies will make. But our "catch-up" rewards have been realized, which means we'll have to settle for a single-dip in the future.

We face another obstacle: In a finite world, high growth rates must self-destruct. If the base from which the growth is taking place is tiny, this law may not operate for a time. But when the base balloons, the party ends: A high growth rate eventually forges its own anchor.

Carl Sagan has entertainingly described this phenomenon, musing about the destiny of bacteria that reproduce by dividing into two every 15 minutes. Says Sagan: "That means four doublings an hour, and 96 doublings a day. Although a bacterium weighs only about a trillionth of a gram, its descendants, after a day of wild asexual abandon, will collectively weigh as much as a mountain...in two days, more than the sun — and before very long, everything in the universe will be made of bacteria." Not to worry, says Sagan: Some obstacle always impedes this kind of exponential growth. "The bugs run out of food, or they poison each other, or they are shy about reproducing in public."

Even on bad days, Charlie Munger (Berkshire's Vice Chairman and my partner) and I do not think of Berkshire as a bacterium. Nor, to our unending sorrow, have we found a way to double its net worth every 15 minutes. Furthermore, we are not the least bit shy about reproducing — financially — in public. Nevertheless, Sagan's observations apply. From Berkshire's present base of $4.9 billion in net worth, we will find it much more difficult to average 15% annual growth in book value than we did to average 23.8% from the $22 million we began with.

Taxes

Our 1989 gain of $1.5 billion was achieved after we took a charge of about $712 million for income taxes. In addition, Berkshire's share of the income taxes paid by its five major investees totaled about $175 million.

Of this year's tax charge, about $172 million will be paid currently; the remainder, $540 million, is deferred. Almost all of the deferred portion relates to the 1989 increase in unrealized profits in our common stock holdings. Against this increase, we have reserved a 34% tax.

We also carry reserves at that rate against all unrealized profits generated in 1987 and 1988. But, as we explained last year, the unrealized gains we amassed before 1987 — about $1.2 billion — carry reserves booked at the 28% tax rate that then prevailed.

A new accounting rule is likely to be adopted that will require companies to reserve against all gains at the current tax rate, whatever it may be. With the rate at 34%, such a rule would increase our deferred tax liability, and decrease our net worth, by about $71 million — the result of raising the reserve on our pre-1987 gain by six percentage points. Because the proposed rule has sparked widespread controversy and its final form is unclear, we have not yet made this change.

As you can see from our balance sheet on page 27, we would owe taxes of more than $1.1 billion were we to sell all of our securities at year-end market values. Is this $1.1 billion liability equal, or even similar, to a $1.1 billion liability payable to a trade creditor 15 days after the end of the year? Obviously not — despite the fact that both items have exactly the same effect on audited net worth, reducing it by $1.1 billion.

On the other hand, is this liability for deferred taxes a meaningless accounting fiction because its payment can be triggered only by the sale of stocks that, in very large part, we have no intention of selling? Again, the answer is no.

In economic terms, the liability resembles an interest-free loan from the U.S. Treasury that comes due only at our election (unless, of course, Congress moves to tax gains before they are realized). This "loan" is peculiar in other respects as well: It can be used only to finance the ownership of the particular, appreciated stocks and it fluctuates in size — daily as market prices change and periodically if tax rates change. In effect, this deferred tax liability is equivalent to a very large transfer tax that is payable only if we elect to move from one asset to another. Indeed, we sold some relatively small holdings in 1989, incurring about $76 million of "transfer" tax on $224 million of gains.

Because of the way the tax law works, the Rip Van Winkle style of investing that we favor — if successful — has an important mathematical edge over a more frenzied approach. Let's look at an extreme comparison.

Imagine that Berkshire had only $1, which we put in a security that doubled by yearend and was then sold. Imagine further that we used the after-tax proceeds to repeat this process in each of the next 19 years, scoring a double each time. At the end of the 20 years, the 34% capital gains tax that we would have paid on the profits from each sale would have delivered about $13,000 to the government and we would be left with about $25,250. Not bad. If, however, we made a single fantastic investment that *itself* doubled 20 times during the 20 years, our dollar would grow to $1,048,576. Were we then to cash out, we would pay a 34% tax of roughly $356,500 and be left with about $692,000.

The sole reason for this staggering difference in results would be the timing of tax payments. Interestingly, the government would gain from Scenario 2 in exactly the same 27:1 ratio as we — taking in taxes of $356,500 vs. $13,000 — though, admittedly, it would have to wait for its money.

We have not, we should stress, adopted our strategy favoring long-term investment commitments because of these mathematics. Indeed, it is possible we could earn greater after-tax returns by moving rather frequently from one investment to another. Many years ago, that's exactly what Charlie and I did.

Now we would rather stay put, even if that means slightly lower returns. Our reason is simple: We have found splendid business relationships to be so rare and so enjoyable that we want to retain all we develop. This decision is particularly easy for us because we feel that these relationships will produce good — though perhaps not optimal — financial results. Considering that, we think it makes little sense for us to give up time with people we know to be interesting and admirable for time with others we do not know and who are likely to have human qualities far closer to average. That would be akin to marrying for money — a mistake under most circumstances, insanity if one is already rich.

Sources of Reported Earnings

The table below shows the major sources of Berkshire's reported earnings. In this presentation, amortization of Goodwill and other major purchase-price accounting adjustments are not charged against the specific businesses to which they apply, but are instead aggregated and shown separately. This procedure lets you view the earnings of our businesses as they would have been reported had we not purchased them. I've explained in past reports why this form of presentation seems to us to be more useful to investors and managers than one utilizing generally accepted accounting principles (GAAP), which require purchase-price adjustments to be made on a business-by-business basis. The total net earnings we show in the table are, of course, identical to the GAAP total in our audited financial statements.

Further information about these businesses is given in the Business Segment section on pages 37-39, and in the Management's Discussion section on pages 40-44. In these sections you also will find our segment earnings reported on a GAAP basis. For information on Wesco's businesses, I urge you to read Charlie Munger's letter, which starts on page 54. In addition, we have reprinted on page 71 Charlie's May 30, 1989 letter to the U. S. League of Savings Institutions, which conveyed our disgust with its policies and our consequent decision to resign.

	(000s omitted)			
	Pre-Tax Earnings		*Berkshire's Share of Net Earnings (after taxes and minority interests)*	
	1989	*1988*	*1989*	*1988*
Operating Earnings:				
Insurance Group:				
Underwriting	$ (24,400)	$ (11,081)	$ (12,259)	$ (1,045)
Net Investment Income	243,599	231,250	213,642	197,779
Buffalo News	46,047	42,429	27,771	25,462
Fechheimer	12,621	14,152	6,789	7,720
Kirby	26,114	26,891	16,803	17,842
Nebraska Furniture Mart	17,070	18,439	8,441	9,099
Scott Fetzer Manufacturing Group	33,165	28,542	19,996	17,640
See's Candies	34,235	32,473	20,626	19,671
Wesco - other than Insurance	13,008	16,133	9,810	10,650
World Book	25,583	27,890	16,372	18,021
Amortization of Goodwill	(3,387)	(2,806)	(3,372)	(2,806)
Other Purchase-Price Accounting Charges	(5,740)	(6,342)	(6,668)	(7,340)
Interest Expense*	(42,389)	(35,613)	(27,098)	(23,212)
Shareholder-Designated Contributions	(5,867)	(4,966)	(3,814)	(3,217)
Other	23,755	41,059	12,863	27,177
Operating Earnings	393,414	418,450	299,902	313,441
Sales of Securities	223,810	131,671	147,575	85,829
Total Earnings - All Entities	$ 617,224	$ 550,121	$ 447,477	$ 399,270

**Excludes interest expense of Scott Fetzer Financial Group and Mutual Savings & Loan.*

We refer you also to pages 45-51, where we have rearranged Berkshire's financial data into four segments. These correspond to the way Charlie and I think about the business and should help you calculate Berkshire's intrinsic value. Shown on these pages are balance sheets and earnings statements for: (1) our insurance operations, with their major investment positions itemized; (2) our manufacturing, publishing and retailing businesses, leaving aside certain non-operating assets and purchase-price accounting adjustments; (3) our subsidiaries engaged in finance-type operations, which are Mutual Savings and Scott Fetzer Financial; and (4) an all-other category that includes the non-operating assets (primarily marketable securities) held by the companies in segment (2), all purchase-price accounting adjustments, and various assets and debts of the Wesco and Berkshire parent companies.

If you combine the earnings and net worths of these four segments, you will derive totals matching those shown on our GAAP statements. However, I want to emphasize that this four-category presentation does not fall within the purview of our auditors, who in no way bless it.

In addition to our reported earnings, we also benefit from significant earnings of investees that standard accounting rules do not permit us to report. On page 15, we list five major investees from which we received dividends in 1989 of about $45 million, after taxes. However, our share of the *retained* earnings of these investees totaled about $212 million last year, not counting large capital gains realized by GEICO and Coca-Cola. If this $212 million had been distributed to us, our own operating earnings, after the payment of additional taxes, would have been close to $500 million rather than the $300 million shown in the table.

The question you must decide is whether these undistributed earnings are as valuable to us as those we report. We believe they are — and even think they may be more valuable. The reason for this a-bird-in-the-bush-may-be-worth-two-in-the-hand conclusion is that earnings retained by these investees will be deployed by talented, owner-oriented managers who sometimes have better uses for these funds in their own businesses than we would have in ours. I would not make such a generous assessment of most managements, but it is appropriate in these cases.

In our view, Berkshire's fundamental earning power is best measured by a "look-through" approach, in which we append our share of the operating earnings retained by our investees to our own reported operating earnings, excluding capital gains in both instances. For our intrinsic business value to grow at an average of 15% per year, our "look-through" earnings must grow at about the same pace. We'll need plenty of help from our present investees, and also need to add a new one from time to time, in order to reach this 15% goal.

Non-Insurance Operations

In the past, we have labeled our major manufacturing, publishing and retail operations "The Sainted Seven." With our acquisition of Borsheim's early in 1989, the challenge was to find a new title both alliterative and appropriate. We failed: Let's call the group "The Sainted Seven Plus One."

This divine assemblage — Borsheim's, The Buffalo News, Fechheimer Bros., Kirby, Nebraska Furniture Mart, Scott Fetzer Manufacturing Group, See's Candies, World Book — is a collection of businesses with economic characteristics that range from good to superb. Its managers range from superb to superb.

Most of these managers have no need to work for a living; they show up at the ballpark because they like to hit home runs. And that's exactly what they do. Their combined financial statements (including those of some smaller operations), shown on page 49, illustrate just how outstanding their performance is. On an historical accounting basis, after-tax earnings of these operations were 57% on average equity capital. Moreover, this return was achieved with no net leverage: Cash equivalents have matched funded debt. When I call off the names of our managers — the Blumkin, Friedman and Heldman families, Chuck Huggins, Stan Lipsey, and Ralph Schey — I feel the same glow that Miller Huggins must have experienced when he announced the lineup of his 1927 New York Yankees.

Let's take a look, business by business:

- In its first year with Berkshire, Borsheim's met all expectations. Sales rose significantly and are now considerably better than twice what they were four years ago when the company moved to its present location. In the six years prior to the move, sales had also doubled. Ike Friedman, Borsheim's managing genius — and I mean that — has only one speed: fast-forward.

If you haven't been there, you've never seen a jewelry store like Borsheim's. Because of the huge volume it does at one location, the store can maintain an enormous selection across all price ranges. For the same reason, it can hold its expense ratio to about one-third that prevailing at jewelry stores offering comparable merchandise. The store's tight control of expenses, accompanied by its unusual buying power, enable it to offer prices far lower than those of other jewelers. These prices, in turn, generate even more volume, and so the circle goes 'round and 'round. The end result is store traffic as high as 4,000 people on seasonally-busy days.

Ike Friedman is not only a superb businessman and a great showman but also a man of integrity. We bought the business without an audit, and all of our surprises have been on the plus side. "If you don't know jewelry, know your jeweler" makes sense whether you are buying the whole business or a tiny diamond.

A story will illustrate why I enjoy Ike so much: Every two years I'm part of an informal group that gathers to have fun and explore a few subjects. Last September, meeting at Bishop's Lodge in Santa Fe, we asked Ike, his wife Roz, and his son Alan to come by and educate us on jewels and the jewelry business.

Ike decided to dazzle the group, so he brought from Omaha about $20 million of particularly fancy merchandise. I was somewhat apprehensive — Bishop's Lodge is no Fort Knox — and I mentioned my concern to Ike at our opening party the evening before his presentation. Ike took me aside. "See that safe?" he said. "This afternoon we changed the combination and now even the hotel management doesn't know what it is." I breathed easier. Ike went on: "See those two big fellows with guns on their hips? They'll be guarding the safe all night." I now was ready to rejoin the party. But Ike leaned closer: "And besides, Warren," he confided, "the jewels aren't in the safe."

How can we miss with a fellow like that — particularly when he comes equipped with a talented and energetic family, Alan, Marvin Cohn, and Don Yale.

- At See's Candies we had an 8% increase in pounds sold, even though 1988 was itself a record year. Included in the 1989 performance were excellent same-store poundage gains, our first in many years.

Advertising played an important role in this outstanding performance. We increased total advertising expenditures from $4 million to $5 million and also got copy from our agency, Hal Riney & Partners, Inc., that was 100% on the money in conveying the qualities that make See's special.

In our media businesses, such as the Buffalo News, we sell advertising. In other businesses, such as See's, we are buyers. When we buy, we practice exactly what we preach when we sell. At See's, we more than tripled our expenditures on newspaper advertising last year, to the highest percentage of sales that I can remember. The payoff was terrific, and we thank both Hal Riney and the power of well-directed newspaper advertising for this result.

See's splendid performances have become routine. But there is nothing routine about the management of Chuck Huggins: His daily involvement with all aspects of production and sales imparts a quality-and-service message to the thousands of employees we need to produce and distribute over 27 million pounds of candy annually. In a company with 225 shops and a massive mail order and phone business, it is no small trick to run things so that virtually every customer leaves happy. Chuck makes it look easy.

- The Nebraska Furniture Mart had record sales and excellent earnings in 1989, but there was one sad note. Mrs. B — Rose Blumkin, who started the company 52 years ago with $500 — quit in May, after disagreeing with other members of the Blumkin family/management about the remodeling and operation of the carpet department.

Mrs. B probably has made more smart business decisions than any living American, but in this particular case I believe the other members of the family were entirely correct: Over the past three years, while the store's other departments increased sales by 24%, carpet sales declined by 17% (but not because of any lack of sales ability by Mrs. B, who has always personally sold far more merchandise than any other salesperson in the store).

You will be pleased to know that Mrs. B continues to make Horatio Alger's heroes look like victims of tired blood. At age 96 she has started a new business selling — what else? — carpet and furniture. And as always, she works seven days a week.

At the Mart Louie, Ron, and Irv Blumkin continue to propel what is by far the largest and most successful home furnishings store in the country. They are outstanding merchants, outstanding managers, and a joy to be associated with. One reading on their acumen: In the fourth quarter of 1989, the carpet department registered a 75.3% consumer share in the Omaha market, up from 67.7% a year earlier and over six times that of its nearest competitor.

NFM and Borsheim's follow precisely the same formula for success: (1) unparalleled depth and breadth of merchandise at one location; (2) the lowest operating costs in the business; (3) the shrewdest of buying, made possible in part by the huge volumes purchased; (4) gross margins, and therefore prices, far below competitors'; and (5) friendly personalized service with family members on hand at all times.

Another plug for newspapers: NFM increased its linage in the local paper by over 20% in 1989 — off a record 1988 — and remains the paper's largest ROP advertiser by far. (ROP advertising is the kind printed in the paper, as opposed to that in preprinted inserts.) To my knowledge, Omaha is the only city in which a home furnishings store is the advertising leader. Many retailers cut space purchases in 1989; our experience at See's and NFM would indicate they made a major mistake.

- The Buffalo News continued to star in 1989 in three important ways: First, among major metropolitan papers, both daily and Sunday, the News is number one in household penetration — the percentage of local households that purchase it each day. Second, in "news hole" — the portion of the paper devoted to news — the paper stood at 50.1% in 1989 vs. 49.5% in 1988, a level again making it more news-rich than any comparable American paper. Third, in a year that saw profits slip at many major papers, the News set its seventh consecutive profit record.

To some extent, these three factors are related, though obviously a high-percentage news hole, by itself, reduces profits significantly. A large and intelligently-utilized news hole, however, attracts a wide spectrum of readers and thereby boosts penetration. High penetration, in turn, makes a newspaper particularly valuable to retailers since it allows them to talk to the entire community through a single "megaphone." A low-penetration paper is a far less compelling purchase for many advertisers and will eventually suffer in both ad rates and profits.

It should be emphasized that our excellent penetration is neither an accident nor automatic. The population of Erie County, home territory of the News, has been falling — from 1,113,000 in 1970 to 1,015,000 in 1980 to an estimated 966,000 in 1988. Circulation figures tell a different story. In 1975, shortly before we started our Sunday edition, the Courier-Express, a long-established Buffalo paper, was selling 207,500 Sunday copies in Erie County. Last year — with population at least 5% lower — the News sold an average of 292,700 copies. I believe that in no other major Sunday market has there been anything close to that increase in penetration.

When this kind of gain is made — and when a paper attains an unequaled degree of acceptance in its home town — someone is doing something right. In this case major credit clearly belongs to Murray Light, our long-time editor who daily creates an informative, useful, and interesting product. Credit should go also to the Circulation and Production Departments: A paper that is frequently late, because of production problems or distribution weaknesses, will lose customers, no matter how strong its editorial content.

Stan Lipsey, publisher of the News, has produced profits fully up to the strength of our product. I believe Stan's managerial skills deliver at least five extra percentage points in profit margin compared to the earnings that would be achieved by an average manager given the same circumstances. That is an amazing performance, and one that could only be produced by a talented manager who knows — and cares — about every nut and bolt of the business.

Stan's knowledge and talents, it should be emphasized, extend to the editorial product. His early years in the business were spent on the news side and he played a key role in developing and editing a series of stories that in 1972 won a Pulitzer Prize for the Sun Newspaper of Omaha. Stan and I have worked together for over 20 years, through some bad times as well as good, and I could not ask for a better partner.

- At Fechheimer, the Heldman clan — Bob, George, Gary, Roger and Fred — continue their extraordinary performance. Profits in 1989 were down somewhat because of problems the business experienced in integrating a major 1988 acquisition. These problems will be ironed out in time. Meanwhile, return on invested capital at Fechheimer remains splendid.

Like all of our managers, the Heldmans have an exceptional command of the details of their business. At last year's annual meeting I mentioned that when a prisoner enters San Quentin, Bob and George probably know his shirt size. That's only a slight exaggeration: No matter what area of the country is being discussed, they know exactly what is going on with major customers and with the competition.

Though we purchased Fechheimer four years ago, Charlie and I have never visited any of its plants or the home office in Cincinnati. We're much like the lonesome Maytag repairman: The Heldman managerial product is so good that a service call is never needed.

- Ralph Schey continues to do a superb job in managing our largest group — World Book, Kirby, and the Scott Fetzer Manufacturing Companies. Aggregate earnings of these businesses have increased every year since our purchase and returns on invested capital continue to be exceptional. Ralph is running an enterprise large enough, were it standing alone, to be on the Fortune 500. And he's running it in a fashion that would put him high in the top decile, measured by return on equity.

For some years, World Book has operated out of a single location in Chicago's Merchandise Mart. Anticipating the imminent expiration of its lease, the business is now decentralizing into four locations. The expenses of this transition are significant; nevertheless profits in 1989 held up well. It will be another year before costs of the move are fully behind us.

Kirby's business was particularly strong last year, featuring large gains in export sales. International business has more than doubled in the last two years and quintupled in the past four; its share of unit sales has risen from 5% to 20%. Our largest capital expenditures in 1989 were at Kirby, in preparation for a major model change in 1990.

Ralph's operations contribute about 40% of the total earnings of the non-insurance group whose results are shown on page 49. When we bought Scott Fetzer at the start of 1986, our acquisition of Ralph as a manager was fully as important as our acquisition of the businesses. In addition to generating extraordinary earnings, Ralph also manages capital extremely well. These abilities have produced funds for Berkshire that, in turn, have allowed us to make many other profitable commitments.

And that completes our answer to the 1927 Yankees.

Insurance Operations

Shown below is an updated version of our usual table presenting key figures for the property-casualty 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	3.7	109.6	8.4	6.5
1983	5.0	112.0	6.8	3.8
1984	8.5	118.0	16.9	3.8
1985	22.1	116.3	16.1	3.0
1986	22.2	108.0	13.5	2.6
1987	9.4	104.6	7.8	3.1
1988	4.4	105.4	5.5	3.3
1989 (Est.)................	2.1	110.4	8.7	4.2

Source: A.M. Best Co.

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 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.

For the reasons laid out in previous reports, we expect the industry's incurred losses to grow by about 10% annually, even in years when general inflation runs considerably lower. (Actually, over the last 25 years, incurred losses have grown at a still faster rate, 11%.) If premium growth meanwhile materially lags that 10% rate, underwriting losses will mount, though the industry's tendency to under-reserve when business turns bad may obscure their size for a time.

Last year we said the climb in the combined ratio was "almost certain to continue — and probably will accelerate — for at least two more years." This year we will not predict acceleration, but otherwise must repeat last year's forecast. Premium growth is running far below the 10% required annually. Remember also that a 10% rate would only stabilize the combined ratio, not bring it down.

The increase in the combined ratio in 1989 was a little more than we had expected because catastrophes (led by Hurricane Hugo) were unusually severe. These abnormalities probably accounted for about two points of the increase. If 1990 is more of a "normal" year, the combined ratio should rise only minimally from the catastrophe-swollen base of 1989. In 1991, though, the ratio is apt to climb by a greater degree.

