Berkshire Hathaway Inc.

1996
ANNUAL REPORT

Business Activities

Berkshire Hathaway Inc. is a holding company owning subsidiaries engaged in a number of diverse business activities. The most important of these is the property and casualty insurance business conducted on both a direct and reinsurance basis through a number of subsidiaries collectively referred to in this report as the Berkshire Hathaway Insurance Group. Included in this group of subsidiaries is GEICO Corporation, the seventh largest auto insurer in the United States.

Investment portfolios of insurance subsidiaries include meaningful equity ownership percentages of other publicly traded companies. Such investments at the end of 1996 include approximately 10½% of the outstanding capital stock of American Express Company, approximately 8% of the capital stock of The Coca-Cola Company, approximately 3½% of the capital stock of The Walt Disney Company, approximately 9% of the capital stock of Federal Home Loan Mortgage Corporation ("Freddie Mac"), approximately 8½% of the capital stock of The Gillette Company, approximately 16% of the capital stock of The Washington Post Company, approximately 8% of the common stock of Wells Fargo & Company, and common and convertible preferred stock of Salomon Inc having approximately 18% of the total voting power of that company. Much information about these publicly-owned companies is available, including information released from time to time by the companies themselves.

Additionally, Berkshire Hathaway Inc. publishes the *Buffalo News*, a daily and Sunday newspaper in Western New York. Other business activities conducted by non-insurance subsidiaries include publication and distribution of encyclopedias and related educational and instructional material (*World Book* and *Childcraft* products), manufacture and marketing of home cleaning systems and related accessories (sold principally under the *Kirby* name), manufacture and sale of boxed chocolates and other confectionery products (*See's Candies*), retailing of home furnishings (*Nebraska Furniture Mart* and *R.C. Willey Home Furnishings*), manufacture and distribution of uniforms (*Fechheimer Brothers Company*), manufacture, import and distribution of footwear (*H.H. Brown Shoe Company*, *Lowell Shoe, Inc.* and *Dexter Shoe Company*), retailing of fine jewelry (*Borsheim's* and *Helzberg's Diamond Shops*) and manufacture and distribution of air compressors, air tools and painting systems (*Campbell Hausfeld* products). On December 23, 1996, Berkshire Hathaway completed its previously announced acquisition of FlightSafety International, Inc. (*FlightSafety*). *FlightSafety* provides high-technology training to operators of aircraft and ships throughout the world. Berkshire also owns a number of other businesses engaged in a variety of activities, as identified in this report.

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

BERKSHIRE HATHAWAY INC.

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Berkshire's Corporate Performance vs. the S&P 500

Year	Annual Percentage Change in Per-Share Book Value of Berkshire (1)	Annual Percentage Change in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 1996 was $6.2 billion, or 36.1%. Per-share book value, however, grew by less, 31.8%, because the number of Berkshire shares increased: We issued stock in acquiring FlightSafety International and also sold new Class B shares.* Over the last 32 years (that is, since present management took over) per-share book value has grown from $19 to $19,011, or at a rate of 23.8% compounded annually.

For technical reasons, we have restated our 1995 financial statements, a matter that requires me to present one of my less-than-thrilling explanations of accounting arcana. I'll make it brief.

The restatement was required because GEICO became a wholly-owned subsidiary of Berkshire on January 2, 1996, whereas it was previously classified as an investment. From an economic viewpoint — taking into account major tax efficiencies and other benefits we gained — the value of the 51% of GEICO we owned at year-end 1995 *increased* significantly when we acquired the remaining 49% of the company two days later. Accounting rules applicable to this type of "step acquisition," however, required us to *write down* the value of our 51% at the time we moved to 100%. That writedown — which also, of course, reduced book value — amounted to $478.4 million. As a result, we now carry our original 51% of GEICO at a value that is both lower than its market value at the time we purchased the remaining 49% of the company and lower than the value at which we carry that 49% itself.

There is an offset, however, to the reduction in book value I have just described: Twice during 1996 we issued Berkshire shares at a premium to book value, first in May when we sold the B shares for cash and again in December when we used both A and B shares as part-payment for FlightSafety. In total, the three non-operational items affecting book value contributed less than one percentage point to our 31.8% per-share gain last year.

I dwell on this rise in per-share book value because it roughly indicates our economic progress during the year. But, as Charlie Munger, Berkshire's Vice Chairman, and I have repeatedly told you, what counts at Berkshire is intrinsic value, not book value. The last time you got that message from us was in the Owner's Manual, sent to you in June after we issued the Class B shares. In that manual, we not only defined certain key terms — such as intrinsic value — but also set forth our economic principles.

For many years, we have listed these principles in the front of our annual report, but in this report, on pages 58 to 67, we reproduce the entire Owner's Manual. In this letter, we will occasionally refer to the manual so that we can avoid repeating certain definitions and explanations. For example, if you wish to brush up on "intrinsic value," see pages 64 and 65.

Last year, for the first time, we supplied you with a table that Charlie and I believe will help anyone trying to estimate Berkshire's intrinsic value. In the updated version of that table, which follows, we trace two key indices of value. The first column lists our per-share ownership of investments (including cash and equivalents) and the second column shows our per-share earnings from Berkshire's operating businesses before taxes and purchase-accounting adjustments but after all interest and corporate overhead expenses.

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*Each Class B share has an economic interest equal to 1/30th of that possessed by a Class A share, which is the new designation for the only stock that Berkshire had outstanding before May 1996. Throughout this report, we state all per-share figures in terms of "Class A equivalents," which are the sum of the Class A shares outstanding and 1/30th of the Class B shares outstanding.

The operating-earnings column excludes all dividends, interest and capital gains that we realized from the investments presented in the first column. In effect, the two columns show what Berkshire would have reported had it been broken into two parts.

Year	Investments Per Share	Pre-tax Earnings Per Share Excluding All Income from Investments
1965	$ 4	$ 4.08
1975	159	(6.48)
1985	2,443	18.86
1995	22,088	258.20
1996	28,500	421.39
Annual Growth Rate, 1965-95	33.4%	14.7%
One-Year Growth Rate, 1995-96	29.0%	63.2%

As the table tells you, our investments per share increased in 1996 by 29.0% and our non-investment earnings grew by 63.2%. Our goal is to keep the numbers in both columns moving ahead at a reasonable (or, better yet, unreasonable) pace.

Our expectations, however, are tempered by two realities. First, our past rates of growth cannot be matched nor even approached: Berkshire's equity capital is now large — in fact, fewer than ten businesses in America have capital larger — and an abundance of funds tends to dampen returns. Second, whatever our rate of progress, it will not be smooth: Year-to-year moves in the first column of the table above will be influenced in a major way by fluctuations in securities markets; the figures in the second column will be affected by wide swings in the profitability of our catastrophe-reinsurance business.

In the table, the donations made pursuant to our shareholder-designated contributions program are charged against the second column, though we view them as a shareholder benefit rather than as an expense. All other corporate expenses are also charged against the second column. These costs may be lower than those of any other large American corporation: Our after-tax headquarters expense amounts to less than two basis points (1/50th of 1%) measured against net worth. Even so, Charlie used to think this expense percentage outrageously high, blaming it on my use of Berkshire's corporate jet, *The Indefensible.* But Charlie has recently experienced a "counter-revelation": With our purchase of FlightSafety, whose major activity is the training of corporate pilots, he now rhapsodizes at the mere mention of jets.