Commentators frequently discuss the "underwriting cycle" and speculate about its next turn. If that term is used to connote rhythmic qualities, it is in our view a misnomer that leads to faulty thinking about the industry's fundamental economics.

The term was appropriate some decades ago when the industry and regulators cooperated to conduct the business in cartel fashion. At that time, the combined ratio fluctuated rhythmically for two reasons, both related to lags. First, data from the past were analyzed and then used to set new "corrected" rates, which were subsequently put into effect by virtually all insurers. Second, the fact that almost all policies were then issued for a one- to three-year term — which meant that it took a considerable time for mispriced policies to expire — delayed the impact of new rates on revenues. These two lagged responses made combined ratios behave much like alternating

current. Meanwhile, the absence of significant price competition guaranteed that industry profits, averaged out over the cycle, would be satisfactory.

The cartel period is long gone. Now the industry has hundreds of participants selling a commodity-like product at independently-established prices. Such a configuration — whether the product being sold is steel or insurance policies — is certain to cause subnormal profitability in all circumstances but one: a shortage of usable capacity. Just how often these periods occur and how long they last determines the average profitability of the industry in question.

In most industries, capacity is described in physical terms. In the insurance world, however, capacity is customarily described in financial terms; that is, it's considered appropriate for a company to write no more than X dollars of business if it has Y dollars of net worth. In practice, however, constraints of this sort have proven ineffective. Regulators, insurance brokers, and customers are all slow to discipline companies that strain their resources. They also acquiesce when companies grossly overstate their true capital. Hence, a company can write a great deal of business with very little capital if it is so inclined. At bottom, therefore, the amount of industry capacity at any particular moment primarily depends on the mental state of insurance managers.

All this understood, it is not very difficult to prognosticate the industry's profits. Good profits will be realized only when there is a shortage of capacity. Shortages will occur only when insurers are frightened. That happens rarely — and most assuredly is not happening now.

Some analysts have argued that the more onerous taxes recently imposed on the insurance industry and 1989's catastrophes — Hurricane Hugo and the California earthquake — will cause prices to strengthen significantly. We disagree. These adversities have not destroyed the eagerness of insurers to write business at present prices. Therefore, premium volume won't grow by 10% in 1990, which means the negative underwriting trend will not reverse.

The industry will meantime say it needs higher prices to achieve profitability matching that of the average American business. Of course it does. So does the steel business. But needs and desires have nothing to do with the long-term profitability of industries. Instead, economic fundamentals determine the outcome. Insurance profitability will improve only when virtually all insurers are turning away business *despite* higher prices. And we're a long way from that point.

Berkshire's premium volume may drop to $150 million or so in 1990 (from a high of $1 billion in 1986), partly because our traditional business continues to shrink and partly because the contract under which we received 7% of the business of Fireman's Fund expired last August. Whatever the size of the drop, it will not disturb us. We have no interest in writing insurance that carries a mathematical expectation of loss; we experience enough disappointments doing transactions we believe to carry an expectation of profit.

However, our appetite for appropriately-priced business is ample, as one tale from 1989 will tell. It concerns "CAT covers," which are reinsurance contracts that primary insurance companies (and also reinsurers themselves) buy to protect themselves against a single catastrophe, such as a tornado or hurricane, that produces losses from a large number of policies. In these contracts, the primary insurer might retain the loss from a single event up to a maximum of, say, $10 million, buying various layers of reinsurance above that level. When losses exceed the retained amount, the reinsurer typically pays 95% of the excess up to its contractual limit, with the primary insurer paying the remainder. (By requiring the primary insurer to keep 5% of each layer, the reinsurer leaves him with a financial stake in each loss settlement and guards against his throwing away the reinsurer's money.)

CAT covers are usually one-year policies that also provide for one automatic reinstatement, which requires a primary insurer whose coverage has been exhausted by a catastrophe to buy a second cover for the balance of the year in question by paying another premium. This provision protects the primary company from being "bare" for even a brief period after a first catastrophic event. The duration of "an event" is usually limited by contract to any span of 72 hours designated by the primary company. Under this definition, a wide-spread storm, causing damage for three days, will be classified as a single event if it arises from a single climatic cause. If the storm lasts four days, however, the primary company will file a claim carving out the 72 consecutive hours during

which it suffered the greatest damage. Losses that occurred outside that period will be treated as arising from a separate event.

In 1989, two unusual things happened. First, Hurricane Hugo generated $4 billion or more of insured loss, at a pace, however, that caused the vast damage in the Carolinas to occur slightly more than 72 hours after the equally severe damage in the Caribbean. Second, the California earthquake hit within weeks, causing insured damage that was difficult to estimate, even well after the event. Slammed by these two — or possibly three — major catastrophes, some primary insurers, and also many reinsurers that had themselves bought CAT protection, either used up their automatic second cover or became uncertain as to whether they had done so.

At that point sellers of CAT policies had lost a huge amount of money — perhaps twice because of the reinstatements — and not taken in much in premiums. Depending upon many variables, a CAT premium might generally have run 3% to 15% of the amount of protection purchased. For some years, we've thought premiums of that kind inadequate and have stayed away from the business.

But because the 1989 disasters left many insurers either actually or possibly bare, and also left most CAT writers licking their wounds, there was an immediate shortage after the earthquake of much-needed catastrophe coverage. Prices instantly became attractive, particularly for the reinsurance that CAT writers themselves buy. Just as instantly, Berkshire Hathaway offered to write up to $250 million of catastrophe coverage, advertising that proposition in trade publications. Though we did not write all the business we sought, we did in a busy ten days book a substantial amount.

Our willingness to put such a huge sum on the line for a loss that could occur tomorrow sets us apart from any reinsurer in the world. There are, of course, companies that sometimes write $250 million or even far more of catastrophe coverage. But they do so only when they can, in turn, reinsure a large percentage of the business with other companies. When they can't "lay off" in size, they disappear from the market.

Berkshire's policy, conversely, is to retain the business we write rather than lay it off. When rates carry an expectation of profit, we want to assume as much risk as is prudent. And in our case, that's a lot.

We will accept more reinsurance risk for our own account than any other company because of two factors: (1) by the standards of regulatory accounting, we have a net worth in our insurance companies of about $6 billion — the second highest amount in the United States; and (2) we simply don't care what earnings we report quarterly, or even annually, just as long as the decisions leading to those earnings (or losses) were reached intelligently.

Obviously, if we write $250 million of catastrophe coverage and retain it all ourselves, there is some probability that we will lose the full $250 million in a single quarter. That probability is low, but it is not zero. If we had a loss of that magnitude, our after-tax cost would be about $165 million. Though that is far more than Berkshire normally earns in a quarter, the damage would be a blow only to our pride, not to our well-being.

This posture is one few insurance managements will assume. Typically, they are willing to write scads of business on terms that almost guarantee them mediocre returns on equity. But they do not want to expose themselves to an embarrassing single-quarter loss, even if the managerial strategy that causes the loss promises, over time, to produce superior results. I can understand their thinking: What is best for their owners is not necessarily best for the managers. Fortunately Charlie and I have both total job security and financial interests that are identical with those of our shareholders. We are willing to *look* foolish as long as we don't feel we have *acted* foolishly.

Our method of operation, incidentally, makes us a stabilizing force in the industry. We add huge capacity when capacity is short and we become less competitive only when capacity is abundant. Of course, we don't follow this policy in the interest of stabilization — we follow it because we believe it to be the most sensible and profitable course of action. Nevertheless, our behavior steadies the market. In this case, Adam Smith's invisible hand works as advertised.

Currently, we hold an exceptional amount of float compared to premium volume. This circumstance should produce quite favorable insurance results for us during the next few years as it did in 1989. Our underwriting losses should be tolerable and our investment income from policyholder funds large. This pleasant situation, however, will gradually deteriorate as our float runs off.

At some point, however, there will be an opportunity for us to write large amounts of profitable business. Mike Goldberg and his management team of Rod Eldred, Dinos Iordanou, Ajit Jain, Phil Urban, and Don Wurster continue to position us well for this eventuality.

Marketable Securities

In selecting marketable securities for our insurance companies, we generally 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.

● Below we list our common stock holdings having a value of over $100 million. A small portion of these investments belongs to subsidiaries of which Berkshire owns less than 100%.

Shares	*Company*	*Cost*	*12/31/89 Market*
		(000s	omitted)
3,000,000	Capital Cities/ABC, Inc.	$ 517,500	$1,692,375
23,350,000	The Coca-Cola Co.	1,023,920	1,803,787
2,400,000	Federal Home Loan Mortgage Corp.	71,729	161,100
6,850,000	GEICO Corp.	45,713	1,044,625
1,727,765	The Washington Post Company	9,731	486,366

This list of companies is the same as last year's and in only one case has the number of shares changed: Our holdings of Coca-Cola increased from 14,172,500 shares at the end of 1988 to 23,350,000.

This Coca-Cola investment provides yet another example of the incredible speed with which your Chairman responds to investment opportunities, no matter how obscure or well-disguised they may be. I believe I had my first Coca-Cola in either 1935 or 1936. Of a certainty, it was in 1936 that I started buying Cokes at the rate of six for 25¢ from Buffett & Son, the family grocery store, to sell around the neighborhood for 5¢ each. In this excursion into high-margin retailing, I duly observed the extraordinary consumer attractiveness and commercial possibilities of the product.

I continued to note these qualities for the next 52 years as Coke blanketed the world. During this period, however, I carefully avoided buying even a single share, instead allocating major portions of my net worth to street railway companies, windmill manufacturers, anthracite producers, textile businesses, trading-stamp issuers, and the like. (If you think I'm making this up, I can supply the names.) Only in the summer of 1988 did my brain finally establish contact with my eyes.

What I then perceived was both clear and fascinating. After drifting somewhat in the 1970's, Coca-Cola had in 1981 become a new company with the move of Roberto Goizueta to CEO. Roberto, along with Don Keough, once my across-the-street neighbor in Omaha, first rethought and focused the company's policies and then energetically carried them out. What was already the world's most ubiquitous product gained new momentum, with sales overseas virtually exploding.

Through a truly rare blend of marketing and financial skills, Roberto has maximized both the growth of his product and the rewards that this growth brings to shareholders. Normally, the CEO of a consumer products company, drawing on his natural inclinations or experience, will cause either marketing or finance to dominate the business at the expense of the other discipline. With Roberto, the mesh of marketing and finance is perfect and the result is a shareholder's dream.

Of course, we should have started buying Coke much earlier, soon after Roberto and Don began running things. In fact, if I had been thinking straight I would have persuaded my grandfather to sell the grocery store back in 1936 and put all of the proceeds into Coca-Cola stock. I've learned my lesson: My response time to the next glaringly attractive idea will be slashed to well under 50 years.

As I mentioned earlier, the yearend prices of our major investees were much higher relative to their intrinsic values than theretofore. While those prices may not yet cause nosebleeds, they are clearly vulnerable to a general market decline. A drop in their prices would not disturb us at all — it might in fact work to our eventual benefit — but it *would* cause at least a one-year reduction in Berkshire's net worth. We think such a reduction is almost certain in at least one of the next three years. Indeed, it would take only about a 10% year-to-year decline in the aggregate value of our portfolio investments to send Berkshire's net worth down.

We continue to be blessed with extraordinary managers at our portfolio companies. They are high-grade, talented, and shareholder-oriented. The exceptional results we have achieved while investing with them accurately reflect their exceptional personal qualities.

● We told you last year that we expected to do little in arbitrage during 1989, and that's the way it turned out. Arbitrage positions are a substitute for short-term cash equivalents, and during part of the year we held relatively low levels of cash. In the rest of the year we had a fairly good-sized cash position and even so chose not to engage in arbitrage. The main reason was corporate transactions that made no economic sense to us; arbitraging such deals comes too close to playing the greater-fool game. (As Wall Streeter Ray DeVoe says: "Fools rush in where angels fear to trade.") We will engage in arbitrage from time to time — sometimes on a large scale — but only when we like the odds.

● Leaving aside the three convertible preferreds discussed in the next section, we substantially reduced our holdings in both medium- and long-term fixed-income securities. In the long-terms, just about our only holdings have been Washington Public Power Supply Systems (WPPSS) bonds carrying coupons ranging from low to high. During the year we sold a number of the low-coupon issues, which we originally bought at very large discounts. Many of these issues had approximately doubled in price since we purchased them and in addition had paid us 15%-17% annually, tax-free. Our prices upon sale were only slightly cheaper than typical high-grade tax-exempts then commanded. We have kept all of our high-coupon WPPSS issues. Some have been called for redemption in 1991 and 1992, and we expect the rest to be called in the early to mid-1990s.

We also sold many of our medium-term tax-exempt bonds during the year. When we bought these bonds we said we would be happy to sell them — regardless of whether they were higher or lower than at our time of purchase — if something we liked better came along. Something did — and concurrently we unloaded most of these issues at modest gains. Overall, our 1989 profit from the sale of tax-exempt bonds was about $51 million pre-tax.

● The proceeds from our bond sales, along with our excess cash at the beginning of the year and that generated later through earnings, went into the purchase of three convertible preferred stocks. In the first transaction, which took place in July, we purchased $600 million of The Gillette Co. preferred with an 8 3/4% dividend, a mandatory redemption in ten years, and the right to convert into common at $50 per share. We next purchased $358 million of USAir Group, Inc. preferred stock with mandatory redemption in ten years, a dividend of 9 1/4%, and the right to convert into common at $60 per share. Finally, late in the year we purchased $300 million of Champion International Corp. preferred with mandatory redemption in ten years, a 9 1/4% dividend, and the right to convert into common at $38 per share.

Unlike standard convertible preferred stocks, the issues we own are either non-salable or non-convertible for considerable periods of time and there is consequently no way we can gain from short-term price blips in the common stock. I have gone on the board of Gillette, but I am not on the board of USAir or Champion. (I thoroughly enjoy the boards I am on, but can't handle any more.)

Gillette's business is very much the kind we like. Charlie and I think we understand the company's economics and therefore believe we can make a reasonably intelligent guess about its future. (If you haven't tried Gillette's new Sensor razor, go right out and get one.) However, we have no ability to forecast the economics of the investment banking business (in which we have a position through our 1987 purchase of Salomon convertible preferred), the airline industry, or the paper industry. This does not mean that we predict a negative future for these industries: we're agnostics, not atheists. Our lack of strong convictions about these businesses, however, means that we must structure our investments in them differently from what we do when we invest in a business appearing to have splendid economic characteristics.

In one major respect, however, these purchases are not different: We only want to link up with people whom we like, admire, and trust. John Gutfreund at Salomon, Colman Mockler, Jr. at Gillette, Ed Colodny at USAir, and Andy Sigler at Champion meet this test in spades.

They in turn have demonstrated some confidence in us, insisting in each case that our preferreds have unrestricted voting rights on a fully-converted basis, an arrangement that is far from standard in corporate finance. In effect they are trusting us to be intelligent owners, thinking about tomorrow *instead* of today, just as we are trusting them to be intelligent managers, thinking about tomorrow *as well* as today.

The preferred-stock structures we have negotiated will provide a mediocre return for us if industry economics hinder the performance of our investees, but will produce reasonably attractive results for us if they can earn a return comparable to that of American industry in general. We believe that Gillette, under Colman's management, will far exceed that return and believe that John, Ed, and Andy will reach it unless industry conditions are harsh.

Under almost any conditions, we expect these preferreds to return us our money plus dividends. If that is all we get, though, the result will be disappointing, because we will have given up flexibility and consequently will have missed some significant opportunities that are bound to present themselves during the decade. Under that scenario, we will have obtained only a preferred-stock yield during a period when the typical preferred stock will have held no appeal for us whatsoever. The only way Berkshire can achieve satisfactory results from its four preferred issues is to have the common stocks of the investee companies do well.

Good management and at least tolerable industry conditions will be needed if that is to happen. But we believe Berkshire's investment will also help and that the other shareholders of each investee will profit over the years ahead from our preferred-stock purchase. The help will come from the fact that each company now has a major, stable, and interested shareholder whose Chairman and Vice Chairman have, through Berkshire's investments, indirectly committed a very large amount of their own money to these undertakings. In dealing with our investees, Charlie and I will be supportive, analytical, and objective. We recognize that we are working with experienced CEOs who are very much in command of their own businesses but who nevertheless, at certain moments, appreciate the chance to test their thinking on someone without ties to their industry or to decisions of the past.

As a group, these convertible preferreds will not produce the returns we can achieve when we find a business with wonderful economic prospects that is unappreciated by the market. Nor will the returns be as attractive as those produced when we make our favorite form of capital deployment, the acquisition of 80% or more of a fine business with a fine management. But both opportunities are rare, particularly in a size befitting our present and anticipated resources.

In summation, Charlie and I feel that our preferred stock investments should produce returns moderately above those achieved by most fixed-income portfolios and that we can play a minor but enjoyable and constructive role in the investee companies.

Zero-Coupon Securities

In September, Berkshire issued $902.6 million principal amount of Zero-Coupon Convertible Subordinated Debentures, which are now listed on the New York Stock Exchange. Salomon Brothers handled the underwriting in superb fashion, providing us helpful advice and a flawless execution.

Most bonds, of course, require regular payments of interest, usually semi-annually. A zero-coupon bond, conversely, requires no current interest payments; instead, the investor receives his yield by purchasing the security at a significant discount from maturity value. The effective interest rate is determined by the original issue price, the maturity value, and the amount of time between issuance and maturity.

In our case, the bonds were issued at 44.314% of maturity value and are due in 15 years. For investors purchasing the bonds, that is the mathematical equivalent of a 5.5% current payment compounded semi-annually. Because we received only 44.31¢ on the dollar, our proceeds from this offering were $400 million (less about $9.5 million of offering expenses).

The bonds were issued in denominations of $10,000 and each bond is convertible into .4515 shares of Berkshire Hathaway. Because a $10,000 bond cost $4,431, this means that the conversion price was $9,815 per Berkshire share, a 15% premium to the market price then existing. Berkshire can call the bonds at any time after September 28, 1992 at their accreted value (the original issue price plus 5.5% compounded semi-annually) and on two specified days, September 28 of 1994 and 1999, the bondholders can require Berkshire to buy the securities at their accreted value.

For tax purposes, Berkshire is entitled to deduct the 5.5% interest accrual each year, even though we make no payments to the bondholders. Thus the net effect to us, resulting from the reduced taxes, is positive cash flow. That is a very significant benefit. Some unknowable variables prevent us from calculating our exact effective rate of interest, but under all circumstances it will be well below 5.5%. There is meanwhile a symmetry to the tax law: Any taxable holder of the bonds must pay tax each year on the 5.5% interest, even though he receives no cash.

Neither our bonds nor those of certain other companies that issued similar bonds last year (notably Loews and Motorola) resemble the great bulk of zero-coupon bonds that have been issued in recent years. Of these, Charlie and I have been, and will continue to be, outspoken critics. As I will later explain, such bonds have often been used in the most deceptive of ways and with deadly consequences to investors. But before we tackle that subject, let's travel back to Eden, to a time when the apple had not yet been bitten.

If you're my age you bought your first zero-coupon bonds during World War II, by purchasing the famous Series E U. S. Savings Bond, the most widely-sold bond issue in history. (After the war, these bonds were held by one out of two U. S. households.) Nobody, of course, called the Series E a zero-coupon bond, a term in fact that I doubt had been invented. But that's precisely what the Series E was.

These bonds came in denominations as small as $18.75. That amount purchased a $25 obligation of the United States government due in 10 years, terms that gave the buyer a compounded annual return of 2.9%. At the time, this was an attractive offer: the 2.9% rate was higher than that generally available on Government bonds and the holder faced no market-fluctuation risk, since he could at any time cash in his bonds with only a minor reduction in interest.

A second form of zero-coupon U. S. Treasury issue, also benign and useful, surfaced in the last decade. One problem with a normal bond is that even though it pays a given interest rate — say 10% — the holder cannot be assured that a compounded 10% return will be realized. For that rate to materialize, each semi-annual coupon must be reinvested at 10% as it is received. If current interest rates are, say, only 6% or 7% when these coupons come due, the holder will be unable to compound his money over the life of the bond at the advertised rate. For pension funds or other investors with long-term liabilities, "reinvestment risk" of this type can be a serious problem. Savings Bonds might have solved it, except that they are issued only to individuals and are unavailable in large denominations. What big buyers needed was huge quantities of "Savings Bond Equivalents."

Enter some ingenious and, in this case, highly useful investment bankers (led, I'm happy to say, by Salomon Brothers). They created the instrument desired by "stripping" the semi-annual coupons from standard Government issues. Each coupon, once detached, takes on the essential character of a Savings Bond since it represents a single sum due sometime in the future. For example, if you strip the 40 semi-annual coupons from a U. S. Government Bond due in the year 2010, you will have 40 zero-coupon bonds, with maturities from six months to 20 years, each of which can then be bundled with other coupons of like maturity and marketed. If current interest rates are, say, 10% for all maturities, the six-month issue will sell for 95.24% of maturity value and the 20-year issue will sell for 14.20%. The purchaser of any given maturity is thus guaranteed a compounded rate of 10% for his entire holding period. Stripping of government bonds has occurred on a large scale in recent years, as long-term investors, ranging from pension funds to individual IRA accounts, recognized these high-grade, zero-coupon issues to be well suited to their needs.

But as happens in Wall Street all too often, what the wise do in the beginning, fools do in the end. In the last few years zero-coupon bonds (and their functional equivalent, pay-in-kind bonds, which distribute additional PIK bonds semi-annually as interest instead of paying cash) have been issued in enormous quantities by ever-junkier credits. To these issuers, zero (or PIK) bonds offer one overwhelming advantage: It is impossible to default on a promise to pay nothing. Indeed, if LDC governments had issued no debt in the 1970's other than long-term zero-coupon obligations, they would now have a spotless record as debtors.