Seriously, costs matter. For example, equity mutual funds incur corporate expenses — largely payments to the funds' managers — that average about 100 basis points, a levy likely to cut the returns their investors earn by 10% or more over time. Charlie and I make no promises about Berkshire's results. We do promise you, however, that virtually all of the gains Berkshire makes will end up with shareholders. We are here to make money with you, not off you.

The Relationship of Intrinsic Value to Market Price

In last year's letter, with Berkshire shares selling at $36,000, I told you: (1) Berkshire's gain in market value in recent years had outstripped its gain in intrinsic value, even though the latter gain had been highly satisfactory; (2) that kind of overperformance could not continue indefinitely; (3) Charlie and I did not at that moment consider Berkshire to be undervalued.

Since I set down those cautions, Berkshire's intrinsic value has increased very significantly — aided in a major way by a stunning performance at GEICO that I will tell you more about later — while the market price of our shares has changed little. This, of course, means that in 1996 Berkshire's stock underperformed the business. Consequently, today's price/value relationship is both much different from what it was a year ago and, as Charlie and I see it, more appropriate.

Over time, the aggregate gains made by Berkshire shareholders must of necessity match the business gains of the company. When the stock temporarily overperforms or underperforms the business, a limited number of shareholders — either sellers or buyers — receive outsized benefits at the expense of those they trade with. Generally, the sophisticated have an edge over the innocents in this game.

Though our primary goal is to maximize the amount that our shareholders, in total, reap from their ownership of Berkshire, we wish also to minimize the benefits going to some shareholders at the expense of others. These are goals we would have were we managing a family partnership, and we believe they make equal sense for the manager of a public company. In a partnership, fairness requires that partnership interests be valued equitably when partners enter or exit; in a public company, fairness prevails when market price and intrinsic value are in sync. Obviously, they won't always meet that ideal, but a manager — by his policies and communications — can do much to foster equity.

Of course, the longer a shareholder holds his shares, the more bearing Berkshire's business results will have on his financial experience — and the less it will matter what premium or discount to intrinsic value prevails when he buys and sells his stock. That's one reason we hope to attract owners with long-term horizons. Overall, I think we have succeeded in that pursuit. Berkshire probably ranks number one among large American corporations in the percentage of its shares held by owners with a long-term view.

Acquisitions of 1996

We made two acquisitions in 1996, both possessing exactly the qualities we seek — excellent business economics and an outstanding manager.

The first acquisition was Kansas Bankers Surety (KBS), an insurance company whose name describes its specialty. The company, which does business in 22 states, has an extraordinary underwriting record, achieved through the efforts of Don Towle, an extraordinary manager. Don has developed first-hand relationships with hundreds of bankers and knows every detail of his operation. He thinks of himself as running a company that is "his," an attitude we treasure at Berkshire. Because of its relatively small size, we placed KBS with Wesco, our 80%-owned subsidiary, which has wanted to expand its insurance operations.

You might be interested in the carefully-crafted and sophisticated acquisition strategy that allowed Berkshire to nab this deal. Early in 1996 I was invited to the 40th birthday party of my nephew's wife, Jane Rogers. My taste for social events being low, I immediately, and in my standard, gracious way, began to invent reasons for skipping the event. The party planners then countered brilliantly by offering me a seat next to a man I always enjoy, Jane's dad, Roy Dinsdale — so I went.

The party took place on January 26. Though the music was loud — Why must bands play as if they will be paid by the decibel? — I just managed to hear Roy say he'd come from a directors meeting at Kansas Bankers Surety, a company I'd always admired. I shouted back that he should let me know if it ever became available for purchase.

On February 12, I got the following letter from Roy: "Dear Warren: Enclosed is the annual financial information on Kansas Bankers Surety. This is the company that we talked about at Janie's party. If I can be of any further help, please let me know." On February 13, I told Roy we would pay $75 million for the company — and before long we had a deal. I'm now scheming to get invited to Jane's next party.

Our other acquisition in 1996 — FlightSafety International, the world's leader in the training of pilots — was far larger, at about $1.5 billion, but had an equally serendipitous origin. The heroes of this story are first, Richard Sercer, a Tucson aviation consultant, and second, his wife, Alma Murphy, an ophthalmology graduate of Harvard Medical School, who in 1990 wore down her husband's reluctance and got him to buy Berkshire stock. Since then, the two have attended all our Annual Meetings, but I didn't get to know them personally.

Fortunately, Richard had also been a long-time shareholder of FlightSafety, and it occurred to him last year that the two companies would make a good fit. He knew our acquisition criteria, and he thought that

Al Ueltschi, FlightSafety's 79-year-old CEO, might want to make a deal that would both give him a home for his company and a security in payment that he would feel comfortable owning throughout his lifetime. So in July, Richard wrote Bob Denham, CEO of Salomon Inc, suggesting that he explore the possibility of a merger.

Bob took it from there, and on September 18, Al and I met in New York. I had long been familiar with FlightSafety's business, and in about 60 seconds I knew that Al was exactly our kind of manager. A month later, we had a contract. Because Charlie and I wished to minimize the issuance of Berkshire shares, the transaction we structured gave FlightSafety shareholders a choice of cash or stock but carried terms that encouraged those who were tax-indifferent to take cash. This nudge led to about 51% of FlightSafety's shares being exchanged for cash, 41% for Berkshire A and 8% for Berkshire B.

Al has had a lifelong love affair with aviation and actually piloted Charles Lindbergh. After a barnstorming career in the 1930s, he began working for Juan Trippe, Pan Am's legendary chief. In 1951, while still at Pan Am, Al founded FlightSafety, subsequently building it into a simulator manufacturer and a worldwide trainer of pilots (single-engine, helicopter, jet and marine). The company operates in 41 locations, outfitted with 175 simulators of planes ranging from the very small, such as Cessna 210s, to Boeing 747s. Simulators are not cheap — they can cost as much as $19 million — so this business, unlike many of our operations, is capital intensive. About half of the company's revenues are derived from the training of corporate pilots, with most of the balance coming from airlines and the military.

Al may be 79, but he looks and acts about 55. He will run operations just as he has in the past: We never fool with success. I have told him that though we don't believe in splitting Berkshire stock, we will split his age 2-for-1 when he hits 100.

An observer might conclude from our hiring practices that Charlie and I were traumatized early in life by an EEOC bulletin on age discrimination. The real explanation, however, is self-interest: It's difficult to teach a new dog old tricks. The many Berkshire managers who are past 70 hit home runs today at the same pace that long ago gave them reputations as young slugging sensations. Therefore, to get a job with us, just employ the tactic of the 76-year-old who persuaded a dazzling beauty of 25 to marry him. "How did you ever get her to accept?" asked his envious contemporaries. The comeback: "I told her I was 86."

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And now we pause for our usual commercial: If you own a large business with good economic characteristics and wish to become associated with an exceptional collection of businesses having similar characteristics, Berkshire may well be the home you seek. Our requirements are set forth on page 21. If your company meets them — and if I fail to make the next birthday party you attend — give me a call.

Insurance Operations — Overview

Our insurance business was terrific in 1996. In both primary insurance, where GEICO is our main unit, and in our "super-cat" reinsurance business, results were outstanding.

As we've explained in past reports, what counts in our insurance business is, first, the amount of "float" we generate and, second, its cost to us. These are matters that are important for you to understand because float is a major component of Berkshire's intrinsic value that is not reflected in book value.