This principle at work — that you need not default for a long time if you solemnly promise to pay nothing for a long time — has not been lost on promoters and investment bankers seeking to finance ever-shakier deals. But its acceptance by lenders took a while: When the leveraged buy-out craze began some years back, purchasers could borrow only on a reasonably sound basis, in which conservatively-estimated *free* cash flow — that is, operating earnings plus depreciation and amortization less normalized capital expenditures — was adequate to cover both interest and modest reductions in debt.

Later, as the adrenalin of deal-makers surged, businesses began to be purchased at prices so high that all free cash flow necessarily had to be allocated to the payment of interest. That left nothing for the paydown of debt. In effect, a Scarlett O'Hara "I'll think about it tomorrow" position in respect to principal payments was taken by borrowers and accepted by a new breed of lender, the buyer of original-issue junk bonds. Debt now became something to be refinanced rather than repaid. The change brings to mind a *New Yorker* cartoon in which the grateful borrower rises to shake the hand of the bank's lending officer and gushes: "I don't know how I'll ever repay you."

Soon borrowers found even the new, lax standards intolerably binding. To induce lenders to finance even sillier transactions, they introduced an abomination, EBDIT — Earnings Before Depreciation, Interest and Taxes — as the test of a company's ability to pay interest. Using this sawed-off yardstick, the borrower ignored depreciation as an expense on the theory that it did not require a current cash outlay.

Such an attitude is clearly delusional. At 95% of American businesses, capital expenditures that over time roughly approximate depreciation are a necessity and are every bit as real an expense as labor or utility costs. Even a high school dropout knows that to finance a car he must have income that covers not only interest and operating expenses, but also realistically-calculated depreciation. He would be laughed out of the bank if he started talking about EBDIT.

Capital outlays at a business can be skipped, of course, in any given month, just as a human can skip a day or even a week of eating. But if the skipping becomes routine and is not made up, the body weakens and eventually dies. Furthermore, a start-and-stop feeding policy will over time produce a less healthy organism, human or corporate, than that produced by a steady diet. As businessmen, Charlie and I relish having competitors who are unable to fund capital expenditures.

You might think that waving away a major expense such as depreciation in an attempt to make a terrible deal look like a good one hits the limits of Wall Street's ingenuity. If so, you haven't been paying attention during the past few years. Promoters needed to find a way to justify even pricier acquisitions. Otherwise, they risked — heaven forbid! — losing deals to other promoters with more "imagination."

So, stepping through the Looking Glass, promoters and their investment bankers proclaimed that EBDIT should now be measured against cash interest only, which meant that interest accruing on zero-coupon or PIK bonds could be ignored when the financial feasibility of a transaction was being assessed. This approach not only relegated depreciation expense to the let's-ignore-it corner, but gave similar treatment to what was usually a significant portion of interest expense. To their shame, many professional investment managers went along with this nonsense, though they usually were careful to do so only with clients' money, not their own. (Calling these managers "professionals" is actually too kind; they should be designated "promotees.")

Under this new standard, a business earning, say, $100 million pre-tax and having debt on which $90 million of interest must be paid currently, might use a zero-coupon or PIK issue to incur another $60 million of annual interest that would accrue and compound but not come due for some years. The rate on these issues would typically be very high, which means that the situation in year 2 might be $90 million cash interest plus $69 million accrued interest, and so on as the compounding proceeds. Such high-rate reborrowing schemes, which a few years ago were appropriately confined to the waterfront, soon became models of modern finance at virtually all major investment banking houses.

When they make these offerings, investment bankers display their humorous side: They dispense income and balance sheet projections extending five or more years into the future for companies they barely had heard of a few months earlier. If you are shown such schedules, I suggest that you join in the fun: Ask the investment banker for the *one-year* budgets that his own firm prepared as the last few years began and then compare these with what actually happened.

Some time ago Ken Galbraith, in his witty and insightful *The Great Crash*, coined a new economic term: "the bezzle," defined as the current amount of undiscovered embezzlement. This financial creature has a magical quality: The embezzlers are richer by the amount of the bezzle, while the embezzlees do not yet feel poorer.

Professor Galbraith astutely pointed out that this sum should be added to the National Wealth so that we might know the Psychic National Wealth. Logically, a society that wanted to *feel* enormously prosperous would both encourage its citizens to embezzle and try not to detect the crime. By this means, "wealth" would balloon though not an erg of productive work had been done.

The satirical nonsense of the bezzle is dwarfed by the real-world nonsense of the zero-coupon bond. With zeros, one party to a contract can experience "income" without his opposite experiencing the pain of expenditure. In our illustration, a company capable of earning only $100 million dollars annually — and therefore capable of paying only that much in interest — magically creates "earnings" for bondholders of $150 million. As long as major investors willingly don their Peter Pan wings and repeatedly say "I believe," there is no limit to how much "income" can be created by the zero-coupon bond.

Wall Street welcomed this invention with the enthusiasm less-enlightened folk might reserve for the wheel or the plow. Here, finally, was an instrument that would let the Street make deals at prices no longer limited by actual earning power. The result, obviously, would be more transactions: Silly prices will always attract sellers. And, as Jesse Unruh might have put it, transactions are the mother's milk of finance.

The zero-coupon or PIK bond possesses one additional attraction for the promoter and investment banker, which is that the time elapsing between folly and failure can be stretched out. This is no small benefit. If the period before all costs must be faced is long, promoters can create a string of foolish deals — and take in lots of fees — before any chickens come home to roost from their earlier ventures.

But in the end, alchemy, whether it is metallurgical or financial, fails. A base business can not be transformed into a golden business by tricks of accounting or capital structure. The man claiming to be a financial alchemist may become rich. But gullible investors rather than business achievements will usually be the source of his wealth.

Whatever their weaknesses, we should add, many zero-coupon and PIK bonds will not default. We have in fact owned some and may buy more if their market becomes sufficiently distressed. (We've not, however, even considered buying a new issue from a weak credit.) No financial instrument is evil per se; it's just that some variations have far more potential for mischief than others.

The blue ribbon for mischief-making should go to the zero-coupon issuer unable to make its interest payments on a current basis. Our advice: Whenever an investment banker starts talking about EBDIT — or whenever someone creates a capital structure that does not allow all interest, both payable and accrued, to be comfortably met out of current cash flow *net of ample capital expenditures* — zip up your wallet. Turn the tables by suggesting that the promoter and his high-priced entourage accept zero-coupon fees, deferring their take until the zero-coupon bonds have been paid in full. See then how much enthusiasm for the deal endures.

Our comments about investment bankers may seem harsh. But Charlie and I — in our hopelessly old-fashioned way — believe that they should perform a gatekeeping role, guarding investors against the promoter's propensity to indulge in excess. Promoters, after all, have throughout time exercised the same judgment and restraint in accepting money that alcoholics have exercised in accepting liquor. At a minimum, therefore, the banker's conduct should rise to that of a responsible bartender who, when necessary, refuses the profit from the next drink to avoid sending a drunk out on the highway. In recent years, unfortunately, many leading investment firms have found bartender morality to be an intolerably restrictive standard. Lately, those who have traveled the high road in Wall Street have not encountered heavy traffic.

One distressing footnote: The cost of the zero-coupon folly will not be borne solely by the direct participants. Certain savings and loan associations were heavy buyers of such bonds, using cash that came from FSLIC-insured deposits. Straining to show splendid earnings, these buyers recorded — but did not receive — ultra-high interest income on these issues. Many of these associations are now in major trouble. Had their loans to shaky credits worked, the owners of the associations would have pocketed the profits. In the many cases in which the loans will fail, the taxpayer will pick up the bill. To paraphrase Jackie Mason, at these associations it was the managers who should have been wearing the ski masks.

Mistakes of the First Twenty-five Years (A Condensed Version)

To quote Robert Benchley, "Having a dog teaches a boy fidelity, perseverance, and to turn around three times before lying down." Such are the shortcomings of experience. Nevertheless, it's a good idea to review past mistakes before committing new ones. So let's take a quick look at the last 25 years.

- My first mistake, of course, was in buying control of Berkshire. Though I knew its business — textile manufacturing — to be unpromising, I was enticed to buy because the price looked cheap. Stock purchases of that kind had proved reasonably rewarding in my early years, though by the time Berkshire came along in 1965 I was becoming aware that the strategy was not ideal.

If you buy a stock at a sufficiently low price, there will usually be some hiccup in the fortunes of the business that gives you a chance to unload at a decent profit, even though the long-term performance of the business may be terrible. I call this the "cigar butt" approach to investing. A cigar butt found on the street that has only one puff left in it may not offer much of a smoke, but the "bargain purchase" will make that puff all profit.

Unless you are a liquidator, that kind of approach to buying businesses is foolish. First, the original "bargain" price probably will not turn out to be such a steal after all. In a difficult business, no sooner is one problem solved than another surfaces — never is there just one cockroach in the kitchen. Second, any initial advantage you secure will be quickly eroded by the low return that the business earns. For example, if you buy a business for $8 million that can be sold or liquidated for $10 million and promptly take either course, you can realize a high return. But the investment will disappoint if the business is sold for $10 million in ten years and in the interim has annually earned and distributed only a few percent on cost. Time is the friend of the wonderful business, the enemy of the mediocre.

You might think this principle is obvious, but I had to learn it the hard way — in fact, I had to learn it several times over. Shortly after purchasing Berkshire, I acquired a Baltimore department store, Hochschild, Kohn, buying through a company called Diversified Retailing that later merged with Berkshire. I bought at a substantial discount from book value, the people were first-class, and the deal included some extras — unrecorded real estate values and a significant LIFO inventory cushion. How could I miss? So-o-o — three years later I was lucky to sell the business for about what I had paid. After ending our corporate marriage to Hochschild, Kohn, I had memories like those of the husband in the country song, "My Wife Ran Away With My Best Friend and I Still Miss Him a Lot."

I could give you other personal examples of "bargain-purchase" folly but I'm sure you get the picture: It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price. Charlie understood this early; I was a slow learner. But now, when buying companies or common stocks, we look for first-class businesses accompanied by first-class managements.

- That leads right into a related lesson: Good jockeys will do well on good horses, but not on broken-down nags. Both Berkshire's textile business and Hochschild, Kohn had able and honest people running them. The same managers employed in a business with good economic characteristics would have achieved fine records. But they were never going to make any progress while running in quicksand.

I've said many times that when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact. I just wish I hadn't been so energetic in creating examples. My behavior has matched that admitted by Mae West: "I was Snow White, but I drifted."

- A further related lesson: Easy does it. After 25 years of buying and supervising a great variety of businesses, Charlie and I have *not* learned how to solve difficult business problems. What we have learned is to avoid them. To the extent we have been successful, it is because we concentrated on identifying one-foot hurdles that we could step over rather than because we acquired any ability to clear seven-footers.

The finding may seem unfair, but in both business and investments it is usually far more profitable to simply stick with the easy and obvious than it is to resolve the difficult. On occasion, tough problems *must* be tackled as was the case when we started our Sunday paper in Buffalo. In other instances, a great investment opportunity occurs when a marvelous business encounters a one-time huge, but solvable, problem as was the case many years back at both American Express and GEICO. Overall, however, we've done better by avoiding dragons than by slaying them.

- My most surprising discovery: the overwhelming importance in business of an unseen force that we might call "the institutional imperative." In business school, I was given no hint of the imperative's existence and I did not intuitively understand it when I entered the business world. I thought then that decent, intelligent, and experienced managers would automatically make rational business decisions. But I learned over time that isn't so. Instead, rationality frequently wilts when the institutional imperative comes into play.

For example: (1) As if governed by Newton's First Law of Motion, an institution will resist any change in its current direction; (2) Just as work expands to fill available time, corporate projects or acquisitions will materialize to soak up available funds; (3) Any business craving of the leader, however foolish, will be quickly supported by detailed rate-of-return and strategic studies prepared by his troops; and (4) The behavior of peer companies, whether they are expanding, acquiring, setting executive compensation or whatever, will be mindlessly imitated.

Institutional dynamics, not venality or stupidity, set businesses on these courses, which are too often misguided. After making some expensive mistakes because I ignored the power of the imperative, I have tried to organize and manage Berkshire in ways that minimize its influence. Furthermore, Charlie and I have attempted to concentrate our investments in companies that appear alert to the problem.

● After some other mistakes, I learned to go into business only with people whom I like, trust, and admire. As I noted before, this policy of itself will not ensure success: A second-class textile or department-store company won't prosper simply because its managers are men that you would be pleased to see your daughter marry. However, an owner — or investor — can accomplish wonders if he manages to associate himself with such people in businesses that possess decent economic characteristics. Conversely, we do not wish to join with managers who lack admirable qualities, no matter how attractive the prospects of their business. We've never succeeded in making a good deal with a bad person.

● Some of my worst mistakes were not publicly visible. These were stock and business purchases whose virtues I understood and yet didn't make. It's no sin to miss a great opportunity outside one's area of competence. But I have passed on a couple of really big purchases that were served up to me on a platter and that I was fully capable of understanding. For Berkshire's shareholders, myself included, the cost of this thumb-sucking has been huge.

● Our consistently-conservative financial policies may appear to have been a mistake, but in my view were not. In retrospect, it is clear that significantly higher, though still conventional, leverage ratios at Berkshire would have produced considerably better returns on equity than the 23.8% we have actually averaged. Even in 1965, perhaps we could have judged there to be a 99% probability that higher leverage would lead to nothing but good. Correspondingly, we might have seen only a 1% chance that some shock factor, external or internal, would cause a conventional debt ratio to produce a result falling somewhere between temporary anguish and default.

We wouldn't have liked those 99:1 odds — and never will. A small chance of distress or disgrace cannot, in our view, be offset by a large chance of extra returns. If your actions are sensible, you are certain to get good results; in most such cases, leverage just moves things along faster. Charlie and I have never been in a big hurry: We enjoy the process far more than the proceeds — though we have learned to live with those also.

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We hope in another 25 years to report on the mistakes of the first 50. If we are around in 2015 to do that, you can count on this section occupying many more pages than it does here.

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.

Our favorite form of purchase is one fitting the Blumkin-Friedman-Heldman mold. In cases like these, the company's owner-managers wish to generate significant amounts of cash, sometimes for themselves, but often for their families or inactive shareholders. At the same time, these managers wish to remain significant owners who continue to run their companies just as they have in the past. We think we offer a particularly good fit for owners with such objectives. We invite potential sellers to check us out by contacting people with whom we have done business in the past.

Charlie and I frequently get approached about acquisitions that don't come close to meeting our tests: We've found that if you advertise an interest in buying collies, a lot of people will call hoping to sell you their cocker spaniels. Our interest in new ventures, turnarounds, or auction-like sales can best be expressed by a Goldwynism: "Please include me out."

Besides being interested in the purchase of 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 Capital Cities, Salomon, Gillette, USAir and Champion. Last year we said we had a special interest in large purchases of convertible preferreds. We still have an appetite of that kind, but it is limited since we now are close to the maximum position we feel appropriate for this category of investment.

* * * * * * * * * * * *

Two years ago, I told you about Harry Bottle, who in 1962 quickly cured a major business mess at the first industrial company I controlled, Dempster Mill Manufacturing (one of my "bargain" purchases) and who 24 years later had reappeared to again rescue me, this time from problems at K&W Products, a small Berkshire subsidiary that produces automotive compounds. As I reported, in short order Harry reduced capital employed at K&W, rationalized production, cut costs, and quadrupled profits. You might think he would then have paused for breath. But last year Harry, now 70, attended a bankruptcy auction and, for a pittance, acquired a product line that is a natural for K&W. That company's profitability may well be increased 50% by this coup. Watch this space for future bulletins on Harry's triumphs.

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With more than a year behind him of trading Berkshire's stock on the New York Stock Exchange, our specialist, Jim Maguire of Henderson Brothers, Inc. ("HBI"), continues his outstanding performance. Before we listed, dealer spreads often were 3% or more of market price. Jim has maintained the spread at 50 points or less, which at current prices is well under 1%. Shareholders who buy or sell benefit significantly from this reduction in transaction costs.

Because we are delighted by our experience with Jim, HBI and the NYSE, I said as much in ads that have been run in a series placed by the NYSE. Normally I shun testimonials, but I was pleased in this instance to publicly compliment the Exchange.

* * * * * * * * * * * *

Last summer we sold the corporate jet that we purchased for $850,000 three years ago and bought another used jet for $6.7 million. Those of you who recall the mathematics of the multiplying bacteria on page 5 will understandably panic: If our net worth continues to increase at current rates, and the cost of replacing planes also continues to rise at the now-established rate of 100% compounded annually, it will not be long before Berkshire's entire net worth is consumed by its jet.

Charlie doesn't like it when I equate the jet with bacteria; he feels it's degrading to the bacteria. His idea of traveling in style is an air-conditioned bus, a luxury he steps up to only when bargain fares are in effect. My own attitude toward the jet can be summarized by the prayer attributed,

apocryphally I'm sure, to St. Augustine as he contemplated leaving a life of secular pleasures to become a priest. Battling the conflict between intellect and glands, he pled: "Help me, Oh Lord, to become chaste — but not yet."

Naming the plane has not been easy. I initially suggested "The Charles T. Munger." Charlie countered with "The Aberration." We finally settled on "The Indefensible."

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About 96.9% of all eligible shares participated in Berkshire's 1989 shareholder-designated contributions program. Contributions made through the program were $5.9 million, and 2,550 charities were recipients.

We urge new shareholders to read the description of our shareholder-designated contributions program that appears on pages 52-53. 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 the nominee name of a broker, bank or depository. Shares not so registered on August 31, 1990 will be ineligible for the 1990 program.

* * * * * * * * * * * *

The annual meeting this year will take place at 9:30 a.m. on Monday, April 30, 1990. Attendance grew last year to about 1,000, very close to the seating capacity of the Witherspoon Hall at Joslyn Museum. So this year's meeting will be moved to the Orpheum Theatre, which is in downtown Omaha, about one-quarter of a mile from the Red Lion Hotel. The Radisson-Redick Tower, a much smaller but nice hotel, is located across the street from the Orpheum. Or you may wish to stay at the Marriott, which is in west Omaha, about 100 yards from Borsheim's. We will have buses at the Marriott that will leave at 8:30 and 8:45 for the meeting and return after it ends.

Charlie and I always enjoy the meeting, and we hope you can make it. The quality of our shareholders is reflected in the quality of the questions we get: We have never attended an annual meeting anywhere that features such a consistently high level of intelligent, owner-related questions.

An attachment to our proxy material explains how you can obtain the card you will need for admission to the meeting. Because weekday parking can be tight around the Orpheum, we have lined up a number of nearby lots for our shareholders to use. The attachment also contains information about them.

As usual, we will have buses to take you to Nebraska Furniture Mart and Borsheim's after the meeting and to take you to downtown hotels or to the airport later. I hope that you will allow plenty of time to fully explore the attractions of both stores. Those of you arriving early can visit the Furniture Mart any day of the week; it is open from 10 a.m. to 5:30 p.m. on Saturdays, and from noon to 5:30 p.m. on Sundays.

Borsheim's normally is closed on Sunday, but we will open for shareholders and their guests from noon to 6 p.m. on Sunday, April 29th. Ike likes to put on a show, and you can rely on him to produce something very special for our shareholders.

In this letter we've had a lot to say about rates of compounding. If you can bear having your own rate turn negative for a day — not a pretty thought, I admit — visit Ike on the 29th.

Warren E. Buffett
Chairman of the Board

March 2, 1990

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders
Berkshire Hathaway Inc.

We have audited the accompanying consolidated balance sheets of Berkshire Hathaway Inc. and subsidiaries as of December 31, 1989 and 1988, and the related consolidated statements of earnings and cash flows for each of the three years in the period ended December 31, 1989. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Berkshire Hathaway Inc. and subsidiaries as of December 31, 1989 and 1988, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1989, in conformity with generally accepted accounting principles.

As discussed in Note 1, the consolidated financial statements give retroactive effect to the Company's adoption in 1989 of Statement of Financial Accounting Standards No. 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments."