To begin with, float is money we hold but don't own. In an insurance operation, float arises because premiums are received before losses are paid. Secondly, the premiums that an insurer takes in typically do not cover the losses and expenses it eventually must pay. That leaves it running an "underwriting loss," which is the cost of float. An insurance business has value if its cost of float over time is less than the cost the company would otherwise incur to obtain funds. But the business is an albatross if the cost of its float is higher than market rates for money.

As the numbers in the following table show, Berkshire's insurance business has been a huge winner. For the table, we have calculated our float — which we generate in large amounts relative to our premium volume — by adding loss reserves, loss adjustment reserves, funds held under reinsurance assumed and unearned premium reserves, and then subtracting agents' balances, prepaid acquisition costs, prepaid taxes and deferred charges applicable to assumed reinsurance. Our cost of float is determined by our underwriting loss or profit. In those years when we have had an underwriting profit, such as the last four, our cost of float has been negative. In effect, we have been paid for holding money.

	(1) Underwriting Loss	(2) Average Float	Approximate Cost of Funds	Yearend Yield on Long-Term Govt. Bonds
	(In $ Millions)		(Ratio of 1 to 2)	
1967	profit	17.3	less than zero	5.50%
1968	profit	19.9	less than zero	5.90%
1969	profit	23.4	less than zero	6.79%
1970	0.37	32.4	1.14%	6.25%
1971	profit	52.5	less than zero	5.81%
1972	profit	69.5	less than zero	5.82%
1973	profit	73.3	less than zero	7.27%
1974	7.36	79.1	9.30%	8.13%
1975	11.35	87.6	12.96%	8.03%
1976	profit	102.6	less than zero	7.30%
1977	profit	139.0	less than zero	7.97%
1978	profit	190.4	less than zero	8.93%
1979	profit	227.3	less than zero	10.08%
1980	profit	237.0	less than zero	11.94%
1981	profit	228.4	less than zero	13.61%
1982	21.56	220.6	9.77%	10.64%
1983	33.87	231.3	14.64%	11.84%
1984	48.06	253.2	18.98%	11.58%
1985	44.23	390.2	11.34%	9.34%
1986	55.84	797.5	7.00%	7.60%
1987	55.43	1,266.7	4.38%	8.95%
1988	11.08	1,497.7	0.74%	9.00%
1989	24.40	1,541.3	1.58%	7.97%
1990	26.65	1,637.3	1.63%	8.24%
1991	119.59	1,895.0	6.31%	7.40%
1992	108.96	2,290.4	4.76%	7.39%
1993	profit	2,624.7	less than zero	6.35%
1994	profit	3,056.6	less than zero	7.88%
1995	profit	3,607.2	less than zero	5.95%
1996	profit	6,702.0	less than zero	6.64%

Since 1967, when we entered the insurance business, our float has grown at an annual compounded rate of 22.3%. In more years than not, our cost of funds has been less than nothing. This access to "free" money has boosted Berkshire's performance in a major way. Moreover, our acquisition of GEICO materially increases the probability that we can continue to obtain "free" funds in increasing amounts.

Super-Cat Insurance

As in the past three years, we once again stress that the good results we are reporting for Berkshire stem in part from our super-cat business having a lucky year. In this operation, we sell policies that insurance and reinsurance companies buy to protect themselves from the effects of mega-catastrophes. Since truly major catastrophes are rare occurrences, our super-cat business can be expected to show large profits in most years — and to record a huge loss occasionally. In other words, the attractiveness of our super-cat business will take a great many years to measure. *What you must understand, however, is that a truly terrible year in the super-cat business is not a possibility — it's a certainty. The only question is when it will come.*

I emphasize this lugubrious point because I would not want you to panic and sell your Berkshire stock upon hearing that some large catastrophe had cost us a significant amount. If you would tend to react that way, you should not own Berkshire shares now, just as you should entirely avoid owning stocks if a crashing market would lead you to panic and sell. Selling fine businesses on "scary" news is usually a bad decision. (Robert Woodruff, the business genius who built Coca-Cola over many decades and who owned a huge position in the company, was once asked when it might be a good time to sell Coke stock. Woodruff had a simple answer: "I don't know. I've never sold any.")

In our super-cat operation, our customers are insurers that are exposed to major earnings volatility and that wish to reduce it. The product we sell — for what we hope is an appropriate price — is our willingness to shift that volatility to our own books. Gyrations in Berkshire's earnings don't bother us in the least: Charlie and I would much rather earn a lumpy 15% over time than a smooth 12%. (After all, our earnings swing wildly on a daily and weekly basis — why should we demand that smoothness accompany each orbit that the earth makes of the sun?) We are most comfortable with that thinking, however, when we have shareholder/partners who can also accept volatility, and that's why we regularly repeat our cautions.

We took on some major super-cat exposures during 1996. At mid-year we wrote a contract with Allstate that covers Florida hurricanes, and though there are no definitive records that would allow us to prove this point, we believe that to have *then* been the largest single catastrophe risk ever assumed by one company for its own account. Later in the year, however, we wrote a policy for the California Earthquake Authority that goes into effect on April 1, 1997, and that exposes us to a loss more than twice that possible under the Florida contract. Again we retained all the risk for our own account. Large as these coverages are, Berkshire's after-tax "worst-case" loss from a true mega-catastrophe is probably no more than $600 million, which is less than 3% of our book value and 1½% of our market value. To gain some perspective on this exposure, look at the table on page 2 and note the much greater volatility that security markets have delivered us.

In the super-cat business, we have three major competitive advantages. First, the parties buying reinsurance from us know that we both can and will pay under the most adverse of circumstances. Were a truly cataclysmic disaster to occur, it is not impossible that a financial panic would quickly follow. If that happened, there could well be respected reinsurers that would have difficulty paying at just the moment that their clients faced extraordinary needs. Indeed, one reason we never "lay off" part of the risks we insure is that we have reservations about our ability to collect from others when disaster strikes. When it's Berkshire promising, insureds know with certainty that they can collect promptly.

Our second advantage — somewhat related — is subtle but important. After a mega-catastrophe, insurers might well find it difficult to obtain reinsurance even though their need for coverage would then be particularly great. At such a time, Berkshire would without question have very substantial capacity available — but it will naturally be our long-standing clients that have first call on it. That business reality has made major insurers and reinsurers throughout the world realize the desirability of doing business with us. Indeed, we are currently getting sizable "stand-by" fees from reinsurers that are simply nailing down their ability to get coverage from us should the market tighten.

Our final competitive advantage is that we can provide dollar coverages of a size neither matched nor approached elsewhere in the industry. Insurers looking for huge covers know that a single call to Berkshire will produce a firm and immediate offering.

A few facts about our exposure to California earthquakes — our largest risk — seem in order. The Northridge quake of 1994 laid homeowners' losses on insurers that greatly exceeded what computer models had told them to expect. Yet the intensity of that quake was mild compared to the "worst-case" possibility for California. Understandably, insurers became — ahem — shaken and started contemplating a retreat from writing earthquake coverage into their homeowners' policies.