Deloitte & Touche

March 7, 1990

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

	December 31,	
	1989	1988
ASSETS		
Cash and cash equivalents	$ 205,127	$ 265,081
Investments:		
Obligations with fixed maturities	2,795,588	1,815,321
Marketable equity securities	5,261,598	3,558,724
Loans and accounts receivable	554,763	579,910
Inventories	195,927	167,293
Properties and equipment	207,432	194,390
Other assets	239,159	236,129
	$ 9,459,594	$ 6,816,848
LIABILITIES AND SHAREHOLDERS' EQUITY		
Losses and loss adjustment expenses	$ 1,436,311	$ 1,407,189
Unearned premiums	143,631	241,818
Savings accounts	291,592	286,909
Accounts payable, accruals and other liabilities	443,602	325,514
Income taxes	1,129,038	598,905
Term debt and other borrowings	1,007,516	480,009
	4,451,690	3,340,344
Minority shareholders' interests	82,778	66,396
Shareholders' equity:		
Common stock of $5 par value. Authorized 1,500,000 shares; issued 1,375,202 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	2,342,198	1,274,657
Retained earnings	2,460,968	2,013,491
	4,967,419	3,452,401
Less common stock in treasury, at cost (228,761 shares)	42,293	42,293
Total shareholders' equity	4,925,126	3,410,108
	$ 9,459,594	$ 6,816,848

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	1989	**1988***	**1987***
Revenues:			
Sales and service revenues	$1,526,459	$1,407,642	$1,326,829
Insurance premiums earned	394,279	584,235	824,895
Interest and dividend income	331,452	314,251	237,319
Realized investment gain	223,810	131,671	28,838
Sundry income	7,892	27,094	13,901
	2,483,892	2,464,893	2,431,782
Cost and expenses:			
Cost of products and services sold	844,056	753,845	705,203
Insurance losses and loss adjustment expenses	309,391	437,695	661,146
Insurance underwriting expenses	109,288	157,621	219,178
Selling, general and administrative expenses	526,359	495,331	488,307
Interest expense	77,574	70,280	47,437
	1,866,668	1,914,772	2,121,271
Earnings before income taxes	617,224	550,121	310,511
Income taxes	159,287	140,791	69,539
	457,937	409,330	240,972
Minority interest	10,460	10,060	6,420
Net earnings	$ 447,477	$ 399,270	$ 234,552
Net earnings per share	$ 390.01	$ 348.23	$ 204.51

**Restated — See Note 1(b)*

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	Year Ended December 31,		
	1989	1988	1987
Cash flows from operating activities:			
Net income	$ 447,477	$ 399,270	$ 234,552
Adjustments to reconcile net income to cash flows from operating activities:			
Depreciation and amortization	32,107	29,808	29,683
Realized investment gain	(223,810)	(131,671)	(28,838)
Minority interests	10,460	10,060	6,420
Increase (decrease) in income taxes payable	(22,181)	3,643	(30,937)
Increase in losses and loss adjustment expenses	29,122	146,767	400,194
Decrease in unearned premiums	(98,187)	(99,526)	(73,642)
Decrease in deferred acquisition costs	30,481	11,783	21,907
Other	124,737	(6,253)	47,401
Net cash flows from operating activities	330,206	363,881	606,740
Cash flows from investing activities:			
Purchases of fixed maturity investments	(1,468,157)	(109,245)	(1,229,290)
Purchases of marketable equity securities	(739,932)	(1,708,971)	(550,112)
Proceeds on sales of fixed maturity investments	519,470	345,351	205,110
Proceeds from maturities of fixed maturity investments	28,985	46,104	92,873
Proceeds on sales of marketable equity securities	821,656	878,228	607,080
Loans originated in finance businesses	(133,546)	(103,602)	(177,840)
Principal collection on loans	109,830	111,745	123,297
Other	(57,174)	21,144	(15,351)
Net cash flows from investing activities	(918,868)	(519,246)	(944,233)
Cash flows from financing activities:			
Proceeds from borrowings	1,172,356	250,000	141,075
Repayments of borrowings	(650,019)	(59,877)	(111,359)
Net increase in savings accounts	4,683	698	3,853
Other	1,688	(2,337)	(4,393)
Net cash flows from financing activities	528,708	188,484	29,176
Increase (decrease) in cash and cash equivalents	(59,954)	33,119	(308,317)
Cash and cash equivalents at beginning of year	265,081	231,962	540,279
Cash and cash equivalents at end of year	$ 205,127	$ 265,081	$ 231,962
Other cash flow information:			
Income taxes paid	$ 181,468	$ 137,148	$ 100,778
Interest paid	70,191	61,798	46,067

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1989

(1) Significant accounting policies and practices

(a) *Basis of consolidation*
The accompanying Consolidated Financial Statements include the accounts of Berkshire Hathaway Inc. (the "Company" or "Berkshire") consolidated with accounts of all its subsidiaries. Intercompany accounts and transactions have been eliminated.

(b) *Restatements*
Berkshire's prior period consolidated financial statements are restated to reflect the applicable provisions of Statement of Financial Accounting Standards No. 97 which require a one-step statement of earnings in which pre-tax realized investment gains and losses are reported as revenues. This presentation replaces the previously utilized form in which net-after-tax operating earnings were shown separately from net-after-tax realized investment gains. Net earnings as restated are unchanged from the amounts originally reported.

(c) *Cash equivalents*
Cash equivalents consist of funds invested in money market accounts and in investments with a maturity of three months or less when purchased.

(d) *Investments*
Investments in obligations with fixed maturities are carried at cost or adjusted cost. Marketable equity securities held by members of the Berkshire Hathaway Insurance Group are carried at market value. Marketable equity securities held by the Company and by non-insurance subsidiaries are carried cost, which in the aggregate is less than market value. See Note 4.

(e) *Investments - sales*
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 taxes, identified cost is used.

(f) *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. The net unamortized balance is carried in other assets.

(g) *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 cost 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.

(1) Significant accounting policies and practices *(Continued)*

(h) 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 $197,090,000 as of December 31, 1989 applying, as present value discount rates, the market interest rates at contract inception dates - the weighted average of which was 9% as of December 31, 1989. Present value of net liabilities for structured settlements was determined for statutory and tax reporting purposes to be $277,744,000 as of December 31, 1989 applying discount rates prescribed by insurance regulatory authority - 5% for contracts incepting after 1986, and 7% with respect to contracts dated prior to 1987.

(j) 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, immaterial in amount (less than $5,000,000 per year for each of the past three years), incurred with respect to participating policies are reflected in the accompanying Consolidated Statements of Earnings as a deduction from earned premiums.

(k) 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 to deferred and prepaid income taxes.

The liability for income taxes in the Consolidated Balance Sheets includes deferred taxes deemed applicable to unrealized appreciation included in carrying value of marketable equity securities. Such taxes were accrued at a rate of 34% relative to increases in unrealized appreciation that arose subsequent to 1986 and at the rate of 28% relative to appreciation that arose in years prior to 1987.

In 1987, the Financial Accounting Standards Board ("FASB") issued Statement No. 96 "Accounting for Income Taxes" and required its implementation in financial statements issued for years beginning after December 15, 1988. Subsequently, the FASB issued statements twice deferring its effective date. Implementation is now required in financial statements for years beginning after December 15, 1991. The statement requires the "liability method" of accounting for income taxes, with a balance sheet focus. It supersedes APB Opinion No. 11 "Accounting for Income Taxes" requiring the "deferred method", with an earnings statement focus. Although early adoption is permitted, the Company has not yet implemented the statement's provisions. If change to the "liability method" were to have been reflected in Berkshire's consolidated balance sheet as of December 31, 1989, a reduction to total shareholders' equity would have resulted. The approximate range of reduction would have been from $35,000,000 to $70,000,000, with the precise amount dependent upon Berkshire's selection between permitted alternative means of implementation.

Notes to Consolidated Financial Statements *(Continued)*

(2) Investment in obligations with fixed maturities

Assets comprising this account at December 31, 1989 and 1988 were as follows:

	1989	1988
Cumulative convertible preferred stocks:		
Champion International Corporation	$ 300,000,000	$ —
The Gillette Company	600,000,000	—
Salomon Inc	700,000,000	700,000,000
USAir Group, Inc.	358,000,000	—
Other preferred stocks	5,191,000	15,072,000
Bonds	832,397,000	1,100,249,000
	$2,795,588,000	$1,815,321,000

There is no regular trading market from which quotations of market value might be obtained for the Champion, Gillette, Salomon Inc and USAir preferred shares nor for some of the bond issues represented in the portfolio; but Berkshire management believes that aggregate market value of the consolidated portfolio of fixed maturity obligations exceeded aggregate cost at both December 31, 1989 and 1988.

(3) Investments in cumulative convertible preferred stocks

(a) Salomon Inc

On October 1, 1987, subsidiaries of Berkshire purchased a new issue of 700,000 shares of 9% Cumulative Convertible Preferred Stock of Salomon Inc ("Salomon"). These shares were purchased for cash at their par value of $1,000 per share and $700,000,000 in the aggregate. Each share is entitled to 26.31579 votes on all matters submitted to a vote of Salomon shareholders. At December 31, 1989, the preferred shares possessed approximately 13% of total Salomon voting rights. 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 are then outstanding.

(b) The Gillette Company

On July 20, 1989, subsidiaries of Berkshire purchased an issue of 600,000 shares of Series B Cumulative Convertible Preferred Stock of The Gillette Company ("Gillette") at a cash price of $1,000 per share - $600,000,000 in the aggregate - with respect to which dividends accrue at the annual rate of $87.50 per share. Each share is entitled to 20 votes on all matters submitted to a vote of Gillette shareholders and at December 31, 1989 the preferred shares possessed approximately 11% of total Gillette voting rights. On July 20, 1991 and until July 20, 1999, each share may be converted into 20 shares of common stock. Also during this period, Gillette may call the shares for redemption at $1,100 per share. If neither called nor converted then Gillette must redeem the shares on July 20, 1999 at $1,000 per share.

(c) USAir Group, Inc.

On August 7, 1989, subsidiaries of Berkshire purchased 358,000 shares of newly issued Series A Convertible Preferred Stock of USAir Group, Inc. ("USAir") at a cash price of $1,000 per share -$358,000,000 in the aggregate. Dividends accrue at an annual rate of $92.50 per share. Each of these shares is entitled to 16 2/3 votes on all matters submitted to a vote of USAir shareholders. At December 31, 1989 the aggregate voting rights of the issue represented 11% of total USAir voting rights. During the eight years beginning August 7, 1991 each preferred share will be convertible into 16 2/3 common shares and USAir may call the shares for redemption at $1,100 per share. If neither called nor converted, the shares must be redeemed on August 7, 1999 at their issue price.

(d) Champion International Corporation

On December 6, 1989, subsidiaries of Berkshire purchased a new issue of 300,000 shares of Preference Stock of Champion International Corporation ("Champion"). These shares were purchased for cash at a price of $1,000 per share - $300,000,000 in the aggregate. The annual dividend accrual rate is $92.50 per share and each share is entitled to 26.31579 votes on all matters submitted to a vote of shareholders of Champion. At December 31, 1989, the aggregate voting rights of the issue represented approximately 8% of total Champion voting rights. Each preference share may be converted at any time into 26.31579 common shares of Champion. Champion has the right to redeem the shares at any time prior to December 6, 1999 at $1,150 per share. If the shares are not called or converted, then Champion must redeem them on December 6, 1999 at their issue price.

(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, 1989			
Common stock of:	*Cost*	*Unrealized Gain*	*Market*	*Carrying Value*
Capital Cities/ABC, Inc.	$ 517,500,000	$ 1,174,875,000	$ 1,692,375,000	$ 1,672,794,000
The Coca-Cola Company	1,023,919,000	779,868,000	1,803,787,000	1,801,995,000
GEICO Corporation	45,713,000	998,912,000	1,044,625,000	1,044,625,000
The Washington Post Company	9,731,000	476,635,000	486,366,000	486,366,000
All other marketable equity securities	217,797,000	136,008,000	353,805,000	255,818,000
	$1,814,660,000	$3,566,298,000	$5,380,958,000	$5,261,598,000

	December 31, 1988			
Common stock of:	*Cost*	*Unrealized Gain*	*Market*	*Carrying Value*
Capital Cities/ABC, Inc.	$ 517,500,000	$ 569,250,000	$ 1,086,750,000	$ 1,077,262,000
The Coca-Cola Company	592,540,000	39,908,000	632,448,000	632,448,000
GEICO Corporation	45,713,000	803,687,000	849,400,000	849,400,000
RJR Nabisco Inc.	281,765,000	22,775,000	304,540,000	304,180,000
The Washington Post Company	9,731,000	354,395,000	364,126,000	364,126,000
All other marketable equity securities	288,000,000	97,653,000	385,653,000	331,308,000
	$1,735,249,000	$1,887,668,000	$3,622,917,000	$3,558,724,000

Unrealized gain is shown net of nominal unrealized loss as to certain stocks included above in the category captioned "All other marketable equity securities."

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

Common shares of Capital Cities/ABC, Inc. ("Capital Cities") owned by Berkshire subsidiaries possessed approximately 17% of the voting rights of all Capital Cities shares outstanding at December 31, 1989. The shares are held subject to an Agreement the terms of which grant to Capital Cities a right of first refusal to purchase the shares and otherwise govern until January 3, 1997 the manner by which the shares may be sold or transferred. Also, Berkshire and its subsidiaries have delivered to Capital Cities irrevocable proxies with respect to these shares in favor of Thomas S. Murphy so long as he shall be the chief executive officer of Capital Cities, or Daniel B. Burke so long as he shall be the chief executive officer of Capital Cities, to vote the shares at any and all meetings of shareholders of Capital Cities. The proxies expire on January 2, 1997 or at the earlier date when neither of such persons is chief executive officer of Capital Cities.

(6) Investment in GEICO Corporation

Subsidiaries of Berkshire, at both December 31, 1989 and at December 31, 1988, owned 6,850,000 shares of common stock of GEICO Corporation. The shares possessed approximately 45% of the voting rights of all GEICO shares outstanding at December 31, 1989, 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 the shares, Berkshire does not use the equity method of accounting for its investment in GEICO.

Notes to Consolidated Financial Statements *(Continued)*

(7) Loans and accounts receivable

Loans and accounts receivable represent the following:

	Dec. 31, 1989	Dec. 31, 1988
Trade accounts receivable	$257,776,000	$234,009,000
Loans of Mutual Savings and Loan Association ("Mutual"), principally real estate	153,755,000	136,970,000
Installment receivables purchased by Scott Fetzer Financial Group ("SFFG")	69,479,000	69,229,000
Due Insurance Group members, principally premiums	42,583,000	63,275,000
Investment income due and accrued	31,170,000	43,168,000
Amounts due from sales of securities	—	33,259,000
	$554,763,000	$579,910,000

(8) Income taxes

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

	Dec. 31, 1989	Dec. 31, 1988
Payable currently	$ 36,906,000	$ 46,758,000
Deferred, relating to unrealized appreciation of marketable equity securities	1,100,784,000	548,470,000
Deferred (prepaid) arising from timing differences	(8,652,000)	3,677,000
	$1,129,038,000	$ 598,905,000

The Consolidated Statements of Earnings reflect charges for income taxes as shown below:

	1989	1988	1987
Federal	$ 142,996,000	$ 122,492,000	$ 56,597,000
State	15,514,000	15,871,000	11,551,000
Foreign	777,000	2,428,000	1,391,000
	$159,287,000	$140,791,000	$ 69,539,000
Taxes payable currently	$ 171,616,000	$ 149,835,000	$ 122,351,000
Increase (decrease) in net deferred taxes	(12,329,000)	(9,044,000)	(52,812,000)
	$159,287,000	$140,791,000	$ 69,539,000

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

Applicable to:	*1989*	*1988*	*1987*
Deferred insurance premium acquisition costs	$ (10,363,000)	$ (7,377,000)	$ (13,577,000)
Structured settlement liabilities	5,607,000	6,902,000	4,714,000
Discounting of losses and loss adjustment expense reserves	(3,588,000)	(10,988,000)	(37,692,000)
Deferred gross profit on installment receivables	(7,752,000)	(4,610,000)	(8,745,000)
Other, net	3,767,000	7,029,000	2,488,000
	$(12,329,000)	$ (9,044,000)	$(52,812,000)

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

	1989	*1988*	*1987*
Net earnings before income taxes	$617,224,000	$550,121,000	$310,511,000
Hypothetical amounts applicable to above computed at the Federal statutory rate (34% in 1989 and 1988, 40% in 1987)	$ 209,856,000	$ 187,041,000	$ 124,204,000
Decreases, resulting from:			
Tax-exempt interest income	(26,735,000)	(33,477,000)	(40,501,000)
Dividends received deduction	(36,065,000)	(21,461,000)	(10,830,000)
State income taxes, less Federal income tax benefit	10,240,000	10,597,000	6,931,000
Net other differences	1,991,000	(1,909,000)	(10,265,000)
Total income taxes	$159,287,000	$140,791,000	$ 69,539,000

(9) Term debt and other borrowings

The following table sets forth the term debt and other borrowings of the Company and its subsidiaries at December 31, 1989 and 1988.

Company	*1989*	*1988*
Zero Coupon Convertible Subordinated Notes Due 2004	$ 405,683,000	$ —
10% Debentures due January 1, 2018, redeemable through operation of a sinking fund which calls for annual repayments of $7,500,000 beginning in 1999	150,000,000	150,000,000
9 3/4% Debentures due January 15, 2018, redeemable through operation of sinking fund which calls for annual repayments of $5,000,000 beginning in 1999	100,000,000	100,000,000
7.7% Loan repayable August 1, 1993 or at earlier demand	109,120,000	—
Other notes, payable through 1993	9,396,000	11,316,000
	774,199,000	261,316,000
Subsidiaries		
8.125% Notes, payable in 1996	120,000,000	120,000,000
10% Notes, payable in annual installments of $2,625,000 through 1997 with a final payment of $2,750,000 on August 31, 1998	23,750,000	26,375,000
9 1/2% Notes, payable in annual installments of $2,500,000 through 1998	22,500,000	25,000,000
8 7/8% Notes, payable in 1999	30,000,000	—
10 1/8% Notes, originally due in 1991, refunded in 1989	—	25,000,000
Federal Home Loan Bank advance, due August 1994, bearing interest at 8.73%	16,900,000	—
Other notes maturing through 2014	20,167,000	22,318,000
	$1,007,516,000	$480,009,000

The Zero Coupon Convertible Subordinated Notes Due 2004 were issued on September 28, 1989 at 44.314% of their face value which totaled $902,640,000. The issue price reflected an original issue discount rate and yield to maturity of 5.5% per annum; there will be no periodic payments of interest. Each $10,000 face amount note may be converted at any time prior to redemption or purchase by the Company into 0.4515 shares of common stock. A holder entitled upon conversion to a fractional share of common stock shall receive cash equal to the then current market value of such fractional share. The conversion rate will be adjusted only upon occurrence of certain dilutive events affecting the common stock. The Company may redeem the notes for cash at any time after September 28, 1992. A holder may require the Company to purchase any of its holdings on September 28, 1994 and again on September 28, 1999. The price at which notes will be purchased or redeemed will be issue price plus accrued original discount to the date of purchase or redemption.

No materially restrictive covenants are included in any of the various borrowing Agreements.

Principal payments on borrowings outstanding at December 31, 1989 are required during the succeeding five years as shown in the table immediately below. Amounts have been determined without regard to optional repayment provisions of the governing instruments.

1990	$ 11,731,000
1991	8,028,000
1992	8,043,000
1993	118,860,000
1994	22,892,000

Notes to Consolidated Financial Statements *(Continued)*

(10) Shareholders' equity accounts

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

	Net Unrealized Appreciation	*Retained Earnings*	*Treasury Stock*
Balance at December 31, 1986	$ 874,813,000	$ 1,379,669,000	$ 40,938,000
Increase during 1987 in unrealized appreciation included in carrying value of marketable equity securities	349,147,000		
Change during 1987 in deemed applicable income taxes	(119,837,000)		
Net earnings 1987		234,552,000	
Balance at December 31, 1987	1,104,123,000	1,614,221,000	40,938,000
Increase during 1988 in unrealized appreciation included in carrying value of marketable equity securities	259,486,000		
Change during 1988 in deemed applicable income taxes	(88,763,000)		
Increase in minority shareholders' interest in unrealized appreciation	(189,000)		
Net earnings 1988		399,270,000	
Value of Berkshire stock received in connection with termination of pension plans (note 12)			1,355,000
Balance at December 31, 1988	1,274,657,000	2,013,491,000	42,293,000
Increase during 1989 in unrealized appreciation included in carrying value of marketable equity securities	1,623,462,000		
Change during 1989 in deemed applicable income taxes	(552,314,000)		
Increase in minority shareholders' interest in unrealized appreciation	(3,607,000)		
Net earnings 1989		447,477,000	
Balance December 31, 1989	$2,342,198,000	$2,460,968,000	$ 42,293,000

(11) Interest and dividend income

Interest and dividend income for each of the past three years were comprised of the following:

	1989	*1988*	*1987*
Interest earned with respect to:			
Investment securities	$ 114,928,000	$ 164,499,000	$ 149,534,000
Loans and financed receivables	50,904,000	51,135,000	51,271,000
Dividends with respect to:			
Fixed maturity preferred stocks	102,181,000	63,652,000	17,241,000
Marketable equity securities	63,439,000	34,965,000	19,273,000
	$331,452,000	$314,251,000	$237,319,000

(12) Sundry income

Sundry income for 1989 and 1988 includes approximately $553,000 and $16,366,000 respectively, which represents the approximate fair value of cash and securities that reverted to the Company and to certain of its subsidiaries upon termination of overfunded pension plans.

(13) Interest expense

Interest expense is comprised of interest on savings accounts of Mutual plus interest on debt as follows:

	1989	*1988*	*1987*
Savings accounts of Mutual	$ 21,261,000	$ 20,579,000	$ 20,903,000
Debt of Mutual	599,000	—	—
Debt of SFFG	13,325,000	14,088,000	15,060,000
Other debt	42,389,000	35,613,000	11,474,000
	$77,574,000	$70,280,000	$47,437,000

(14) Dividend restrictions - insurance subsidiaries

Payments of dividends by Insurance Group members are restricted by insurance statutes and regulations. Without prior regulatory approval in 1990, Berkshire can receive up to approximately $580,900,000 as dividends from insurance subsidiaries.

Combined shareholder's equity of insurance subsidiaries determined pursuant to statutory accounting rules (Statutory Surplus as Regards Policyholders) was approximately $6,000,000,000 at December 31, 1989. This amount exceeded by approximately $1,000,000,000 the corresponding amounts determined on the basis of generally accepted accounting principles; the difference is principally represented by deferred income tax liabilities recognized for financial reporting purposes but not for statutory reporting purposes.

(15) Business segment data

In 1989, Berkshire had seven reportable business segments as defined in Financial Accounting Standards Board Statement No. 14. This is unchanged from 1988. The principle activity/product/service of each is described below:

Segment	Activity/product/service
Insurance	Property/casualty insurance and reinsurance.
Candy	Boxed chocolates and other confectionery products.
Newspaper	Publication of the *Buffalo News*, a daily and Sunday newspaper.
Retailing of home furnishings	Carpet, furniture, appliances, electronics and related products.
Encyclopedias, other reference materials	Composition, publication and marketing of *World Book* encyclopedias and other educational and reference works.
Home cleaning systems	Manufacture and distribution of principally *Kirby* branded home cleaning systems and products.
Uniform manufacturing and distribution	Manufacture and distribution of uniforms, trousers, jackets, shirts, and caps.

The tables which follow reflect data for those segments for each of the three most recent years.

Revenues

	1989	*1988*	*1987*
Insurance	$ 865,026,000	$ 943,873,000	$ 1,003,821,000
Candy	186,053,000	168,166,000	157,391,000
Newspaper	135,647,000	131,664,000	122,955,000
Retailing of home furnishings	156,762,000	152,541,000	145,997,000
Encyclopedias, other reference materials	338,397,000	337,990,000	325,772,000
Home cleaning systems	158,959,000	144,145,000	129,678,000
Uniform manufacturing and distribution	93,930,000	92,514,000	74,734,000
Revenues not identified with segments	549,118,000	494,000,000	471,434,000
	$2,483,892,000	$2,464,893,000	$2,431,782,000

Notes to Consolidated Financial Statements *(Continued)*

(15) **Business segment data** *(continued)*

Operating profit before taxes

	1989	*1988*	*1987*
Insurance	$ 439,223,000	$ 347,900,000	$ 122,985,000
Candy	33,260,000	31,498,000	30,718,000
Newspaper	45,448,000	41,830,000	38,811,000
Retailing of home furnishings	16,624,000	17,994,000	16,328,000
Encyclopedias, other reference materials	25,332,000	27,639,000	25,494,000
Home cleaning systems	26,188,000	27,210,000	23,325,000
Uniform manufacturing and distribution	11,899,000	13,425,000	12,613,000
Pre-tax operating profits not identified with segments *(a)*	70,798,000	86,958,000	60,029,000
Unallocated corporate costs	(9,159,000)	(8,720,000)	(8,318,000)
Interest on debt *(a)*	(42,389,000)	(35,613,000)	(11,474,000)
	$617,224,000	$550,121,000	$310,511,000

(a) Interest expense of finance and savings and loan operations has been deducted in determining pre-tax profits not identified with segments. Accordingly, such interest is not included in interest on debt.

Capital expenditures

	1989	*1988*	*1987*
Insurance	$ 525,000	$ 838,000	$ 804,000
Candy	3,882,000	3,509,000	4,758,000
Newspaper	971,000	988,000	1,266,000
Retailing of home furnishings	2,247,000	2,037,000	3,103,000
Encyclopedias, other reference materials	3,552,000	329,000	376,000
Home cleaning systems	11,191,000	2,370,000	1,320,000
Uniform manufacturing and distribution	2,272,000	2,203,000	981,000
Other	17,897,000	5,418,000	5,155,000
	$ 42,537,000	$ 17,692,000	$ 17,763,000

Depreciation and amortization of tangible assets

	1989	*1988*	*1987*
Insurance	$ 918,000	$ 722,000	$ 648,000
Candy	3,574,000	3,392,000	3,200,000
Newspaper	2,757,000	2,836,000	2,909,000
Retailing of home furnishings	1,745,000	1,612,000	1,515,000
Encyclopedias, other reference materials	749,000	746,000	770,000
Home cleaning systems	3,274,000	2,575,000	2,627,000
Uniform manufacturing and distribution	2,115,000	1,698,000	1,192,000
Other	13,589,000	13,421,000	13,960,000
	$ 28,721,000	$ 27,002,000	$ 26,821,000

Identifiable assets at year-end

	Dec. 31, 1989	*Dec. 31, 1988*	*Dec. 31, 1987*
Insurance	$ 7,871,097,000	$ 5,421,195,000	$ 4,519,657,000
Candy	66,278,000	64,304,000	64,742,000
Newspaper	48,917,000	50,755,000	54,326,000
Retailing of home furnishings	71,107,000	70,660,000	71,461,000
Encyclopedias, other reference materials	103,159,000	85,675,000	80,318,000
Home cleaning systems	60,147,000	45,675,000	46,191,000
Uniform manufacturing and distribution	70,597,000	73,009,000	61,595,000
Other	1,168,292,000	1,005,575,000	964,945,000
	$9,459,594,000	$6,816,848,000	$5,863,235,000

(15) Business segment data *(continued)*

Revenues of the insurance segment

	1989	1988	1987
Premiums written	$296,092,000	$484,709,000	$ 751,253,000
Premiums earned:			
Primary or direct insurance	$ 188,920,000	$ 292,309,000	$ 441,635,000
Reinsurance assumed excluding structured settlements and portfolio reinsurance	146,827,000	229,323,000	372,763,000
Subtotal	335,747,000	521,632,000	814,398,000
Structured settlements and portfolio reinsurance	58,532,000	62,603,000	10,497,000
Total premiums earned	394,279,000	584,235,000	824,895,000
Investment income	250,723,000	231,907,000	152,995,000
Realized investment gain	220,024,000	127,731,000	25,931,000
	$865,026,000	$943,873,000	$1,003,821,000

Insurance segment operating profit before taxes

	1989	1988	1987
Underwriting gain (loss):			
Primary or direct insurance operations	$ 4,243,000	$ 17,466,000	$ (2,715,000)
Reinsurance assumed excluding structured settlements and portfolio reinsurance	(11,204,000)	(14,472,000)	(27,745,000)
Subtotal	(6,961,000)	2,994,000	(30,460,000)
Structured settlements and portfolio reinsurance	(17,439,000)	(14,075,000)	(24,969,000)
Total underwriting (loss)	(24,400,000)	(11,081,000)	(55,429,000)
Net investment income	243,599,000	231,250,000	152,483,000
Realized investment gain	220,024,000	127,731,000	25,931,000
	$ 439,223,000	$ 347,900,000	$ 122,985,000

(16) Quarterly data

A summary of revenues and earnings by quarter for each of the last two years is presented in the following table. This information is unaudited. Dollars are in thousands, except per share amounts.

	1ST QUARTER		2ND QUARTER		3RD QUARTER		4TH QUARTER	
	1989	1988	1989	1988	1989	1988	1989	1988
Revenues	$701,707	$641,678	$564,214	$576,374	$597,143	$583,949	$620,828	$662,892
Earnings excluding realized investment gain	$ 72,241	$ 77,835	$ 62,424	$ 69,506	$ 70,932	$ 75,961	$ 94,305	$ 90,139
- per share	63.01	67.87	54.45	60.62	61.87	66.26	82.49	78.62
Realized investment gain	$ 54,813	$ 21,222	$ 25,011	$ 24,939	$ 50,723	$ 8,564	$ 17,028	$ 31,104
- per share	47.81	18.51	21.82	21.75	44.25	7.47	14.34	27.13
Net earnings	$ 127,054	$ 99,057	$ 87,435	$ 94,445	$ 121,655	$ 84,525	$ 111,333	$ 121,243
- per share	110.82	86.38	76.27	82.37	106.12	73.73	96.83	105.75

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. 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.

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

Results of Operations

Net earnings for each of the past three years are disaggregated in the table that follows. Amounts are in thousands, and each figure is income tax-effected.

Activity or Item	Contribution to Net Earnings 1989	1988	1987
Insurance underwriting	$ (12,259)	$ (1,045)	$ (20,659)
Insurance segment investment income	213,642	197,779	136,621
	201,383	196,734	115,962
Manufacturing, merchandising, and services	131,451	135,652	109,681
Pension plan asset reversions*	268	9,983	—
Interest on debt**	(27,098)	(23,212)	(5,905)
Other unallocated corporate costs	(6,102)	(5,716)	(4,992)
Earnings before realized investment gain	299,902	313,441	214,746
Realized investment gain	147,575	85,829	19,806
Net earnings	$ 447,477	$ 399,270	$ 234,552

**Net earnings that resulted from asset reversions to the Company and certain subsidiaries upon termination of overfunded pension plans are set out separately because of their comparative significance.*

***Interest expense with respect to debt of consumer finance subsidiaries as well as interest expense of Mutual Savings & Loan Association are not reflected in "Interest on debt." Instead, for purposes of this table, those items have been netted against the directly related service activity revenues.*

Berkshire has adopted Financial Accounting Standards Board Statement No. 97. The Statement requires pre-tax realized investment gains to be shown as a component of revenues. As a result, Berkshire's Statements of Earnings no longer reflect net-after-tax investment gains separately from net-after-tax operating earnings. However, in our discussions of Berkshire's results, we expect to continue to show separately the net contribution to earnings of those differing components.

Note 15 to the consolidated financial statements ("the Segment Note") shows data for a number of the individual Berkshire businesses and should be read in conjunction with this discussion.

Insurance Underwriting

The after-tax figures shown above for the Insurance underwriting segment derive from the following:

	000s Omitted 1989	1988	1987
Underwriting gain (loss):			
Primary or Direct Insurance Operations	$ 4,243	$ 17,466	$ (2,715)
Reinsurance Assumed, excluding Structured Settlements and Portfolio Reinsurance	(11,204)	(14,472)	(27,745)
Structured Settlements and Portfolio Reinsurance	(17,439)	(14,075)	(24,969)
Underwriting loss — pre-tax	(24,400)	(11,081)	(55,429)
Applicable income tax credit*	11,781	9,670	34,461
Applicable minority interest	360	366	309
After-tax underwriting loss	$(12,259)	$ (1,045)	$(20,659)

**Income tax credits applicable to underwriting losses include a "fresh start" tax benefit of approximately $3 million for 1989, $5 million for 1988 and $8 million for 1987.*

Insurance Underwriting (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.

	1989		*1988*		*1987*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Premiums written	$ 169,661		$ 218,838		$ 412,748	
Premiums earned	188,920	100.0	292,309	100.0	441,635	100.0
Losses and loss expenses	125,873	66.6	196,165	67.1	338,575	76.7
Underwriting expenses	58,804	31.1	78,678	26.9	105,775	23.9
Total losses and expenses	184,677	97.7	274,843	94.0	444,350	100.6
Underwriting gain (loss) — pre-tax	$ 4,243		$ 17,466		$ (2,715)	

Premiums earned from primary or direct operations decreased in 1989 from 1988 by about 35% and in 1988 from 1987 by about 34%. During the 1987-1989 period, a continuously decreasing number of policies were issued from each of the separately-focused underwriting areas that make up Berkshire's primary or direct business. Earned premiums from business produced by the Commercial Casualty and the Professional Liability and Special Risks Divisions, both in New York City, have been $241.4 million since inception in 1985 through 1989. They peaked at $93 million for 1987, then declined to $54.1 million for 1988 and to $20.2 million for 1989. Competition for insurance business has significantly eroded prices and successively fewer favorably priced insuring opportunities have been presented since 1986.

The increases from year to year in percent of earned premiums represented by underwriting expenses, evident in the above table, are the result of the declining level of premiums, in two ways. First, the business produced by the New York City divisions has historically carried a lower than group average underwriting expense rate (8.8% inception-to-date), and the proportion of the Group's total primary or direct earned premiums represented by this business has declined from 21% in 1987 to 18% in 1988 and 11% in the most recent year. Secondly, costs of providing underwriting support, particularly personnel costs, for traditional business have decreased at a slower rate than have earned premiums from such business.

Summarized below is loss and loss expense data from primary or direct underwriting:

	000s Omitted		
	1989	*1988*	*1987*
Unpaid losses and loss expenses at beginning of year	$667,592	$628,077	$429,505
Incurred losses recorded:			
Current year occurrences	145,907	225,309	348,010
All prior years' occurrences	(20,034)	(29,144)	(9,435)
	125,873	196,165	338,575
Payments with respect to:			
Current year occurrences	27,645	39,263	44,856
All prior years' occurrences	126,674	117,387	95,147
	154,319	156,650	140,003
Unpaid losses and loss expenses at end of year	$639,146	$667,592	$628,077

As indicated above by the credits shown for incurred losses recorded for all prior years' occurrences, favorable developments of loss reserves have been recorded for this business in each of the past three years. The credits represent 10.6% — 1989, 10.0% — 1988, and 2.1% — 1987, of direct or primary premiums earned in those respective years. The bulk of favorable loss development recorded in 1989 related to National Indemnity Company's traditional liability coverages for bus and truck operators.

Management's Discussion *(continued)*

Insurance Underwriting (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.

	1989		1988		1987	
	Amount	%	Amount	%	Amount	%
Premiums written	$ 65,954		$ 203,268		$ 328,011	
Premiums earned	146,827	100.0	229,323	100.0	372,763	100.0
Losses and loss expenses	109,419	74.5	170,492	74.3	287,638	77.2
Underwriting expenses	48,612	33.1	73,303	32.0	112,870	30.2
Total losses and expenses	158,031	107.6	243,795	106.3	400,508	107.4
Underwriting (loss) — pre-tax	$ (11,204)		$ (14,472)		$ (27,745)	

The significant decreases reflected above for both written and earned premiums in 1989 are the result of expiration of the quota-share reinsurance arrangement under which National Indemnity Company assumed 7% of the business written by the Fireman's Fund Insurance Companies ("FFC") during the four years from September 1, 1985 to August 31, 1989. Premiums earned from that arrangement during years covered by the above table were approximately $254,000,000 in 1987, $216,000,000 in 1988 and $131,000,000 in 1989. In mid-September 1989, National Indemnity returned to FFC approximately $55 million of premiums, net of ceding commissions, unearned at contract expiration date. The Berkshire Hathaway Insurance Group remains liable for run-off of its share of the losses and loss expenses covered by the contract, and will continue to invest funds offsetting the reserves until the run-off is complete many years hence.

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

	000s Omitted		
	1989	1988	1987
Unpaid losses and loss expenses at beginning of year	$531,334	$488,098	$319,989
Incurred losses recorded:			
Current year occurrences	109,231	169,688	283,151
All prior years' occurrences	188	804	4,487
	109,419	170,492	287,638
Payments with respect to:			
Current year occurrences	31,983	35,474	45,201
All prior years' occurrences	97,392	91,782	74,328
	129,375	127,256	119,529
Unpaid losses and loss expenses at end of year	$511,378	$531,334	$488,098

Unpaid losses and loss expenses from major quota share reinsurance arrangements were $412 million, $435 million, and $388 million at December 31, 1989, 1988, and 1987 respectively. Little in the way of development, either favorable or unfavorable, has been recognized to date for those arrangements. Delayed reporting of loss occurrences for reinsurance business is the norm, however, and developments will be reported over an extended time period of many years. Given the magnitude of the reserves, their extent may be significant.

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

Berkshire contributed additional capital to the Insurance Group in each of the past three years. Approximately $200 million was added in 1987, $275 million in 1988 and $415 million in 1989. The added capital together with reinvested earnings and increased float increased the total invested assets of the Group. Meaningful year-to-year increases resulted in investment income, summarized below for the past three years:

	000s Omitted			
	Investment Income Before Taxes	Applicable Income Taxes	Applicable Minority Interest	Investment Income After Taxes and Minority Int.
1989	$243,599	$ 26,756	$ 3,201	$213,642
1988	231,250	30,698	2,773	197,779
1987	152,483	13,670	2,192	136,621

"Float" from policyholder funds has increased from approximately $1,078,000,000 at December 31, 1986 - three years ago - to approximately $1,541,000,000 at December 31, 1989. The term denotes the sum of unpaid losses, unpaid loss adjustment expenses and unearned premiums, less the aggregate of agents balances receivable, amounts recoverable as reinsurance on paid losses and deferred policy acquisition costs. Of the 1989 year-end total float, structured settlement and portfolio reinsurance liabilities amounted to approximately $285,000,000.

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:

	1989		1988		1987	
	Amount	%	*Amount*	%	*Amount*	%
Revenues	$ 1,613,474	100.0	$ 1,500,724	100.0	$1,425,054	100.0
Costs and expenses	1,389,317	86.0	1,274,466	84.9	1,220,643	85.7
Earnings before income taxes	224,157	14.0	226,258	15.1	204,411	14.3
Applicable income taxes	85,876	5.4	84,231	5.6	90,114	6.3
Applicable minority interest	6,830	0.4	6,375	0.4	4,616	0.3
Net earnings	$ 131,451	8.2	$ 135,652	9.1	$ 109,681	7.7

Operations summarized above numbered twenty five in 1989, two more than in 1988 and 1987, plus, in each of the three years, data are included with respect to moderate scale real estate management activities of Berkshire and Wesco. The operations added in 1989 were (i) retailing of jewelry — in February, Berkshire purchased for cash 80% of Borsheim's Fine Jewelry and Gifts, and (ii) the manufacturing of electrical equipment by New America Electric — 80% purchased for cash by Wesco at the end of 1988. However, for each of the three years, the same six businesses constituted Berkshire's non-insurance "reportable business segments," a standing determined by relative size. The six are: (i) *See's* candy business, (ii) publication daily and Sunday of *The Buffalo News*, (iii) retailing of home furnishings by *The Nebraska Furniture Mart*, (iv) composing, publishing and marketing of *World Book* encyclopedias and other reference works, (v) manufacture and distribution of home cleaning systems — principally *Kirby* branded products and (vi) manufacture and distribution of *Fechheimer* uniforms.

Revenues of those six segments were greater in 1989 by approximately $42 million, or about 4%, than in 1988. And, in the prior year, aggregate revenues of the six were more by approximately $70 million, or 7%, than in 1987. As shown in the table of revenues in the Segment Note, revenue increases from 1987 to 1988 were at a fairly even rate among the six. In 1989, however, the candy business and the home cleaning systems business each recorded about 10% higher sales than in 1988, while the aggregate revenues of the other four increased about 1%.

Manufacturing, Merchandising, and Services (continued)

See's increased sales were accompanied by increased advertising costs, but of a lesser dollar magnitude, so the business contributed about one million dollars more to 1989 than to 1988 net earnings of Berkshire. The increased sales of home cleaning systems were led by a 32% increase in unit foreign sales of *Kirby* products. Strengthened distribution for those products was evident from results in Scandinavia, West Germany, Australia, Italy and Japan. Improved earnings, however, did not follow this segment's improved revenues, principally because of significant start-up costs incurred with respect to production for marketing in the 90's of a new model *Kirby* machine.

Interest Expense

Interest on debt increased in both 1989 and 1988, reflecting increased outstanding borrowings in each year. The 1989 increase over 1988 reflects the expense recorded for accretion of the zero coupon convertible subordinated notes issued on September 28, 1989. The 1988 increase over 1987 reflects the added borrowing costs from Berkshire's $250 million face amount of debentures due 2018, issued in January 1988.

Realized Investment Gain

Realized investment gain has been a recurring element in Berkshire's net earnings for many years. The amount — recorded by Berkshire when appreciated securities are sold — tends to fluctuate significantly from period to period, with a meaningfully varying effect upon Berkshire's consolidated net earnings. But, 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 pre-existence of substantial unrealized price appreciation in Berkshire's consolidated investment portfolio.

Liquidity and Capital Resources

Berkshire's Consolidated Balance Sheet as of December 31, 1989, reflects continuing capital strength. Berkshire shareholders' equity has increased from approximately $2.38 billion at December 31, 1986 to approximately $4.93 billion at December 31, 1989. In that three-year period, realized and unrealized securities gains increased equity capital by approximately $1.72 billion. Reinvested earnings, other than realized securities gains, were approximately $828 million for the three years.

In January 1988 Berkshire issued $250,000,000 face amount of 30 year debentures, redeemable through sinking funds commencing in 1999 with final maturity in 2018. In September 1989, Berkshire received approximately $400 million proceeds from issuance of zero coupon convertible subordinated notes maturing in 2004 at approximately $903 million. Proceeds from the issues were contributed to the equity capital of the Insurance Group. Berkshire borrowed the funds not with a view to any immediate cash needs but rather to increase its already substantial liquidity. Somewhat improved ability to respond to future business acquisition opportunities also resulted.

In early 1989, Standard and Poor's Corporation announced its assignment of a AAA credit rating to Berkshire senior debt. Creditors' indebtedness that is subordinated normally receives a rating one gradation lower than is received for their senior indebtedness. Accordingly, Berkshire's issue of zero coupon subordinated notes received an AA+ rating from that rating agency, when issued in September 1989.

BERKSHIRE HATHAWAY INC.

INSURANCE GROUP

Berkshire's insurance business is conducted by 12 separate subsidiaries, headed by National Indemnity Company headquartered in Omaha, Nebraska. The members underwrite multiple lines of principally casualty coverages for primarily commercial accounts, providing, for example, liability coverages for truck and bus operators, and casualty coverages for especially large or unusual risks. The Commercial Casualty Division and the Professional Liability and Special Risk Division, each with offices in New York City, solicit and underwrite the latter. Members domiciled in the states of Colorado, Kansas and Nebraska provide standard multiple-line property/casualty insurance to "homestate" residents. A California domiciled member provides principally workers' compensation insurance to employers in that state. Also, from a Reinsurance Division in New York City, treaties of reinsurance are offered to other insurers.

The Berkshire Hathaway Insurance Group maintains capital strength at unparalleled high levels, significantly higher than normal in the industry. This strength differentiates Group members from their competitors. For example, the Group's net premiums written in 1989 were approximately 5.5% of the Group's year-end statutory surplus. That compares to an industry average premiums-to-surplus ratio of about 170% (for 1988). The obvious margins of safety thus provided to insureds of the Group are particularly persuasive in marketing of individually negotiated financial insurance and reinsurance contracts, including liability assumptions with respect to loss portfolios and with respect to periodic payment contracts (structured settlements).