In a thoughtful response, Chuck Quackenbush, California's insurance commissioner, designed a new residential earthquake policy to be written by a state-sponsored insurer, The California Earthquake Authority. This entity, which went into operation on December 1, 1996, needed large layers of reinsurance — and that's where we came in. Berkshire's layer of approximately $1 billion will be called upon if the Authority's aggregate losses in the period ending March 31, 2001 exceed about $5 billion. (The press originally reported larger figures, but these would have applied only if all California insurers had entered into the arrangement; instead only 72% signed up.)

So what are the true odds of our having to make a payout during the policy's term? We don't know — nor do we think computer models will help us, since we believe the precision they project is a chimera. In fact, such models can lull decision-makers into a false sense of security and thereby increase their chances of making a really huge mistake. We've already seen such debacles in both insurance and investments. Witness "portfolio insurance," whose destructive effects in the 1987 market crash led one wag to observe that it was the computers that should have been jumping out of windows.

Even if perfection in assessing risks is unattainable, insurers can underwrite sensibly. After all, you need not know a man's precise age to know that he is old enough to vote nor know his exact weight to recognize his need to diet. In insurance, it is essential to remember that virtually all surprises are unpleasant, and with that in mind we try to price our super-cat exposures so that about 90% of total premiums end up being eventually paid out in losses and expenses. Over time, we will find out how smart our pricing has been, but that will not be quickly. The super-cat business is just like the investment business in that it often takes a long time to find out whether you knew what you were doing.

What I can state with certainty, however, is that we have the best person in the world to run our super-cat business: Ajit Jain, whose value to Berkshire is simply enormous. In the reinsurance field, disastrous propositions abound. I know that because I personally embraced all too many of these in the 1970s and also because GEICO has a large runoff portfolio made up of foolish contracts written in the early-1980s, able though its then-management was. Ajit, I can assure you, won't make mistakes of this type.

I have mentioned that a mega-catastrophe might cause a catastrophe in the financial markets, a possibility that is unlikely but not far-fetched. Were the catastrophe a quake in California of sufficient magnitude to tap our coverage, we would almost certainly be damaged in other ways as well. For example, See's, Wells Fargo and Freddie Mac could be hit hard. All in all, though, we can handle this aggregation of exposures.

In this respect, as in others, we try to "reverse engineer" our future at Berkshire, bearing in mind Charlie's dictum: "All I want to know is where I'm going to die so I'll never go there." (Inverting really works: Try singing country western songs backwards and you will quickly regain your house, your car and your wife.) If we can't tolerate a possible consequence, remote though it may be, we steer clear of planting its seeds. That is why we don't borrow big amounts and why we make sure that our super-cat business losses, large though the maximums may sound, will not put a major dent in Berkshire's intrinsic value.

Insurance — GEICO and Other Primary Operations

When we moved to total ownership of GEICO early last year, our expectations were high — and they are all being exceeded. That is true from both a business and personal perspective: GEICO's operating chief, Tony Nicely, is a superb business manager and a delight to work with. Under almost any conditions, GEICO would be an exceptionally valuable asset. With Tony at the helm, it is reaching levels of performance that the organization would only a few years ago have thought impossible.

There's nothing esoteric about GEICO's success: The company's competitive strength flows directly from its position as a low-cost operator. Low costs permit low prices, and low prices attract and retain good policyholders. The final segment of a virtuous circle is drawn when policyholders recommend us to their friends. GEICO gets more than one million referrals annually and these produce more than half of our new business, an advantage that gives us enormous savings in acquisition expenses — and that makes our costs still lower.

This formula worked in spades for GEICO in 1996: Its voluntary auto policy count grew 10%. During the previous 20 years, the company's best-ever growth for a year had been 8%, a rate achieved only once. Better yet, the growth in voluntary policies accelerated during the year, led by major gains in the nonstandard market, which has been an underdeveloped area at GEICO. I focus here on voluntary policies because the involuntary business we get from assigned risk pools and the like is unprofitable. Growth in that sector is most unwelcome.

GEICO's growth would mean nothing if it did not produce reasonable underwriting profits. Here, too, the news is good: Last year we hit our underwriting targets and then some. Our goal, however, is not to widen our profit margin but rather to enlarge the price advantage we offer customers. Given that strategy, we believe that 1997's growth will easily top that of last year.

We expect new competitors to enter the direct-response market, and some of our existing competitors are likely to expand geographically. Nonetheless, the economies of scale we enjoy should allow us to maintain or even widen the protective moat surrounding our economic castle. We do best on costs in geographical areas in which we enjoy high market penetration. As our policy count grows, concurrently delivering gains in penetration, we expect to drive costs materially lower. GEICO's sustainable cost advantage is what attracted me to the company way back in 1951, when the entire business was valued at $7 million. It is also why I felt Berkshire should pay $2.3 billion last year for the 49% of the company that we didn't then own.

Maximizing the results of a wonderful business requires management and focus. Lucky for us, we have in Tony a superb manager whose business focus never wavers. Wanting also to get the entire GEICO organization concentrating as he does, we needed a compensation plan that was itself sharply focused — and immediately after our purchase, we put one in.

Today, the bonuses received by dozens of top executives, starting with Tony, are based upon only two key variables: (1) growth in voluntary auto policies and (2) underwriting profitability on "seasoned" auto business (meaning policies that have been on the books for more than one year). In addition, we use the same yardsticks to calculate the annual contribution to the company's profit-sharing plan. *Everyone* at GEICO knows what counts.

The GEICO plan exemplifies Berkshire's incentive compensation principles: Goals should be (1) tailored to the economics of the specific operating business; (2) simple in character so that the degree to which they are being realized can be easily measured; and (3) directly related to the daily activities of plan participants. As a corollary, we shun "lottery ticket" arrangements, such as options on Berkshire shares, whose ultimate value — which could range from zero to huge — is totally out of the control of the person whose behavior we would like to affect. In our view, a system that produces quixotic payoffs will not only be wasteful for owners but may actually discourage the focused behavior we value in managers.

Every quarter, all 9,000 GEICO associates can see the results that determine our profit-sharing plan contribution. In 1996, they enjoyed the experience because the plan literally went off the chart that had been constructed at the start of the year. Even I knew the answer to that problem: Enlarge the chart. Ultimately, the results called for a record contribution of 16.9% ($40 million), compared to a five-year average of less than

10% for the comparable plans previously in effect. Furthermore, at Berkshire, we never greet good work by raising the bar. If GEICO's performance continues to improve, we will happily keep on making larger charts.

Lou Simpson continues to manage GEICO's money in an outstanding manner: Last year, the equities in his portfolio outdid the S&P 500 by 6.2 percentage points. In Lou's part of GEICO's operation, we again tie compensation to performance — but to investment performance over a four-year period, not to underwriting results nor to the performance of GEICO as a whole. We think it foolish for an insurance company to pay bonuses that are tied to overall corporate results when great work on one side of the business — underwriting or investment — could conceivably be completely neutralized by bad work on the other. If you bat .350 at Berkshire, you can be sure you will get paid commensurately even if the rest of the team bats .200. In Lou and Tony, however, we are lucky to have Hall-of-Famers in both key positions.