Combined financial statements of the Berkshire Hathaway Inc. Insurance Group - unaudited and not fully adjusted to conform to Generally Accepted Accounting Principles - are presented on the following two pages.

BERKSHIRE HATHAWAY INC.

INSURANCE GROUP

Balance Sheets
(dollars in thousands)

	December 31, 1989	December 31, 1988
Assets		
Investments:		
Fixed maturities at amortized cost:		
Bonds:		
Wash. Pub. Power Supply System	$ 194,004	$ 246,982
Other	545,943	802,916
Redeemable preferred stocks:		
Champion International	279,000	—
Gillette	600,000	—
Salomon Inc	624,000	624,000
USAir	348,000	—
Other	668	10,548
Equity Securities at market:		
Common stocks:		
Capital Cities/ABC, Inc.	1,664,169	1,068,637
Coca-Cola Company	1,799,152	632,448
GEICO	1,044,625	849,400
Washington Post	486,366	364,126
Other	123,728	498,614
Nonredeemable preferred stocks	23,509	8,606
	7,733,164	5,106,277
Cash and cash equivalents	45,390	121,614
Receivables	70,998	139,702
Deferred insurance premium acquisition costs	14,975	45,456
Other	2,328	3,299
	$7,866,855	$5,416,348
Liabilities		
Loss and loss adjustment expenses	$ 1,436,311	$ 1,407,189
Unearned premiums	143,631	241,818
Accounts payable, accruals and other	201,008	85,387
Income taxes (Deferred: $1,095,300, 1989; $547,635, 1988)	1,136,174	565,310
	2,917,124	2,299,704
Equity		
Minority shareholders'	35,168	24,957
Berkshire shareholders'	4,914,563	3,091,687
	4,949,731	3,116,644
	$7,866,855	$5,416,348

These statements do not conform to GAAP in all respects
These statements are unaudited

BERKSHIRE HATHAWAY INC.

INSURANCE GROUP

Statements of Earnings
(dollars in thousands)

	1989	1988	1987
Premiums written	$ 296,092	$ 484,709	$ 751,253
Premiums earned	$ 394,279	$ 584,235	$ 824,895
Losses and loss expenses	309,391	437,695	661,146
Underwriting expenses	109,288	157,621	219,178
Total losses and expenses	418,679	595,316	880,324
Underwriting loss - pre-tax	(24,400)	(11,081)	(55,429)
Net investment income	243,876	231,250	152,483
Realized investment gain	220,591	127,878	26,322
Earnings from operations before income taxes	440,067	348,047	123,376
Income taxes - credit (expense)	(88,902)	(63,753)	13,199
	351,165	284,294	136,575
Minority interest	4,017	3,614	1,884
Net earnings	$ 347,148	$ 280,680	$ 134,691

Statements of Net Investment Income
(dollars in thousands)

	1989	1988	1987
Interest:			
Substantially exempt from Federal income taxes:			
Wash. Pub. Power Supply System	$ 26,268	$ 34,615	$ 32,293
Other	52,623	64,545	68,310
Taxable	21,948	46,701	21,177
	100,839	145,861	121,780
Dividends:			
Capital Cities/ABC, Inc.	590	590	590
Champion International	1,864	—	—
Coca-Cola Company	31,322	4,393	—
GEICO	12,330	11,234	9,316
Gillette	23,479	—	—
Salomon Inc	56,160	56,160	14,040
USAir	12,876	—	—
Washington Post	3,179	2,695	2,212
Other	8,084	10,974	5,057
	250,723	231,907	152,995
Investment expenses	(6,847)	(657)	(512)
Net investment income	$ 243,876	$ 231,250	$ 152,483

These statements do not conform to GAAP in all respects
These statements are unaudited

BERKSHIRE HATHAWAY INC.

MANUFACTURING, PUBLISHING AND RETAILING BUSINESSES

Combined financial statements of Berkshire's Manufacturing, Publishing and Retailing businesses - unaudited and not fully adjusted to conform to Generally Accepted Accounting Principles - are presented on the following page. The operations whose data have been combined in these presentations include Berkshire's six non-insurance "reportable business segments," as well as the following:

Operation	*Activity/product/service*
Adalet	Conduit fittings, explosion proof fittings, junction boxes
Blue Chip Stamps	Trading stamps
Borsheim's	Retailing of fine jewelry
Campbell Hausfeld	Air compressors, airless paint sprayers
Carefree	Roll-up awnings, other RV accessories
France	Appliance timing controls, ignition transformers
Halex	Zinc and aluminum die cast fittings
K&W Products	Automotive compounds
Meriam	Pressure and flow measurement devices
New America Electric	Manufacturer of electrical equipment
Northland	Fractional horsepower motors
Powerwinch	Boat winches, windlasses
Precision	Steel service center
Quikut	Varieties of cutlery
Scot Labs	Maintenance chemicals
Stahl	Custom steel bodies for truck chassis
Wayne Home Equipment	Furnace burners; sump, utility & sewage pumps
Western Enterprises	Gas transmission line fittings
Western Plastics	Molded plastic parts

The six non-insurance "reportable business segments" are more fully described below.

Newspaper — The Buffalo News, a division of Berkshire, publishes a Sunday edition and seven editions each weekday. It is the only metropolitan newspaper published daily within a ten county upstate New York distribution area that comprises one of the nation's 50 largest primary market areas.

Uniform Manufacturing and Distribution — Berkshire acquired its 85% ownership interest of *Fechheimers* in mid-1986. Fechheimers manufactures its products at plants in Kentucky, Ohio, Tennessee and Texas, for marketing through approximately three dozen company-owned retail distribution centers and by independent dealers who together serve more than 200 of the country's major metropolitan areas.

Home Cleaning Systems — This segment of Berkshire's business is principally represented by *Kirby* cleaning systems and products, sold to approximately 600 factory distributors who in turn sell them to a network of area distributors and dealers. Independent dealers employ in-the-home demonstrations for direct resale to consumers. *Douglas Products Company* manufacturers specialty vacuum cleaners such as hand-held electric and cordless units distributed through department stores, catalogue showrooms and hardware stores. Data with respect to *Cleveland Wood Products Company*, a manufacturer of vacuum cleaner brushes, is also reported within this segment.

Retailing of Home Furnishings — The Nebraska Furniture Mart operates a home furnishing retail business from a very large - over 200,000 square feet - retail outlet and sizable warehouse facilities in Omaha, Nebraska. It serves a trade area with a radius around Omaha of approximately 300 miles. Berkshire owns 80% of this business; key managers own 20%.

Candy — See's produces boxed chocolates and other confectionary products with an emphasis on quality in two large kitchens in California. See's distributes its candies through its own retail stores - over 200 in number - located in 12 western and midwestern states, including Hawaii. A meaningful volume of candy business is also recorded for direct shipments made nationwide from a seasonally-varying number of quantity order distribution centers.

Encyclopedias, Other Reference Materials — World Book encyclopedias as well as *Childcraft* and *Early World of Learning*, a preschool educational program, are among the products of this segment. Revised editions of the encyclopedia are composed and published annually. In the first quarter of each year an updating yearbook is published and marketed by mail to owners of earlier editions. Otherwise, products are marketed primarily by the direct sales method to schools, libraries and individual households by a commissioned sales force of thousands located throughout the United States, Canada, Australia and the British Isles.

BERKSHIRE HATHAWAY INC.

MANUFACTURING, PUBLISHING and RETAILING BUSINESSES

Balance Sheets
(dollars in thousands)

	December 31, 1989	December 31, 1988
Assets		
Cash and cash equivalents	$ 25,165	$ 43,376
Accounts receivable	175,629	150,394
Inventories	165,751	133,762
Properties and equipment	141,935	130,363
Other	18,363	15,670
	$ 526,843	$ 473,565
Liabilities		
Accounts payable, accruals and other	$ 214,152	$ 179,301
Income taxes	37,948	47,738
Term debt and other borrowings	38,046	37,704
	290,146	264,743
Equity		
Minority shareholders'	25,166	18,999
Berkshire shareholders'	211,531	189,823
	236,697	208,822
	$ 526,843	$ 473,565

Statements of Earnings
(dollars in thousands)

	1989	1988	1987
Revenues:			
Sales and service revenues	$ 1,526,458	$1,407,642	$ 1,326,829
Interest income	8,405	6,724	6,789
Sundry income	2,579	2,472	722
	1,537,442	1,416,838	1,334,340
Costs and expenses:			
Costs of products and services sold	838,741	747,831	699,730
Selling, general and administrative	487,664	461,783	445,970
Interest on debt	6,197	4,955	6,730
	1,332,602	1,214,569	1,152,430
Earnings from operations before income taxes	204,840	202,269	181,910
Income tax expense	78,977	76,216	79,588
	125,863	126,053	102,322
Minority interest	4,982	4,353	3,483
Net earnings	$ 120,881	$ 121,700	$ 98,839

Purchase price accounting adjustments, including goodwill, arising from Berkshire's business acquisitions are not reflected in these statements, but instead are reflected in the statements of non-operating activities at page 51.

These statements do not conform to GAAP in all respects
These statements are unaudited

BERKSHIRE HATHAWAY INC.

FINANCE-TYPE BUSINESSES

Mutual Savings and Loan Association and its subsidiary and *Scott Fetzer Financial Group, Inc.* and its subsidiaries make up Berkshire's finance-type operations.

Balance Sheets
(dollars in thousands)

	December 31, 1989	December 31, 1988
Assets		
Cash and cash equivalents	$ 40,035	$ 63,193
Investments at cost:		
Fixed maturities:		
Bonds	17,473	48,013
Redeemable preferred stocks	30,524	30,524
Equity securities:		
FHLMC common stock	71,729	71,729
Nonredeemable preferred stocks	36,852	36,852
Collateralized loans receivable (1)	153,755	136,970
Installment and other receivables	173,214	152,807
Prepaid income taxes	12,864	13,558
Other	17,183	14,375
	$ 553,629	$ 568,021
Liabilities		
Savings accounts	$ 293,073	$ 288,522
Accounts payable, accruals and other	18,432	32,759
Income taxes	1,481	1,807
Term debt and other borrowings	159,593	150,202
	472,579	473,290
Equity		
Minority shareholders'	9,721	9,882
Berkshire shareholders'	71,329	84,849
	81,050	94,731
	$ 553,629	$ 568,021

Statements of Earnings
(dollars in thousands)

	1989	1988	1987
Revenues:			
Interest and fees on loans and financed receivables	$ 49,421	$ 50,230	$ 47,858
Interest and dividends on investment securities	19,230	20,842	22,708
Sundry income	263	638	1,774
	68,914	71,710	72,340
Expenses:			
Interest on savings accounts	21,530	20,840	20,944
Interest on debt	13,924	14,088	15,060
General and administrative	20,753	23,313	29,493(2)
	56,207	58,241	65,497
Earnings from operations before income taxes	12,707	13,469	6,843
Income tax expense	1,237	2,011	545
	11,470	11,458	6,298
Minority interest	834	975	357
Net earnings	$ 10,636	$ 10,483	$ 5,941

(1) Includes mortgage-backed securities of $34,316, 1989 and $45,367, 1988.
(2) Includes $3,618 write off of prepaid FSLIC insurance premiums.

These statements do not conform to GAAP in all respects
These statements are unaudited

BERKSHIRE HATHAWAY INC.

NON-OPERATING ACTIVITIES

These statements reflect the consolidated financial statement values for assets liabilities, shareholders' equity, revenues and expenses that were not assigned to any Berkshire operating group in the unaudited, and not fully GAAP adjusted group financial statements heretofore presented (pages 45 to 50).

Statements of Net Assets
(dollars in thousands)

	December 31, 1989	December 31, 1988
Assets		
Cash and cash equivalents	$ 96,018	$ 38,511
Investments:		
Fixed maturities:		
Bonds	74,977	2,338
Redeemable preferred stocks	81,000	50,000
Common stocks	11,468	28,312
Property account adjustments (1)	79,524	83,348
Unamortized goodwill (1)	140,544	117,970
Prepaid income taxes	8,985	9,983
Other	64,681	53,606
	$ 557,197	$ 384,068
Liabilities		
Accounts payable, accruals and other	$ 31,610	$ 28,067
Income taxes	(24,716)	7,591
Term debt and other borrowings	809,877	292,103
	816,771	327,761
Equity		
Minority shareholders'	12,723	12,558
Berkshire shareholders'	(272,297)	43,749
	(259,574)	56,307
	$ 557,197	$ 384,068

Statements of Earnings
(dollars in thousands)

	1989	1988	1987
Revenues:			
Interest and dividend income	$ 7,256	$ 7,404	$ 6,969
Sundry income	9,257	28,503(2)	14,823
	16,513	35,907	21,792
Expenses:			
Corporate administration	3,382	3,754	3,380
Shareholder designated contributions	5,867	4,966	4,938
Amortization of goodwill (1)	3,371	2,719	2,862
Property account adjustments (1)	5,987	6,937	5,546
Interest on debt	37,350	30,658	4,930
Other costs and expenses	946	538	1,754
	56,903	49,572	23,410
Excess of expenses before income taxes	(40,390)	(13,665)	(1,618)
Income tax credit (expense)	9,829	1,190	(2,605)
	(30,561)	(12,475)	(4,223)
Minority interest	627	1,118	696
Net loss	$ (31,188)	$ (13,593)	$ (4,919)

(1) "Property account adjustments" and goodwill arose in accounting for business acquisitions.
(2) Includes asset reversions of $16,366 arising from the termination of defined benefit pension plans.

These statements do not conform to GAAP in all respects
These statements are unaudited

BERKSHIRE HATHAWAY INC.

SHAREHOLDER-DESIGNATED CONTRIBUTIONS

The Company has conducted this program of corporate giving during each of the past nine years. On October 14, 1981, the Chairman sent to the shareholders a letter* explaining 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 own 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.

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"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
1988	$5	97.4%	$4,965,665	2,319
1989	$6	96.9%	$5,867,254	2,550

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

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

* * *

The program may not be conducted in the occasional year, if any, when the contributions would produce substandard or no tax deductions. In other years Berkshire expects to inform shareholders of the amount per share that may be designated, and a reply form will accompany the notice allowing shareholders to respond with their designations. If the program is conducted in 1990, the notice will be mailed on or about September 15 **to shareholders of record reflected in our Registrar's records as of the close of business August 31, 1990**, and shareholders will be given until **November 15** to respond.

Shareholders should note that the end-of-August record date is one month earlier in the year than the corresponding of-record date used in past years. The required response date is also fifteen days earlier.

Shareholders should also note the fact that shares held in street name are not eligible to participate in the program. To qualify, shares must be registered on August 31 in the owner's individual name(s) or the name of an owning trust, corporation, partnership or estate, as applicable.

The 1989 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 1989 increased to $24,414,000 ($3.43 per share) from $23,564,000 ($3.31 per share) in the previous year.

Consolidated net income (i.e., after unusual operating items and all net gains from sales of securities) increased to $30,334,000 ($4.26 per share) from $30,089,000 ($4.22 per share) in the previous year.

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

	Year Ended			
	December 31, 1989		December 31, 1988	
	Amount	Per Wesco Share	Amount	Per Wesco Share
"Normal" net operating income of:				
Mutual Savings	$ 4,191	$ .59	$ 4,694	$ .66
Wesco-Financial Insurance business	14,276	2.00	12,094	1.70
Precision Steel's businesses	2,769	.39	3,167	.44
All other "normal" net operating income[2]	3,178	.45	3,609	.51
	24,414	3.43	23,564	3.31
Gain on sale of interest in Bowery Savings Bank	—	—	4,836	.68
Net gains on sales of marketable securities	5,920	.83	1,689	.23
Wesco consolidated net income	$30,334	$4.26	$30,089	$4.22

(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, interest and dividend income from cash equivalents and marketable securities owned outside the savings and loan and insurance subsidiaries, and the electrical equipment manufacturing business, 80%-owned by Wesco since yearend 1988.

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.

Reproduced from 1989 Annual Report of Wesco Financial Corporation

Mutual Savings

Mutual Savings' "normal" net operating income of $4,191,000 in 1989 represented a decrease of 11% from the $4,694,000 figure the previous year.

The decrease in 1989 was primarily attributable to a less favorable interest rate "spread" as cost of holding savings increased more than yield on loans and investments.

As usual, these "normal-income" figures come from a decidedly abnormal savings and loan association.

Separate balance sheets of Mutual Savings at yearend 1988 and 1989 are set forth at the end of this annual report. They show (1) total savings accounts rising to $293 million from $289 million the year before, (2) a very high ratio of shareholders' equity to savings account liabilities (near 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 $154 million at the end of 1989, up slightly from $137 million at the end of 1988.

The loan portfolio at the end of 1989, although containing almost no risk of loss from defaults, bore an average interest rate of only 9.23%, probably near the lowest among U.S. savings and loan associations, but up moderately from 8.70% at the end of 1988. Because the loan portfolio is almost entirely made up of instruments of short maturity or bearing interest rates that adjust automatically with the market, there is now much less unrealized depreciation in the loan portfolio than the net unrealized appreciation in Mutual Savings' interest-bearing securities and public utility preferred stocks. That appreciation at December 31, 1989 was about $11.3 million.

While the "spread" between Mutual Savings' average interest rates paid on savings and received on loans remains too low to provide respectable profits, this "spread" improved again last year. Moreover, the disadvantage from inadequate "spread" has been reduced in each recent year by the effect of various forms of tax-advantaged investment, primarily preferred stock and municipal bonds. The negative side of this tax-advantaged antidote to inadequate interest rate margin on loans is the risk that preferred stock and municipal bonds, with their fixed yield and long life, will decline in value and not provide enough income to cover Mutual Savings' interest and other costs, if the general level of interest rates should sharply rise. In view of this risk, Mutual Savings' total commitment has been kept conservative, relative to the amount of its net worth.

Mutual Savings remains a "qualified thrift lender" under the old federal regulatory definition (which ends June 30, 1991) requiring 60% of assets in various housing-related categories. It plans to continue keeping substantially all loans receivable either with short expected lives or with interest rates that fluctuate with the market. All new variable-rate loans are "capped" at the 25% per annum level, which is over ten percentage points higher than the common 2½-points-over-market "cap" offered by competing associations. Naturally, to gain this extra protection from interest rate increase, Mutual Savings "pays" by (1) getting lower "spreads" over an interest rate index, and (2) not being able to make loans in amounts desired.

As pointed out in Note 10 to the accompanying financial statements, the book value of Wesco's equity in Mutual Savings ($48.9 million at December 31, 1989) 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 $48.9 million reported as book value, the parent corporation would receive much less than $48.9 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 value in unrealized appreciation of securities but also a buried value in real estate. The foreclosed property on hand (mostly 22 acres at or near the oceanfront in Santa Barbara, acquired in 1966) has become worth over a long holding period considerably more than its $8.4 million balance sheet carrying cost. Reasonable, community-sensitive development of this property has been delayed over 14 years in the course of administration of land-use laws. But, miraculous to report, eight houses, plus recreation facilities, are in various stages of completion on the property as part of an authorized development into 32 houses interspersed with large open areas. Mutual Savings plans to make the development first-rate in every respect, and unique in the quality of its landscaping.

The buried value in real estate is limited by the small number of houses allowed (32) and by the fact that only about half of such houses will have a significant ocean view. Additional limitation will come from high cost of private streets, sewage and utility improvements and connections, landscaping, and non-standardized, environmentally sensitive adaptation of housing to the site. Also, 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 the present era. We have "given" a very large fraction of the value of our land to the County of Santa Barbara in exchange for permission to use it at all.

The savings and loan association described in the foregoing paragraphs, quite different from most other associations for a long time, added a significant new abnormality during 1988. Mutual Savings increased its position in stock of Federal Home Loan Mortgage Corporation (widely known as "Freddie Mac") to 2,400,000 shares. This is 4% of the total shares outstanding, the legal limit for any one holder at the time the shares were purchased. Mutual Savings' average cost is $29.89 per share, compared to a price of $67.12 per share in trading on the New York Stock Exchange at the end of 1989. Thus, based on 1989 yearend trading prices, Mutual Savings had an unrealized pre-tax profit in Freddie Mac shares of about $89.4 million. At current tax rates the potential after-tax profit is about $52.6 million, or $7.39 per Wesco share outstanding.

Freddie Mac, formerly created and long run by a federal agency (the Federal Home Loan Bank Board), is now owned privately, largely by institutional investors and is now governed by an independent board of directors. Freddie Mac supports housing primarily by purchasing housing mortgage loans for immediate transmutation into mortgage-backed securities that it guarantees and promptly sells. In the process Freddie Mac earns fees and "spreads" while avoiding most interest-rate-change risk. This is a much better business than that carried on by most (or indeed most of the top 10% of) savings and loan associations, as demonstrated by Freddie Mac's high percentage returns earned on equity capital in recent years. One ironic cause of the high returns is that this creation of federal regulators pays no deposit-insurance premiums as it replaces much of the former function of the savings and loan industry.