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Though they are, of course, smaller than GEICO, our other primary insurance operations turned in equally stunning results last year. National Indemnity's traditional business had a combined ratio of 74.2 and, as usual, developed a large amount of float compared to premium volume. Over the last three years, this segment of our business, run by Don Wurster, has had an average combined ratio of 83.0. Our homestate operation, managed by Rod Eldred, recorded a combined ratio of 87.1 even though it absorbed the expenses of expanding to new states. Rod's three-year combined ratio is an amazing 83.2. Berkshire's workers' compensation business, run out of California by Brad Kinstler, has now moved into six other states and, despite the costs of that expansion, again achieved an excellent underwriting profit. Finally, John Kizer, at Central States Indemnity, set new records for premium volume while generating good earnings from underwriting. In aggregate, our smaller insurance operations (now including Kansas Bankers Surety) have an underwriting record virtually unmatched in the industry. Don, Rod, Brad and John have all created significant value for Berkshire, and we believe there is more to come.

Taxes

In 1961, President Kennedy said that we should ask not what our country can do for us, but rather ask what we can do for our country. Last year we decided to give his suggestion a try — and who says it never hurts to ask? We were told to mail $860 million in income taxes to the U.S. Treasury.

Here's a little perspective on that figure: If an equal amount had been paid by only 2,000 other taxpayers, the government would have had a balanced budget in 1996 without needing a dime of taxes — income or Social Security or what have you — from *any* other American. Berkshire shareholders can truly say, "I gave at the office."

Charlie and I believe that large tax payments by Berkshire are entirely fitting. The contribution we thus make to society's well-being is at most only proportional to its contribution to ours. Berkshire prospers in America as it would nowhere else.

Sources of Reported Earnings

The table that follows shows the main sources of Berkshire's reported earnings. In this presentation, purchase-accounting adjustments are not assigned to 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. For the reasons discussed on pages 65 and 66, 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-premiums to be charged off business-by-business. The total earnings we show in the table are, of course, identical to the GAAP total in our audited financial statements.

	(in millions)			
	Pre-Tax Earnings		*Berkshire's Share of Net Earnings (after taxes and minority interests)*	
	1996	*1995*[1]	*1996*	*1995*[1]
Operating Earnings:				
Insurance Group:				
Underwriting	$222.1	$ 20.5	$142.8	$ 11.3
Net Investment Income	726.2	501.6	593.1	417.7
Buffalo News	50.4	46.8	29.5	27.3
Fechheimer	17.3	16.9	9.3	8.8
Finance Businesses	23.1	20.8	14.9	12.6
Home Furnishings	43.8	29.7[2]	24.8	16.7[2]
Jewelry	27.8	33.9[3]	16.1	19.1[3]
Kirby	58.5	50.2	39.9	32.1
Scott Fetzer Manufacturing Group	50.6	34.1	32.2	21.2
See's Candies	51.9	50.2	30.8	29.8
Shoe Group	61.6	58.4	41.0	37.5
World Book	12.6	8.8	9.5	7.0
Purchase-Accounting Adjustments	(75.7)	(27.0)	(70.5)	(23.4)
Interest Expense[4]	(94.3)	(56.0)	(56.6)	(34.9)
Shareholder-Designated Contributions	(13.3)	(11.6)	(8.5)	(7.0)
Other	58.8	37.4	34.8	24.4
Operating Earnings	1,221.4	814.7	883.1	600.2
Sales of Securities	2,484.5	194.1	1,605.5	125.0
Total Earnings - All Entities	$3,705.9	$1,008.8	$2,488.6	$725.2

[1] *Before the GEICO-related restatement.*
[2] *Includes R.C. Willey from June 29, 1995.*
[3] *Includes Helzberg's from April 30, 1995.*
[4] *Excludes interest expense of Finance Businesses.*

In this section last year, I discussed three businesses that reported a decline in earnings — Buffalo News, Shoe Group and World Book. All, I'm happy to say, recorded gains in 1996.

World Book, however, did not find it easy: Despite the operation's new status as the only direct-seller of encyclopedias in the country (Encyclopedia Britannica exited the field last year), its unit volume fell. Additionally, World Book spent heavily on a new CD-ROM product that began to take in revenues only in early 1997, when it was launched in association with IBM. In the face of these factors, earnings would have evaporated had World Book not revamped distribution methods and cut overhead at headquarters, thereby dramatically reducing its fixed costs. Overall, the company has gone a long way toward assuring its long-term viability in both the print and electronic marketplaces.

Our only disappointment last year was in jewelry: Borsheim's did fine, but Helzberg's suffered a material decline in earnings. Its expense levels had been geared to a sizable increase in same-store sales, consistent with the gains achieved in recent years. When sales were instead flat, profit margins fell. Jeff Comment, CEO of Helzberg's, is addressing the expense problem in a decisive manner, and the company's earnings should improve in 1997.

Overall, our operating businesses continue to perform exceptionally, far outdoing their industry norms. For this, Charlie and I thank our managers. If you should see any of them at the Annual Meeting, add your thanks as well.

More information about our various businesses is given on pages 36-46, where you will also find our segment earnings reported on a GAAP basis. In addition, on pages 51-57, we have rearranged Berkshire's financial data into four segments on a non-GAAP basis, a presentation that corresponds to the way Charlie and I think about the company. Our intent is to supply you with the financial information that we would wish you to give us if our positions were reversed.

"Look-Through" Earnings

Reported earnings are a poor measure of economic progress at Berkshire, in part because the numbers shown in the table presented earlier include only the dividends we receive from investees — though these dividends typically represent only a small fraction of the earnings attributable to our ownership. Not that we mind this division of money, since on balance we regard the undistributed earnings of investees as more valuable to us than the portion paid out. The reason is simple: Our investees often have the opportunity to reinvest earnings at high rates of return. So why should we want them paid out?

To depict something closer to economic reality at Berkshire than reported earnings, though, we employ the concept of "look-through" earnings. As we calculate these, they consist of: (1) the operating earnings reported in the previous section, plus; (2) our share of the retained operating earnings of major investees that, under GAAP accounting, are not reflected in our profits, less; (3) an allowance for the tax that would be paid by Berkshire if these retained earnings of investees had instead been distributed to us. When tabulating "operating earnings" here, we exclude purchase-accounting adjustments as well as capital gains and other major non-recurring items.

The following table sets forth our 1996 look-through earnings, though I warn you that the figures can be no more than approximate, since they are based on a number of judgment calls. (The dividends paid to us by these investees have been included in the operating earnings itemized on page 12, mostly under "Insurance Group: Net Investment Income.")

Berkshire's Major Investees	Berkshire's Approximate Ownership at Yearend[1]	Berkshire's Share of Undistributed Operating Earnings (in millions)[2]
American Express Company	10.5%	$132
The Coca-Cola Company	8.1%	180
The Walt Disney Company	3.6%	50
Federal Home Loan Mortgage Corp.	8.4%	77
The Gillette Company	8.6%	73
McDonald's Corporation	4.3%	38
The Washington Post Company	15.8%	27
Wells Fargo & Company	8.0%	84
Berkshire's share of undistributed earnings of major investees		661
Hypothetical tax on these undistributed investee earnings[3]		(93)
Reported operating earnings of Berkshire		954
Total look-through earnings of Berkshire		$1,522

(1) Does not include shares allocable to minority interests
(2) Calculated on average ownership for the year
(3) The tax rate used is 14%, which is the rate Berkshire pays on the dividends it receives

Common Stock Investments

Below we present our common stock investments. Those with a market value of more than $500 million are itemized.