At Freddie Mac's current dividend rate ($1.60 per annum per share), Mutual Savings' pre-tax yield is only 5.35% on its $29.89 average cost per share. Post-tax, the dividend yield is only 4.4%, but this amounts to about 75% of the current after-tax yield from very high grade mortgages. Moreover, Freddie Mac has a very creditable history of avoiding significant loan losses and increasing its earnings and dividend rate, thus contributing to increases in the market price of its stock. Following are figures for 1985-1989:

Year Ended 12/31:	Earnings per Share	Dividends per Share	Year-End Market Price per Share	Freddie Mac's Return Earned on all Average Equity
1985	$2.98	$ .53	$ 9.19	30.0%
1986	3.72	1.13	15.17	28.5
1987	4.53	1.10	12.12	28.2
1988	5.73	1.25	50.50	27.5
1989	6.57	1.60	67.12	25.0

When Wesco's annual report went to press last year, Congress was midcourse in considering revisions to the savings and loan laws. But it was clear that associations were shortly to be "re-regulated" into some mode less likely to cause a fresh torrent of deposit-insurance losses, borne by taxpayers. Provoking that legislative action was a previous torrent of losses which now seems likely to exceed $150 billion. These losses were caused by a combination of (1) competitive pressure on the "spread" between interest paid and interest received put on associations and banks when federal deposit insurance is provided to entities free to pay any interest rates they wish in order to attract deposits, (2) loose asset deployment rules for associations, (3) admission and retention of crooks and fools as managers of associations without regulatory objection, (4) general real estate calamities in certain big regions, and (5) continuous irresponsible protection and enhancement of unsoundness by the savings and loan lobby and certain members of Congress beholden to the most despicable savings and loan operators.

The new laws, under the acronym FIRREA, were composed and enacted with a speed caused by congressional indignation. (A recent example of such indignation, employing remarkable comparisons, is provided by the words of Congressman Jim Leach: "[If certain allegations are true] Charles Keating is a financiopath of obscene proportions — the Reverend Jim Bakker of American commerce, given a license to steal by a bank board headed by the Neville Chamberlain of regulation — a cheerleader who saw little evil and thus spoke little truth.")

Mutual Savings modestly contributed to tough legislative action by resigning from the U.S. League of Savings Institutions, using a letter of resignation which drew widespread media attention despite its understated criticism. A copy of this letter of resignation is appended at the end of this letter to shareholders.

Mutual Savings, desiring to act responsibly, supported virtually all the law revisions made by FIRREA, even though many of them will hurt Mutual Savings' profits.

For example:

(1) In stages, by July 1, 1994, Mutual Savings (and its service corporation subsidiary) must dispose of:

   (a) High-quality public utility preferred stocks, having tax-advantaged dividend rates averaging about 10.8% per annum, with a carrying value of $41.4 million at yearend 1989, and a market value then higher by about $8.7 million; and

   (b) High-quality convertible preferred stock of Salomon Inc, bearing a tax-advantaged dividend rate of 9% per annum, with a carrying value of $26 million, believed to be below the amount which could be realized in the event of sale.

(2) In stages, by the same date, July 1, 1994, Mutual Savings must write down to zero, in computing net worth for regulatory purposes, its 2,400,000 shares of Freddie Mac, which

had a carrying value of $71.7 million at yearend 1989, and, as reported above, a market value then higher by about $89.4 million.

(3) All new asset commitments, fitting Mutual Savings' proclivities and tax position, are pretty well restricted to (a) housing loans (including indirect loans in the form of mortgage-backed securities) and (b) debt instruments of the U.S. Government or its agencies.

(4) In stages, designed to create compliance during a two-year period commencing July 1, 1991, Mutual Savings will have to increase "qualified thrift lender" assets by 10 percentage points to a 70%-of-assets level, using a new and more limited definition of such "qualified thrift lender" assets which, to our surprise, does not include Freddie Mac stock. If the new test had been in full effect at December 31, 1989, Mutual Savings would have complied by disposing of about $74 million of non-home-loan assets (including some cash equivalents) and placing the proceeds in home loans (including indirect home loans in the form of short-term mortgage-backed securities).

(5) Deposit-insurance premiums have been increased. Short term, Mutual Savings is protected by credits of a nonrecurring nature. But by the mid 1990s the new premium rates will reduce Mutual Savings' annual earning power by about $200,000 from the level which would have occurred if it were still paying at the 0.083%-of-deposits rate which was in effect for years, instead of the new rate of 0.23%. The adverse effect of the higher deposit insurance costs on percentage return on shareholders' equity is much lower at Mutual Savings than at almost all other associations, which suffer substantially. The cause of Mutual Savings' advantage is its much larger percentage of equity, compared to deposits. This is a "one-time" advantage related to one ratio; on an incremental dollar of savings Mutual Savings faces the same damage as everyone else.

These combined effects will reduce Mutual Savings' normal earning power. While conservatively operated, Mutual Savings has been scrambling through recent years in its own way, obtaining a modest success made possible largely by the wide variety of asset-deployment options available under pre-FIRREA law. Consequently, FIRREA will adversely affect Mutual Savings, however wise the new restrictions, public needs considered. Nevertheless, it is probable that Mutual Savings' normal earning power will not be much reduced in 1990 and 1991.

We predict this deferment of decline in normal earnings because:

(1) FIRREA's asset-mix effects are phased in, subject to wide regulatory discretion; and

(2) We anticipate that regulators will be wise enough to exercise their discretion to allow extra-strong associations, with easy-to-sell assets, the same forbearance which will be granted to weak associations with hard-to-sell assets.

If we prove wrong in our prediction about regulators, Mutual Savings' wisest alternative will probably be withdrawal from the savings and loan business and the related obligation to pay deposit-insurance premiums.

If, as seems likely, Mutual Savings stays in the savings and loan business, it will retain a business even more mediocre than before, with only two interesting near-term prospects:

(1) During the next few years, Mutual Savings is almost certain to make a pre-tax profit of a nonrecurring nature as it disposes of the Santa Barbara property it acquired through foreclosure in 1966; and

(2) Mutual Savings will retain prospects for gain from its Freddie Mac stock if, as anticipated, Freddie Mac pays ever-higher dividends and the price of the stock also rises.

Long term, Mutual Savings hopes to find within the savings and loan business some constructive, continuing role which is not dependent on either of the foregoing anticipated near-term prospects. Until the right long-term role is found, our policy is simply to "stagger through."

The FIRREA law revision, while greatly improving the savings and loan system from the taxpayers' point of view, took an approach which can fairly be described as "all stick and no carrot." This is no way to create felicity for the donkey, but we deserve our share of the beating because we were previously so passive in the presence of obvious error and evil. Moreover, the safety-enhancing features of the law revision fell short in one fundamental respect which leaves profits under pressure: banks and associations remain free, within wide limits, to attract government-insured deposits at any interest rate they wish, while they must resell the ultimate fungible commodity, the use of money, into a brutally competitive market. The resulting squeeze on interest-rate "spread" safely attainable, combined with normal competitive disadvantages of associations, leaves the average well-run association with a likely future which should not excite its owners.

The normal competitive disadvantages of the average association, compared with the average bank, now include the following: higher deposit-insurance costs, more confusing new regulation, and less experience and momentum in various important remunerative activities. As a result, even a superbly run conventional association, like the one owned by H. F. Ahmanson & Co., sells in the stock market at a much lower price-to-book-value ratio than a superbly run bank. And the average savings and loan branch office probably now offers more incremental value to an experienced bank than it provides to its present owner.

Moreover, the average association does not now compete only with banks. Also gathering "deposits" are the money-market funds which:

(1) pay no deposit-insurance premiums, saving 0.23% of deposits each year, compared to associations;

(2) are required to employ exactly no capital from profit-earning proprietors ("management companies" in fund parlance), while capital requirements for associations have been raised;

(3) have lower-cost regulation (from an understaffed SEC) than associations;

(4) maintain no expensive branch offices, although they provide check-writing privileges and accept frequent deposits, using fast, low-cost systems which are better adapted in many ways to the new order than the systems of the average association; and,

(5) as a result of all the foregoing advantages, have total annual costs (before proprietors' profits), as a percentage of assets, which are more than 50% lower than annual costs of the most efficient association.

Thus, the natural "almost-no-brainer," non-home-mortgage, deposit-gathering niche is now occupied by a competing, better-adapted new species. This leaves associations in roughly the position of the original rabbit-like mammals which lost ecological market share when the rabbit was introduced into Australia. The adjustable-home-mortgage niche may now provide a decent home for some large, extremely efficient loan originators like Home Savings, but, as we seem to say each year, we have not yet found for Mutual Savings a permanent lending niche which is attractive, as distinguished from bearable. In the mortgage business we thus constantly confirm Samuel Johnson's observation that: "Life is a state in which much is to be endured and little to be enjoyed."

Left in place in the revised savings and loan system is a significant (although much reduced) structural risk for the federal government as deposit insurer. Associations retain a considerable residue of temptation to act imprudently. The temptation, in response to the profit-pressure which is a natural consequence of the structure of the system, is the same one which caused troubles in the

past: the temptation to seek an acceptable interest rate "spread," not available any other way, by bearing undue risk from either (1) mismatched maturities of loans and deposits or (2) losses through defaults of a gamier class of borrowers willing to promise extra-high interest rates. It is almost impossible to have asset deployment controls so tough that a bank or association can't look good for a while (and give the appearance of justifying higher compensation of management) as it takes risks which will in due course destroy its owners' equity and also cause deposit insurance losses. The "all stick" method of control is much better than nothing, but it is far from ideal when it is the exclusive method for prevention of losses borne by the deposit insurer. In contrast, when, long ago, the federal deposit insurer had low losses, the savings and loan system used both carrots and stick, so that the average savings and loan operator could do well without exceptional luck or ability. (The carrots were very low income taxation plus interest-rate controls which reduced cost of holding deposits while giving an advantage over banks in attracting deposits.) We think the present, revised system continues to impose more risk than taxpayers should bear, with high deposit-insurance costs contributing to the risk as well as compensating for it.

Housing is now less assisted than before by the existence of savings and loan associations. An example of the drift away from housing assistance is provided by FIRREA's new restriction preventing large loans to any one house builder. The new requirement is that an association loan no more than 15% of owners' equity to one customer, with exceptions permitted up to 30% for adequately capitalized associations with good records. The new requirement would have greatly reduced the profits and housing contributions of Mutual Savings in its early days when it concentrated resources in development loans while trusting only a few house-builders. And the new requirement now has the same general effect. It will significantly restrict availability of house-building loans in many regions of the country. This result demonstrates the impossibility of revising a complex system without undesired "by-product" effects. The first law of ecology and the first law of legislation are one and the same: "You can never do merely one thing."

Of course, a "by-product" of law revision sometimes helps, instead of hurts, some participant in a market. New "risk-based" capital requirements under FIRREA have such an effect, as they give associations new incentives to transfer monies they otherwise would have earned to Freddie Mac, through exchange of mortgages for credit-enhanced, mortgage-backed securities. (Although the securities then provide less income, they help satisfy regulatory capital requirements, because the securities require less owners' equity to hold.) This income-transfer effect should help Mutual Savings, through its large shareholding position in Freddie Mac.

Precision Steel

The businesses of Wesco's Precision Steel subsidiary, located in the outskirts of Chicago at Franklin Park, Illinois, contributed $2,769,000 to normal net operating income in 1989, down 13% compared with $3,167,000 in 1988. The decrease in 1989 profit occurred as pounds of product sold declined by 12%. Revenues were down less, by 5% to $59,440,000.

Under the skilled leadership of David Hillstrom, Precision Steel's businesses in 1989 continued to provide an extraordinary return on resources employed.

As we never tire of saying, the good financial results have an underlying reason, although not one strong enough to cause the results achieved in the absence of superb management. 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 (for instance, Los Angeles) seek out Precision Steel's service.

It is not common that steel warehouses have results like Precision Steel's. What we see, year after year, under David Hillstrom's leadership is boring, repetitive excellence as he remembers a basic catechism emphasizing service of the highest quality. We hope to be associated with him for a long time.

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 $58 million was invested in 1986, 1987 and 1989.

The new subsidiary, Wes-FIC, 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 Group. 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 ending August 31, 1989. The arrangement put 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 occurred only from the investment side of insurance, as Wes-FIC, instead of Fireman's Fund, invested funds from "float" generated. Wes-FIC's share of premiums earned in 1989, before contract termination, exceeded $37 million.

Upon contract termination, Wes-FIC returned to Fireman's Fund $15.6 million in unearned premiums, net of related ceding commissions, and retained assets of about $91 million offset by claims reserves which will be exhausted slowly over many future years. We regard the totality of Wesco's four-year participation in the Fireman's Fund reinsurance contract as having excellent prospects, all future claim payments considered. Wesco's ultimate parent corporation (and 80% owner) almost certainly did Wesco a favor in allowing Wesco's participation, as was planned at the time.

There was some good luck in the selection, years ago, of a termination date for the Fireman's Fund contract. The date, August 31, 1989, happened to be just before occurrence of both Hurricane Hugo and the San Francisco earthquake. There was some heavenly justice in this outcome, because Wes-FIC caught a share of hurricane losses within hours after the inception of the contract in 1985.

Wes-FIC in 1988 began to write direct business, as distinguished from reinsurance. It is now licensed in Nebraska, Utah and Iowa, but it wrote only $183,000 in direct premiums, almost all surplus lines coverage (permitted for non-admitted insurers) in Alabama. Earned direct premiums were $438,000.

Wes-FIC's "normal" net income for 1989 was $14,276,000, versus $12,094,000 for 1988. The net "normal" income figures excluded securities gains, net of income taxes, of $5,910,000 in 1989, compared with $6,071,000 (including $4,836,000 realized on sale of Wes-FIC's 9% equity interest in Bowery Savings Bank) in 1988. These items are reported as "Net Gains on Sales of Securities," below. Wes-FIC's net income benefitted by about $215,000 in 1989, versus $260,000 in 1988, 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 of the inherent imperfections of Wes-FIC's accounting, based as it is on forecasts of outcomes in many future years.

Wes-FIC retains a "longage" of capital and a shortage of good insurance business. We see few present opportunities for sound expansion, but we expect more insurance writing in due course, made possible by fear that other insurers will become unable or unwilling to pay fair claims.

Effective January 1, 1990, Wes-FIC has begun to reinsure 50% of the book of insurance business (largely workers' compensation insurance) of Cypress Insurance Company, a wholly owned subsidiary of Berkshire Hathaway. Wes-FIC's share of premiums written is expected to approximate $8 million in 1990. We regard this reinsurance contract as worth having at Wesco, but it is not nearly as promising, per dollar of insurance written, as was the Fireman's Fund contract.

All Other "Normal" Net Operating Income

All other "normal" net operating income, net of interest paid and general corporate expenses, decreased to $3,178,000 in 1989 from $3,609,000 in 1988. Sources were (1) rents ($2,518,000 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), (2) interest and dividends from cash equivalents and marketable securities held outside the savings and loan and insurance subsidiaries, and (3) earnings of New America Electrical Corporation. The decrease in this "all other" component of earnings in 1989 resulted primarily from transfer of assets, with their related incomes, to Wesco's insurance subsidiary to augment its capital position.

Net Gains On Sales Of Securities

Wesco's aggregate net gains on sales of securities, combined, after income taxes, decreased to $5,920,000 in 1989 from $6,525,000 in 1988. As noted above, $5,910,000 of these gains were realized in the Wes-FIC insurance subsidiary in 1989, versus $6,071,000 realized in 1988.

Convertible Preferred Stock of 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 included the following: (1) the preferred stock pays 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 on the New York Stock Exchange) 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 Wesco acquired its 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.

At the end of 1989 Salomon common stock was trading at $23⅜, compared with $24⅛ at the end of 1988, after much constructive adjustment of Salomon's business to new conditions.

Salomon's credit as a potential source of preferred dividends and stock redemptions improved during its 1988 recovery, when generally available dividend rates on preferred stock were roughly stable. And during 1989 Salomon was a star performer, compared to most other securities firms. With Wesco's preferred stock now shorter in contractual duration, and its conversion privilege enhanced in value during the last two years, we believe that the fair market value of Wesco's investment was somewhat in excess of its cost, and that the aggregate amount of any such excess was not material to Wesco, at December 31, 1989.

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

Other Convertible Preferred Stocks

In transactions similar to that which created our Salomon investment, Wesco and its subsidiaries during 1989 invested a total of $75 million in several new issues of convertible preferred stock. The common stock of all issuers is listed on the New York Stock Exchange. These transactions are briefly summarized below:

(1) ***The Gillette Company***
On July 20, 1989, Wesco's Wes-FIC subsidiary invested $40 million in newly issued shares of convertible preferred stock of The Gillette Company ("Gillette"). The stock provides an 8¾% annual dividend, must be redeemed by Gillette in 10 years, and is convertible into Gillette common stock at $50 per share. Warren Buffett, Chairman of Wesco's parent company, has joined Gillette's board of directors. Gillette has just introduced a new product, the Sensor razor, which will sell well because it provides significant improvements to the wet-shaving process.

(2) ***USAir Group, Inc.***
On August 7, 1989, Wes-FIC invested $12 million in the newly issued convertible preferred stock of USAir Group, Inc. ("USAir"). The stock provides an annual 9¼% dividend, must be redeemed by USAir in 10 years, and is convertible into USAir common stock at $60 per share.

(3) ***Champion International Corporation***
On December 6, 1989, Wesco and certain of its subsidiaries invested $23 million in a new issue of convertible preferred stock of Champion International Corporation ("Champion"). The stock provides an annual 9¼% dividend, must be redeemed by Champion in 10 years, and is convertible into Champion common stock at $38 per share.

While we admire the corporations and managements involved, we regard these investments in the aggregate as sound but not exciting. Few, if any, investors have ever prospered mightily from investing in convertible preferred stocks of leading corporations. Considering alternatives available when the investments were made, we were pleased to buy the stocks, but Wesco shareholders should expect no bonanza.

New America Electrical Corporation

At the close of 1988, Wesco acquired 80% of the stock of New America Electrical Corporation ("New America Electric") for a price of $8,200,000. Of this price $7,165,000 was cash paid to a liquidating trust for the former shareholders of New America Fund and $1,035,000 was a ten-year, 10% note payable to Glen Mitchel, CEO of New America Electric, who retains the 20% of New America Electric not acquired by Wesco. The pattern of this acquisition is a common one within the Berkshire Hathaway group, where we are willing to be an 80% owner in many a business we would not be in if we did not admire and trust people who retain the other 20% and are expected to continue to operate the business, with little help and no hindrance from us.

Glen Mitchel is a long-time friend and trusted and admired business associate of the undersigned, Wesco's CEO. Indeed, because Wesco's CEO and his family owned a higher percentage of New America Electric than Wesco, our whole transaction was approved by the Wesco board with the recommendation and participation of Warren Buffett, CEO and major shareholder of Berkshire Hathaway, Wesco's parent company. Mr. Buffett had no financial interest in New America Electric, and he, plus Messrs. Munger and Mitchel, all believed that $10,250,000 was a fair valuation for 100% of New America Electric at yearend 1988.

This acquisition became available to Wesco because Glen Mitchel preferred minority (20%) ownership of a Berkshire Hathaway group subsidiary instead of dominant 30% ownership in New America Electric, with all other New America Electric stock pretty well scattered through a new public offering, which was the alternative offered. We like causing such confidence and try always to deserve it.

New America Electric is a manufacturer of various electrical products including switchgear, circuit breakers, lighting ballasts and starters and electrical equipment for marinas and mobile home and recreational vehicle parks. Its facilities are in Orange County, California.

When Wesco purchased its 80% interest, New America Electric had a book net worth of about $6,400,000, including approximately $2,500,000 in cash and equivalents, and a long history of earning high returns on capital, but with current earnings reduced by an industry-wide price war.

Unfortunately, financial results in New America Electric's first year after acquisition are an embarrassment to us. In 1989, New America Electric earned only $168,000, after taxes (before adjustments under consolidated accounting convention incident to our purchase of stock), which is (1) only 2.6% on historical book value of shareholders' equity, and (2) only 1.6% on the price Wesco paid. After consolidated accounting adjustments, the total contribution of New America Electric to Wesco's 1989 earnings was even lower: only $59,000 (included in our earnings breakdown in the "all other normal net operating income" category).

The year-to-year earnings decline at New America Electric was a stunning 77%. Part of the earnings decline was caused by high expense incurred in consolidating previously scattered operations in a large, newly leased building. Other factors were (1) escalation of the price war accompanied by a 2.5% year-to-year decline in sales, (2) a ridiculous, unfair result in a lawsuit, and (3) at least one decision which, with hindsight, looks like an error.

New America Electric's 1989 troubles were limited to the income statement. Its balance sheet remained strong. For instance, at yearend 1989, despite major improvements of facilities and purchase of new equipment, the same amount of cash and equivalents was on hand as at the start of the year: $2.5 million.

We appraise the 1989 earnings decline as temporary. We think Glen Mitchel is tackling the problems with his usual skill and diligence. We are impressed with the new building and new equipment, which will both reduce costs and improve quality of products and service. And we

admire not only Glen Mitchel but also his chief officers: Thomas Johnson, Jeff Mowry and Thomas Vogele.

We will be very supportive as operations are fixed. Our sharing of disappointing times without irrational panic is an entitlement for people who choose to make these 80%-20% deals with us. But we will not obscure, in reports to our shareholders, poor financial results, temporary or not, from any recent business acquisition. And we will be particularly anxious to highlight bad results, no matter how "immaterial" (in accountingspeak), in a case where Wesco's Chairman had an interest in the business acquired. If Wesco's shareholders don't hear much about New America Electric in the future, it will be success, not failure, which causes de-emphasis.

Consolidated Balance Sheet and Related Discussion

Wesco's consolidated balance sheet (1) retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others and (2) reflects a continuing slow pace of acquisition of additional businesses because few are found available, despite constant search, at prices deemed rational from the standpoint of Wesco shareholders.

As indicated in the accompanying financial statements, the aggregate market value of Wesco's marketable equity securities was higher than their aggregate carrying value at December 31, 1989 by about $98 million, up significantly from about $54 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 $103 million. As earlier emphasized, about $101 million of this unrealized appreciation lies within the savings and loan subsidiary, and includes $89.4 million of appreciation in stock of Freddie Mac. In addition, there is about $29 million of unrealized appreciation in common stocks (mostly stock of The Coca Cola Company) held by Wesco's insurance subsidiary. Under a peculiar accounting convention applicable only to insurance companies this appreciation, after deducting income taxes which would be due if the stocks were sold, is already included in Wesco's audited net worth, even though the gain has never passed through any audited report of income.

Wesco's Pasadena real estate comprises 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, which it would probably be wiser to destroy than improve. This real estate has a market value substantially in excess of carrying value. The existence of unrealized appreciation is demonstrated by (1) mortgage debt ($4,643,000 at 9.25% fixed) against this real estate now exceeding its depreciated carrying value ($2,862,000) in Wesco's balance sheet at December 31, 1989, 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 97% 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. In fact, we are about to refurbish all the bathrooms, even though there is almost nothing wrong with them. (We have observed many recent instances of mismanagement at other buildings where managers prefer to paint the financial record, instead of the building. We try, with an occasional lapse, to stay a long way removed from such conduct, considering it contrary to both implicit obligation to tenants and long-run interest of the owner.) 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. Following this practice, and to reduce interest costs, Wesco during 1989 paid off at

par its $25 million of 10⅛% debentures due in June 1991, and issued $30 million of new 8⅞% debentures due in November 1999. The low interest rate on the new debentures was made possible by Wesco's AA+ credit rating.

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 requires patience, at least for people like us, as explained below.

It is assumed by many business school graduates, and by almost all consultants, that a corporation can easily improve its outcome by purchasing unrelated or tenuously related businesses. According to this widely shared view, if only the obvious steps had been taken, if the right "mission statement" had been adopted and the right "experts" hired, then each railroad, instead of remaining bound in chains by new forms of competition and obsolete and hostile laws and union rules, would have become another Federal Express, another United Parcel Service, or even another brilliant performer in the mode of Emerson Electric.

Our experience, both actual and vicarious, makes us less optimistic about easy solutions through business acquisition. We think undue optimism arises because successful records draw too much attention. Many people then reason as I would if I forecasted good prospects in big-time tennis after observation limited to Ivan Lendl and Steffi Graf, or good prospects in the California lottery after limiting observation to winners. The converse is also true, only more so. Far too little attention is given to the terrible effects on shareholders (or other owners) of the worst examples of corporate acquisitions such as CBS-DuMont, Xerox-Scientific Data Systems, General Electric-Utah International, Exxon-Reliance Electric, Sohio-Kennecott, First Interstate Bancorp-Allied Bancshares, Arizona Public Service-MeraBank, USX-Texas Oil & Gas, Prudential Insurance-Bache, Mobil Oil-Montgomery Ward, General Motors-Hughes Aircraft, and Avon Products-Practically Anybody. The list ends here for want of space, not a shortage of additional examples. The acquiring corporations listed are great enterprises, honorably run. In fact, their greatness augments their utility as examples as they show how hard it is, even for managers promoted to power through meritocratic procedures at admired corporations, to advance by acquisition the interests of owners.

The full implications of the worst examples are lost, in part, because the conventions of corporate reporting cause managers to present data in a manner which obscures both facts and implications. Horrible results are obscured, and mediocre results are made to look fine. Techniques for masking the truth include (1) mixing bad or mediocre results into other good results which would have been much better, absent the mixture, and (2) taking several poor results off the stage at once through the "big bath" technique. The "big bath" technique, in turn, is often accompanied by some extraordinary gain elsewhere which is cashed on a time schedule designed for obfuscation. Or a loss is mixed into a "restructuring," adopting word usage which would explain Napoleon's outcome at Waterloo as a thoughtful strengthening of France.

As we appraise it, the corporate mode of "solving your problems by acquisition" far more often ends in the mediocre "follow-the-fad-of-the-year" record of a Peter Grace than in the wonderful record of a Dover Corporation. Nor does the avoidance of dubious methodology guarantee success. It is hard to win at the game, even if one (1) does not rely on the valuation judgment of outside acquisition "experts" paid per transaction recommended and closed, and (2) does not create the in-house equivalent of the outside adviser who must buy to thrive, namely the internal department which has no function except acquisitions and often bears a label including "planning," or even "strategic planning."

Perhaps more instructive than the rarity of good corporate acquisition records is the striking rarity of important acquisitions within the few good records. Most winners act as a wise baseball hitter would if permitted to pass as many pitches as he wished before swinging.

For instance, among the best acquisition records is that of Tom Murphy and Dan Burke at Capital Cities/ABC. Yet the major acquisitions, which accounted for more than 80% of ending economic value for continuing shareholders, occurred less often than once each two years. This slow pace occurred even though they were in full control, were (and are) two of the quickest learners and actors around, did all the important work themselves, and were located in the midst of a profit- laden and long-lasting communications revolution (television broadcasting) wherein rapid change churned out opportunities for the acute at an above-normal rate. (The writer has to believe that the opportunities seized by Murphy and Burke were recognizable only by the acute. This follows from the writer's participation in rejecting a television-station opportunity, long ago given by Murphy and Burke when they were barred by law from purchase. The price was less than one-tenth of present-day value.)

A particularly depressing lesson, for the action-prone, might also be extracted from the business acquisition record of Wesco's ultimate parent, Berkshire Hathaway. Over 24 years, Berkshire transformed a small, doomed New England textile enterprise into a large and diversified company, without ending up with many more shares outstanding. Yet if you removed from Berkshire's record the six most significant acquisitions, extracting occurrences averaging one every four years, the record would not now be mentioned here, or anywhere else.

It has always been easy (indeed, one attracts scores of helpers) to make disadvantageous business purchases in a hurry with corporate cash. And it has been even easier to cause disadvantage if one is unwise enough, like General Electric in the Utah International merger, or Xerox in the merger with Scientific Data Systems, not to be super-sensitive to the probability that any attainable stock-for-stock merger will transfer more intrinsic business value than is acquired. On the other hand, advantageous business purchases, not involving competitors or branded products which can be sold through the acquirer's present sales system, are difficult to find.

It is not just the Peter Principle which makes corporate acquisition records so bad, on average, although that Principle does especially intense damage in the acquisition field. (This occurs because, when you promote the General Sales Manager to CEO making unrelated business acquisitions, you naturally cause more trouble than you earlier did when you made a less substantive change by promoting the Sales Manager of some territory to General Sales Manager.) Even a CEO with good acquisition judgment is lucky if, in his remaining career, he finds one large opportunity which tempts rational response.

The scarcity of good acquisition transactions, of course, does not imply that no wonderful businesses are ever for sale. It is just that, in a finite, competitive world, no business is so wonderful that it can't be ruined as an acquisition candidate by increasing the price. When this happens, many corporations buy anyway, for reasons Columbia's great philosopher, Charles Frankel, so well understood. The system is so constructed (irresponsibly, Frankel would say) that the corporate manager gains even though the shareholder loses. (Incidentally, Frankel was mugged to death in a final inadvertent contribution to the study of irresponsible systems, reminding many conservative social critics of Socrates.)

At this point, a last question remains: If successful corporate business acquisition is so hard, how does one explain the widespread recent success of most of the leveraged-buy-out ("LBO") operators who have purchased corporations? A huge part of the answer comes from income-tax effects and other simple effects. When, in a typical LBO, the typical mostly equity corporate capitalization was replaced by 90% debt plus a new 10%-of-capitalization common stock position:

(1) the combined market value of all the new common stock plus all the new debt became much higher than the previous market value of all the old common stock, because the existing stream of pre-tax earnings was no longer shared with corporate income tax

collectors who, in many cases, had previously received more cash each year than shareholders; and

(2) even after the value-enhancing effect of the corporate tax reduction was shared with former shareholders by paying them extra-high prices to leave, a retained residue of value-enhancing tax effect made the new common stock (which now became much like a speculative warrant with good terms) worth considerably more than cost as the ink dried on acquisition papers; and

(3) the new "owners" then resorted to strategies, difficult neither to conceive nor implement, including the following:

  (a) they eliminated many of the easily removable costs (largely personnel costs) and sub-par segments which in some mix (i) bedevil successful corporations (including ours) with sloth and folly and (ii) create their humane grace and, through present sacrifice, good long-term prospects, justifying sacrifice endured; and

  (b) they sold off a few operations at super-high prices, sometimes exercising the easiest microeconomic insight by selling to a direct competitor and sometimes selling to a surprisingly easy-to-find non-competitive corporate buyer, not owned by its managers, willing to pay almost as high a price as a competitor would; and

(4) the new "owners" then profited, in due course, not only from the tax effect and other simple reshuffling activities described above, but also from the wonderful upside effects of extreme financial leverage during a long business boom accompanied by a rising stock market.

Whether the country wants a large number (or even any) of its large corporations to have extremely leveraged capitalizations, except through occasional adversity, presents interesting social questions. Is one social function of corporations to be financially strong so that they act as shock absorbers, protecting dependent employees, suppliers and customers from part of the volatility implicit in capitalism? Was Ben Franklin right when he included the following folk wisdom in *Poor Richard's Almanac:* "It is hard for an empty sack to stand upright." Is a weak corporation, borrowed to the hilt, the social equivalent of a bridge with an inadequate reserve of structural strength? Granting that leveraged buy outs have some favorable effects (as well as unfavorable effects) on long term efficiency, how many thousands of able people do we wish to attract into promotional corporate recapitalization activity which (1) reduces corporate income taxes, (2) often tests the limits of antitrust law, and (3) focuses business attention on short-term cash generation to pay down oppressive levels of debt? Finally, as Columbia Law School's Professor Lou Lowenstein puts it (more or less): "Do we really want entire corporate businesses, as important social institutions, continuously traded like pork belly contracts?"

However the social questions are answered, three aspects of the present situation are clear. First, the corporate tax effect is so large in LBO transactions that easy success in such transactions does not imply that success is easy in ordinary corporate acquisitions. Second, the hordes of leveraged-buy-out operators now with us raise the general level of acquisition prices to the detriment of other would-be acquirers, including Wesco, which are not willing to maximize tax benefits through maximized borrowing. And, third, the LBO operators will not go away so long as present permissive laws last. The operators have a real advantage under such laws, not just a fig leaf aiding promotion. Even though failure and disgrace will reduce their number, and prices paid in leveraged-buy-out transactions will fall, the capitalized value of reducing the corporate income tax will remain. Therefore, plenty of rational incentive will remain for transactions. The LBO genie will encounter reverses, but he is not going back in the bottle unless ordered to do so by new laws.

It should also be noted that the LBO operators' incentives to bid high do not end with real advantages derived from tax law and willingness to reshuffle businesses with much speed and few scruples. Additional incentives for high bids come from typical structures in which general partners of LBO partnerships risk little of their own money (often less than none after fees are taken into account), yet share significantly in gains. Such arrangements are similar to the system of the race track tout. And who has ever seen a tout who didn't want his backer to make a lot of bets?

To Wesco, as a non-LBO operator, the good-corporate-acquisition game was always tough. And that game in each recent year has become more like fishing for muskies at Leech Lake, in Minnesota, where the writer's earliest business partner, Ed Hoskins, had the following conversation with his Indian guide:

"Are any muskies caught in this lake?"

"More muskies are caught in this lake than in any other lake in Minnesota. This lake is famous for muskies."

"How long have you been fishing here?"

"19 years."

"And how many muskies have you caught?"

"None."

When a management has our point of view, infrequency of business acquisition may safely be predicted. Whether this happens, as we like to believe, because the game is hard for almost everyone, or merely because the game is hard for us, the result for Wesco shareholders is the same: less worthwhile activity than we all would like. But there may be one consolation: A series of big, incorrectable acquisition troubles, with no meaningful salvage, is seldom caused by people who think the acquisition game is like fishing for muskies at Leech Lake. One terrible acquisition result is, of course, quite possible. For instance, Wesco would cheerfully invest $75 million tomorrow, with a 60% chance of total loss, provided the pay-off for winning was large enough to cause statistical expectation to provide a handsome return.

As indicated in Schedule I accompanying Wesco's financial statements, investments, both those in the savings and loan and insurance 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 11% in 1987-89, was dependent to a significant extent on securities gains, irregular by nature.

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. It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent. There must be some wisdom in the folk saying: "It's the strong swimmers who drown". Our 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.

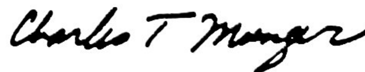
Moreover, our approach continues to be applied to no great base position. Wesco has only a tiny fraction of its total intrinsic value in businesses with enough commercial advantage in place to assure permanent high future returns on capital employed. In contrast, Berkshire Hathaway, Wesco's parent corporation,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

The foregoing description of attitude, as well as the following historical explanation of the current situation, is repeated in the annual report each year, accompanied by a standard disclaimer designed to deter inappropriate optimism. 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 (including the signer of this letter) 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 a large gain in 1985 from an investment in General Foods.

A corporation like Wesco, with no significant proportion of intrinsic value in great businesses, continues to be like a tortoise in a race of hares. And, as we have demonstrated in one more year, this particular tortoise is not very sprightly. Moreover, what sprightliness remains is often deterred by remembrance of past new-activity outcomes which were at least as bad as those of the writer's dog when it limped home from its first foray outside the yard both (1) injured by a car and (2) bloated from overeating garbage. (Some long-time Wesco shareholders may painfully remember one such once-new activity: hillside subdivision in the place with the ironic name, "Friendly Valley.")

On January 25, 1990, Wesco increased its regular quarterly dividend from 19½ cents per share to 20½ cents per share, payable March 13, 1990, to shareholders of record as of the close of business on February 28, 1990.

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

March 5, 1990

Reproduced on this page is a copy of the May 30, 1989 letter of resignation of Mutual Savings and Loan Association from United States League of Savings Institutions.

315 EAST COLORADO BLVD. • PASADENA, CALIFORNIA 91101-1954

May 30, 1989

United States League of Savings Institutions,
1709 New York Avenue N. W.,
Washington, D. C. 20006

Gentlemen:

This letter is the formal resignation of Mutual Savings and Loan Association from the United States League of Savings Institutions.

Mutual Savings is a subsidiary of Wesco Financial Corporation, listed ASE, and Berkshire Hathaway Inc., listed NYSE, which are no longer willing to be associated with the League.

Mutual Savings does not lightly resign after belonging to the League for many years. But we believe that the League's current lobbying operations are so flawed, indeed disgraceful, that we are not willing to maintain membership.

Our savings and loan industry has now created the largest mess in the history of U. S. financial institutions. While the mess has many causes, which we tried to summarize fairly in our last annual report to stockholders, it was made much worse by (1) constant and successful inhibition over many years, through League lobbying, of proper regulatory response to operations of a minority of insured institutions dominated by crooks and fools, (2) mickey-mouse accounting which made many insured institutions look sounder than they really were, and (3) inadequate levels of real equity capital underlying insured institutions' promises to holders of savings accounts.

It is not unfair to liken the situation now facing Congress to cancer and to liken the League to a significant carcinogenic agent, And, like cancer, our present troubles will recur if Congress lacks the wisdom and courage to excise elements which helped cause the troubles.

Moreover, despite the obvious need for real legislative reform, involving painful readjustment, the League's recent lobbying efforts regularly resist minimal reform. For instance, the League supports (1) extension of accounting conventions allowing "goodwill" (in the financial institutions' context translate "air") to count as capital in relations with regulators and (2) minimization of the amount of real equity capital required as a condition of maintenance of full scale operations relying on federal deposit insurance.

In the face of a national disaster which League lobbying plainly helped cause, the League obdurately persists in prescribing continuation of loose accounting principles, inadequate capital and, in effect, inadequate management at many insured institutions. The League responds to the savings and loan mess as Exxon would have responded to the oil spill from the Valdez if it had insisted thereafter on liberal use of whiskey by tanker captains.

It would be much better if the League followed the wise example, in another era, of the manufacturer which made a public apology to Congress. Because the League has clearly misled its government for a long time, to the taxpayers' great detriment, a public apology is in order, not redoubled efforts to mislead further.

We know that there is a school of thought that trade associations are to be held to no high standard, that they are supposed to act as the League is acting. In this view, each industry creates a trade association not to proffer truth or reason or normal human courtesy following egregious fault, but merely to furnish self-serving nonsense and political contributions to counterbalance, in the legislative milieu, the self-serving nonsense and political contributions of other industries' trade associations. But the evidence is now before us that this type of trade association conduct, when backed as in the League's case by vocal and affluent constituents in every congressional district, has an immense capacity to do harm to the country. Therefore, the League's public duty is to behave in an entirely different way, much as major-league baseball reformed after the "Black Sox" scandal. Moreover, just as client savings institutions are now worse off because of the increased mess caused by League short-sightedness in the past, client institutions will later prove ill-served by present short-sightedness of the League.

Believing this, Mr. Warren E. Buffett and I are not only causing Mutual Savings to resign from the U.S. League of Savings Institutions; we are also, as one small measure of protest, releasing to the media, for such attention as may ensue, copies of this letter of resignation.

Truly yours,

MUTUAL SAVINGS AND LOAN ASSOCIATION

Charles T. Munger

Charles T. Munger
Chairman of the Board

BERKSHIRE HATHAWAY INC.

Selected Financial Data for the Past Five Years
(dollars in thousands, except per share data)

	1985	1986	1987	1988	1989
Revenues:					
Sales and service revenues	$ 504,872	$ 1,219,252	$ 1,326,829	$ 1,407,642	$ 1,526,459
Insurance premiums earned	317,059	823,884	824,895	584,235	394,279
Interest and dividend income	144,722	181,992	237,319	314,251	331,452
Realized investment gain	495,055	220,764	28,838	131,671	223,810
Sundry	1,930	6,316	13,901	27,094	7,892
Total revenues	$1,463,638	$2,452,208	$2,431,782	$2,464,893	$2,483,892
Earnings:					
Before realized investment gain	$ 92,948	$ 131,464	$ 214,746	$ 313,441	$ 299,902
Realized investment gain	342,867	150,897	19,806	85,829	147,575
Net earnings	$ 435,815	$ 282,361	$ 234,552	$ 399,270	$ 447,477
Earnings per share:					
Before realized investment gain	$ 81.04	$ 114.62	$ 187.24	$ 273.37	$ 262.46
Realized investment gain	298.95	131.57	17.27	74.86	127.55
Net earnings	$ 379.99	$ 246.19	$ 204.51	$ 348.23	$ 390.01
Year-end data:					
Total assets	$ 3,480,789	$ 4,931,354	$ 5,863,235	$ 6,816,848	$ 9,459,594
Term debt and other borrowings	117,879	260,170	289,886	480,009	1,007,516
Shareholders' equity	1,885,330	2,377,797	2,841,659	3,410,108	4,925,126
Common shares outstanding, in thousands	1,147	1,147	1,147	1,146	1,146
Shareholders' equity per outstanding share	$ 1,644	$ 2,073	$ 2,477	$ 2,975	$ 4,296

COMMON STOCK

Stock Transfer Agent

The Bank of Boston Shareholder Services Division, P.O. Box 644, Boston, MA 02102 serves as Transfer Agent and Registrar for the Company's common stock. Correspondence with the Division may be directed to Customer Service Section, Mail Stop 45-02-09. Certificates for re-issue or transfer should be directed to the Transfer Processing Section, Mail Stop 45-01-05. Certificates should not be mailed to the Company.

Shareholders

The Company had approximately 6,300 record holders of its common stock at March 1, 1990. Record owners included nominees holding at least 145,000 shares on behalf of beneficial-but-not-of-record owners. Management believes that the Company has more than 13,000 beneficial owners.

Price Range of Common Stock

The Company's Common Stock is listed for trading on the New York Stock Exchange, trading symbol: BRK. The following table sets forth the high and low sales prices per share, as reported on the New York Stock Exchange Composite List since November 29, 1988, and as reported by the National Association of Securities Dealers Automated Quotation System/National Market System prior to that date, during the periods indicated:

1989	High	Low
First Quarter	$5,025	$4,625
Second Quarter	7,000	4,950
Third Quarter	8,750	6,600
Fourth Quarter	8,900	7,950

1988	High	Low
First Quarter	$3,500	$3,000
Second Quarter	4,150	3,400
Third Quarter	5,000	4,040
Fourth Quarter	5,050	4,600

Dividends

Berkshire has not declared a cash dividend since 1967.

BERKSHIRE HATHAWAY INC.

DIRECTORS

WARREN E. BUFFETT, *Chairman*
Chief Executive Officer of Berkshire

CHARLES T. MUNGER, *Vice Chairman*
Chairman of the Board of Directors of Daily Journal Corporation, publisher of specialty newspapers in California

KENNETH V. CHACE
Retired, Former Chief Operating Officer of Textile Operations of Berkshire

MALCOLM G. CHACE, JR.
Retired, Former Chairman of Berkshire's Board

J. VERNE McKENZIE
Chief Financial Officer of Berkshire

WALTER SCOTT, JR.
Chairman and Chief Executive Officer of Peter Kiewit Sons', Inc., engaged worldwide in construction, mining, packaging and timberlands.

OFFICERS

WARREN E. BUFFETT, *Chairman and CEO*
CHARLES T. MUNGER, *Vice Chairman*
ROBERT H. BIRD, *Vice President*
MICHAEL A. GOLDBERG, *Vice President*
STANFORD LIPSEY, *Vice President*
J. VERNE McKENZIE, *Vice President, Secretary*
J. WILLIAM SCOTT, *Vice President*
MARC D. HAMBURG, *Treasurer*
DANIEL J. JAKSICH, *Controller*

Two compilations of letters from earlier Annual Reports are available upon request. One is from reports for 1977 through 1983, the other, from reports for 1984 through 1988. Single copies are furnished without charge in response to requests received by the Company at 3555 Farnam St., Suite 1440, Omaha, NE 68131.

Berkshire Hathaway Inc.
Executive Offices — 1440 Kiewit Plaza, Omaha, Nebraska 68131