Shares	Company	12/31/96 Cost*	Market
		(dollars in millions)	
49,456,900	American Express Company	$ 1,392.7	$ 2,794.3
200,000,000	The Coca-Cola Company	1,298.9	10,525.0
24,614,214	The Walt Disney Company	577.0	1,716.8
64,246,000	Federal Home Loan Mortgage Corp. ("Freddie Mac")	333.4	1,772.8
48,000,000	The Gillette Company	600.0	3,732.0
30,156,600	McDonald's Corporation	1,265.3	1,368.4
1,727,765	The Washington Post Company	10.6	579.0
7,291,418	Wells Fargo & Company	497.8	1,966.9
	Others	1,934.5	3,295.4
	Total Common Stocks	$ 7,910.2	$27,750.6

* Represents tax-basis cost which, in aggregate, is $1.2 billion less than GAAP cost.

Our portfolio shows little change: We continue to make more money when snoring than when active.

Inactivity strikes us as intelligent behavior. Neither we nor most business managers would dream of feverishly trading highly-profitable subsidiaries because a small move in the Federal Reserve's discount rate was predicted or because some Wall Street pundit had reversed his views on the market. Why, then, should we behave differently with our minority positions in wonderful businesses? The art of investing in public companies successfully is little different from the art of successfully acquiring subsidiaries. In each case you simply want to acquire, at a sensible price, a business with excellent economics and able, honest management. Thereafter, you need only monitor whether these qualities are being preserved.

When carried out capably, an investment strategy of that type will often result in its practitioner owning a few securities that will come to represent a very large portion of his portfolio. This investor would get a similar result if he followed a policy of purchasing an interest in, say, 20% of the future earnings of a number of outstanding college basketball stars. A handful of these would go on to achieve NBA stardom, and the investor's take from them would soon dominate his royalty stream. To suggest that this investor should sell off portions of his most successful investments simply because they have come to dominate his portfolio is akin to suggesting that the Bulls trade Michael Jordan because he has become so important to the team.

In studying the investments we have made in both subsidiary companies and common stocks, you will see that we favor businesses and industries unlikely to experience major change. The reason for that is simple: Making either type of purchase, we are searching for operations that we believe are virtually certain to possess enormous competitive strength ten or twenty years from now. A fast-changing industry environment may offer the chance for huge wins, but it precludes the certainty we seek.

I should emphasize that, as citizens, Charlie and I welcome change: Fresh ideas, new products, innovative processes and the like cause our country's standard of living to rise, and that's clearly good. As investors, however, our reaction to a fermenting industry is much like our attitude toward space exploration: We applaud the endeavor but prefer to skip the ride.

Obviously all businesses change to some extent. Today, See's is different in many ways from what it was in 1972 when we bought it: It offers a different assortment of candy, employs different machinery and sells through different distribution channels. But the reasons why people today buy boxed chocolates, and why they buy them from us rather than from someone else, are virtually unchanged from what they were

in the 1920s when the See family was building the business. Moreover, these motivations are not likely to change over the next 20 years, or even 50.

We look for similar predictability in marketable securities. Take Coca-Cola: The zeal and imagination with which Coke products are sold has burgeoned under Roberto Goizueta, who has done an absolutely incredible job in creating value for his shareholders. Aided by Don Keough and Doug Ivester, Roberto has rethought and improved every aspect of the company. But the fundamentals of the business — the qualities that underlie Coke's competitive dominance and stunning economics — have remained constant through the years.

I was recently studying the 1896 report of Coke (and you think that you are behind in your reading!). At that time Coke, though it was already the leading soft drink, had been around for only a decade. But its blueprint for the next 100 years was already drawn. Reporting sales of $148,000 that year, Asa Candler, the company's president, said: "We have not lagged in our efforts to go into all the world teaching that Coca-Cola is the article, par excellence, for the health and good feeling of all people." Though "health" may have been a reach, I love the fact that Coke still relies on Candler's basic theme today — a century later. Candler went on to say, just as Roberto could now, "No article of like character has ever so firmly entrenched itself in public favor." Sales of syrup that year, incidentally, were 116,492 gallons versus about 3.2 billion in 1996.

I can't resist one more Candler quote: "Beginning this year about March 1st . . . we employed ten traveling salesmen by means of which, with systematic correspondence from the office, we covered almost the territory of the Union." That's my kind of sales force.

Companies such as Coca-Cola and Gillette might well be labeled "The Inevitables." Forecasters may differ a bit in their predictions of exactly how much soft drink or shaving-equipment business these companies will be doing in ten or twenty years. Nor is our talk of inevitability meant to play down the vital work that these companies must continue to carry out, in such areas as manufacturing, distribution, packaging and product innovation. In the end, however, no sensible observer — not even these companies' most vigorous competitors, assuming they are assessing the matter honestly — questions that Coke and Gillette will dominate their fields worldwide for an investment lifetime. Indeed, their dominance will probably strengthen. Both companies have significantly expanded their already huge shares of market during the past ten years, and all signs point to their repeating that performance in the next decade.

Obviously many companies in high-tech businesses or embryonic industries will grow much faster in percentage terms than will The Inevitables. But I would rather be certain of a good result than hopeful of a great one.

Of course, Charlie and I can identify only a few Inevitables, even after a lifetime of looking for them. Leadership alone provides no certainties: Witness the shocks some years back at General Motors, IBM and Sears, all of which had enjoyed long periods of seeming invincibility. Though some industries or lines of business exhibit characteristics that endow leaders with virtually insurmountable advantages, and that tend to establish Survival of the Fattest as almost a natural law, most do not. Thus, for every Inevitable, there are dozens of Impostors, companies now riding high but vulnerable to competitive attacks. Considering what it takes to be an Inevitable, Charlie and I recognize that we will never be able to come up with a Nifty Fifty or even a Twinkling Twenty. To the Inevitables in our portfolio, therefore, we add a few "Highly Probables."

You can, of course, pay too much for even the best of businesses. The overpayment risk surfaces periodically and, in our opinion, may now be quite high for the purchasers of virtually all stocks, The Inevitables included. Investors making purchases in an overheated market need to recognize that it may often take an extended period for the value of even an outstanding company to catch up with the price they paid.

A far more serious problem occurs when the management of a great company gets sidetracked and neglects its wonderful base business while purchasing other businesses that are so-so or worse. When that happens, the suffering of investors is often prolonged. Unfortunately, that is precisely what transpired years

ago at both Coke and Gillette. (Would you believe that a few decades back they were growing shrimp at Coke and exploring for oil at Gillette?) Loss of focus is what most worries Charlie and me when we contemplate investing in businesses that in general look outstanding. All too often, we've seen value stagnate in the presence of hubris or of boredom that caused the attention of managers to wander. That's not going to happen again at Coke and Gillette, however — not given their current and prospective managements.

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Let me add a few thoughts about your own investments. Most investors, both institutional and individual, will find that the best way to own common stocks is through an index fund that charges minimal fees. Those following this path are sure to beat the net results (after fees and expenses) delivered by the great majority of investment professionals.

Should you choose, however, to construct your own portfolio, there are a few thoughts worth remembering. Intelligent investing is not complex, though that is far from saying that it is easy. What an investor needs is the ability to correctly evaluate selected businesses. Note that word "selected": You don't have to be an expert on every company, or even many. You only have to be able to evaluate companies within your circle of competence. The size of that circle is not very important; knowing its boundaries, however, is vital.

To invest successfully, you need not understand beta, efficient markets, modern portfolio theory, option pricing or emerging markets. You may, in fact, be better off knowing nothing of these. That, of course, is not the prevailing view at most business schools, whose finance curriculum tends to be dominated by such subjects. In our view, though, investment students need only two well-taught courses — How to Value a Business, and How to Think About Market Prices.

Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily-understandable business whose earnings are virtually certain to be materially higher five, ten and twenty years from now. Over time, you will find only a few companies that meet these standards — so when you see one that qualifies, you should buy a meaningful amount of stock. You must also resist the temptation to stray from your guidelines: If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes. Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio's market value.

Though it's seldom recognized, this is the exact approach that has produced gains for Berkshire shareholders: Our look-through earnings have grown at a good clip over the years, and our stock price has risen correspondingly. Had those gains in earnings not materialized, there would have been little increase in Berkshire's value.

The greatly enlarged earnings base we now enjoy will inevitably cause our future gains to lag those of the past. We will continue, however, to push in the directions we always have. We will try to build earnings by running our present businesses well — a job made easy because of the extraordinary talents of our operating managers — and by purchasing other businesses, in whole or in part, that are not likely to be roiled by change and that possess important competitive advantages.

USAir

When Richard Branson, the wealthy owner of Virgin Atlantic Airways, was asked how to become a millionaire, he had a quick answer: "There's really nothing to it. Start as a billionaire and then buy an airline." Unwilling to accept Branson's proposition on faith, your Chairman decided in 1989 to test it by investing $358 million in a 9¼% preferred stock of USAir.

I liked and admired Ed Colodny, the company's then-CEO, and I still do. But my analysis of USAir's business was both superficial and wrong. I was so beguiled by the company's long history of profitable operations, and by the protection that ownership of a senior security seemingly offered me, that I overlooked

the crucial point: USAir's revenues would increasingly feel the effects of an unregulated, fiercely-competitive market whereas its cost structure was a holdover from the days when regulation protected profits. These costs, if left unchecked, portended disaster, however reassuring the airline's past record might be. (If history supplied all of the answers, the Forbes 400 would consist of librarians.)

To rationalize its costs, however, USAir needed major improvements in its labor contracts — and that's something most airlines have found it extraordinarily difficult to get, short of credibly threatening, or actually entering, bankruptcy. USAir was to be no exception. Immediately after we purchased our preferred stock, the imbalance between the company's costs and revenues began to grow explosively. In the 1990-1994 period, USAir lost an aggregate of $2.4 billion, a performance that totally wiped out the book equity of its common stock.

For much of this period, the company paid us our preferred dividends, but in 1994 payment was suspended. A bit later, with the situation looking particularly gloomy, we wrote down our investment by 75%, to $89.5 million. Thereafter, during much of 1995, I offered to sell our shares at 50% of face value. Fortunately, I was unsuccessful.

Mixed in with my many mistakes at USAir was one thing I got right: Making our investment, we wrote into the preferred contract a somewhat unusual provision stipulating that "penalty dividends" — to run five percentage points over the prime rate — would be accrued on any arrearages. This meant that when our 9¼% dividend was omitted for two years, the unpaid amounts compounded at rates ranging between 13¼% and 14%.

Facing this penalty provision, USAir had every incentive to pay arrearages just as promptly as it could. And in the second half of 1996, when USAir turned profitable, it indeed began to pay, giving us $47.9 million. We owe Stephen Wolf, the company's CEO, a huge thank-you for extracting a performance from the airline that permitted this payment. Even so, USAir's performance has recently been helped significantly by an industry tailwind that may be cyclical in nature. The company still has basic cost problems that must be solved.

In any event, the prices of USAir's publicly-traded securities tell us that our preferred stock is now probably worth its par value of $358 million, give or take a little. In addition, we have over the years collected an aggregate of $240.5 million in dividends (including $30 million received in 1997).

Early in 1996, before any accrued dividends had been paid, I tried once more to unload our holdings — this time for about $335 million. You're lucky: I again failed in my attempt to snatch defeat from the jaws of victory.

In another context, a friend once asked me: "If you're so rich, why aren't you smart?" After reviewing my sorry performance with USAir, you may conclude he had a point.

Financings

We wrote four checks to Salomon Brothers last year and in each case were delighted with the work for which we were paying. I've already described one transaction: the FlightSafety purchase in which Salomon was the initiating investment banker. In a second deal, the firm placed a small debt offering for our finance subsidiary.

Additionally, we made two good-sized offerings through Salomon, both with interesting aspects. The first was our sale in May of 517,500 shares of Class B Common, which generated net proceeds of $565 million. As I have told you before, we made this sale in response to the threatened creation of unit trusts that would have marketed themselves as Berkshire look-alikes. In the process, they would have used our past, and definitely nonrepeatable, record to entice naive small investors and would have charged these innocents high fees and commissions.

I think it would have been quite easy for such trusts to have sold many billions of dollars worth of units, and I also believe that early marketing successes by these trusts would have led to the formation of

others. (In the securities business, whatever can be sold will be sold.) The trusts would have meanwhile indiscriminately poured the proceeds of their offerings into a supply of Berkshire shares that is fixed and limited. The likely result: a speculative bubble in our stock. For at least a time, the price jump would have been self-validating, in that it would have pulled new waves of naive and impressionable investors into the trusts and set off still more buying of Berkshire shares.

Some Berkshire shareholders choosing to exit might have found that outcome ideal, since they could have profited at the expense of the buyers entering with false hopes. Continuing shareholders, however, would have suffered once reality set in, for at that point Berkshire would have been burdened with both hundreds of thousands of unhappy, indirect owners (trustholders, that is) and a stained reputation.

Our issuance of the B shares not only arrested the sale of the trusts, but provided a low-cost way for people to invest in Berkshire if they still wished to after hearing the warnings we issued. To blunt the enthusiasm that brokers normally have for pushing new issues — because that's where the money is — we arranged for our offering to carry a commission of only 1½%, the lowest payoff that we have ever seen in a common stock underwriting. Additionally, we made the amount of the offering open-ended, thereby repelling the typical IPO buyer who looks for a short-term price spurt arising from a combination of hype and scarcity.

Overall, we tried to make sure that the B stock would be purchased only by investors with a long-term perspective. Those efforts were generally successful: Trading volume in the B shares immediately following the offering — a rough index of "flipping" — was far below the norm for a new issue. In the end we added about 40,000 shareholders, most of whom we believe both understand what they own and share our time horizons.

Salomon could not have performed better in the handling of this unusual transaction. Its investment bankers understood perfectly what we were trying to achieve and tailored every aspect of the offering to meet these objectives. The firm would have made far more money — perhaps ten times as much — if our offering had been standard in its make-up. But the investment bankers involved made no attempt to tweak the specifics in that direction. Instead they came up with ideas that were counter to Salomon's financial interest but that made it much more certain Berkshire's goals would be reached. Terry Fitzgerald captained this effort, and we thank him for the job that he did.

Given that background, it won't surprise you to learn that we again went to Terry when we decided late in the year to sell an issue of Berkshire notes that can be exchanged for a portion of the Salomon shares that we hold. In this instance, once again, Salomon did an absolutely first-class job, selling $500 million principal amount of five-year notes for $447.1 million. Each $1,000 note is exchangeable into 17.65 shares and is callable in three years at accreted value. Counting the original issue discount and a 1% coupon, the securities will provide a yield of 3% to maturity for holders who do not exchange them for Salomon stock. But it seems quite likely that the notes will be exchanged before their maturity. If that happens, our interest cost will be about 1.1% for the period prior to exchange.

In recent years, it has been written that Charlie and I are unhappy about all investment-banking fees. That's dead wrong. We have paid a great many fees over the last 30 years — beginning with the check we wrote to Charlie Heider upon our purchase of National Indemnity in 1967 — and we are delighted to make payments that are commensurate with performance. In the case of the 1996 transactions at Salomon Brothers, we more than got our money's worth.

Miscellaneous

Though it was a close decision, Charlie and I have decided to enter the 20th Century. Accordingly, we are going to put future quarterly and annual reports of Berkshire on the Internet, where they can be accessed via http://www.berkshirehathaway.com. We will always "post" these reports on a Saturday so that anyone interested will have ample time to digest the information before trading begins. Our publishing schedule for the next 12 months is May 17, 1997, August 16, 1997, November 15, 1997, and March 14, 1998. We will also post any press releases that we issue.

At some point, we may stop mailing our quarterly reports and simply post these on the Internet. This move would eliminate significant costs. Also, we have a large number of "street name" holders and have found that the distribution of our quarterlies to them is highly erratic: Some holders receive their mailings weeks later than others.

The drawback to Internet-only distribution is that many of our shareholders lack computers. Most of these holders, however, could easily obtain printouts at work or through friends. Please let me know if you prefer that we continue mailing quarterlies. We want your input — starting with whether you even read these reports — and at a minimum will make no change in 1997. Also, we will definitely keep delivering the annual report in its present form in addition to publishing it on the Internet.

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About 97.2% of all eligible shares participated in Berkshire's 1996 shareholder-designated contributions program. Contributions made were $13.3 million, and 3,910 charities were recipients. A full description of the shareholder-designated contributions program appears on pages 48-49.

Every year a few shareholders miss out on the program because they don't have their shares registered in their own names on the prescribed record date or because they fail to get the designation form back to us within the 60-day period allowed. This is distressing to Charlie and me. But if replies are received late, we have to reject them because we can't make exceptions for some shareholders while refusing to make them for others.

To participate in future programs, you must own Class A shares that are registered in the name of the actual owner, not the nominee name of a broker, bank or depository. Shares not so registered on August 31, 1997, will be ineligible for the 1997 program. When you get the form, return it promptly so that it does not get put aside or forgotten.

The Annual Meeting

Our capitalist's version of Woodstock — the Berkshire Annual Meeting — will be held on Monday, May 5. Charlie and I thoroughly enjoy this event, and we hope that you come. We will start at 9:30 a.m., break for about 15 minutes at noon (food will be available — but at a price, of course), and then continue talking to hard-core attendees until at least 3:30. Last year we had representatives from all 50 states, as well as Australia, Greece, Israel, Portugal, Singapore, Sweden, Switzerland, and the United Kingdom. The annual meeting is a time for owners to get their business-related questions answered, and therefore Charlie and I will stay on stage until we start getting punchy. (When that happens, I hope you notice a change.)

Last year we had attendance of 5,000 and strained the capacity of the Holiday Convention Centre, even though we spread out over three rooms. This year, our new Class B shares have caused a doubling of our stockholder count, and we are therefore moving the meeting to the Aksarben Coliseum, which holds about 10,000 and also has a huge parking lot. The doors will open for the meeting at 7:00 a.m., and at 8:30 we will — upon popular demand — show a new Berkshire movie produced by Marc Hamburg, our CFO. (In this company, no one gets by with doing only a single job.)

Overcoming our legendary repugnance for activities even faintly commercial, we will also have an abundant array of Berkshire products *for sale* in the halls outside the meeting room. Last year we broke all records, selling 1,270 pounds of See's candy, 1,143 pairs of Dexter shoes, $29,000 of World Books and related publications, and 700 sets of knives manufactured by our Quikut subsidiary. Additionally, many shareholders made inquiries about GEICO auto policies. If you would like to investigate possible insurance savings, bring your present policy to the meeting. We estimate that about 40% of our shareholders can save money by insuring with us. (We'd like to say 100%, but the insurance business doesn't work that way: Because insurers differ in their underwriting judgments, some of our shareholders are currently paying rates that are lower than GEICO's.)

An attachment to the proxy material enclosed with this report explains how you can obtain the card you will need for admission to the meeting. We expect a large crowd, so get both plane and hotel reservations promptly. American Express (800-799-6634) will be happy to help you with arrangements. As usual, we will have buses servicing the larger hotels to take you to and from the meeting, and also to take you to Nebraska Furniture Mart, Borsheim's and the airport after it is over.

NFM's main store, located on a 75-acre site about a mile from Aksarben, is open from 10 a.m. to 9 p.m. on weekdays, 10 a.m. to 6 p.m. on Saturdays, and noon to 6 p.m. on Sundays. Come by and say hello to "Mrs. B" (Rose Blumkin). She's 103 now and sometimes operates with an oxygen mask that is attached to a tank on her cart. But if you try to keep pace with her, it will be you who needs oxygen. NFM did about $265 million of business last year — a record for a single-location home furnishings operation — and you'll see why once you check out its merchandise and prices.

Borsheim's normally is closed on Sunday but will be open for shareholders from 10 a.m. to 6 p.m. on May 4th. Last year on "Shareholder Sunday" we broke every Borsheim's record in terms of tickets, dollar volume and, no doubt, attendees per square inch. Because we expect a capacity crowd this year as well, all shareholders attending on Sunday must bring their admission cards. Shareholders who prefer a somewhat less frenzied experience will get the same special treatment on Saturday, when the store is open from 10 a.m. to 5:30 p.m., or on Monday between 10 a.m. and 8 p.m. Come by at any time this year and let Susan Jacques, Borsheim's CEO, and her skilled associates perform a painless walletectomy on you.

My favorite steakhouse, Gorat's, was sold out last year on the weekend of the annual meeting, even though it added an additional seating at 4 p.m. on Sunday. You can make reservations beginning on April 1st *(but not earlier)* by calling 402-551-3733. I will be at Gorat's on Sunday after Borsheim's, having my usual rare T-bone and double order of hashbrowns. I can also recommend — this is the standard fare when Debbie Bosanek, my invaluable assistant, and I go to lunch — the hot roast beef sandwich with mashed potatoes and gravy. Mention Debbie's name and you will be given an extra boat of gravy.

The Omaha Royals and Indianapolis Indians will play baseball on Saturday evening, May 3rd, at Rosenblatt Stadium. Pitching in my normal rotation — one throw a year — I will start.

Though Rosenblatt is normal in appearance, it is anything but: The field sits on a unique geological structure that occasionally emits short gravitational waves causing even the most smoothly-delivered pitch to sink violently. I have been the victim of this weird phenomenon several times in the past but am hoping for benign conditions this year. There will be lots of opportunities for photos at the ball game, but you will need incredibly fast reflexes to snap my fast ball en route to the plate.

Our proxy statement includes information about obtaining tickets to the game. We will also provide an information packet listing restaurants that will be open on Sunday night and describing various things that you can do in Omaha on the weekend. The entire gang at Berkshire looks forward to seeing you.

Warren E. Buffett
Chairman of the Board

February 28, 1997

BERKSHIRE HATHAWAY INC.

ACQUISITION CRITERIA

We are eager to hear *from principals or their representatives* about businesses that meet all of the following criteria:

(1) Large purchases (at least $25 million of before-tax earnings),
(2) Demonstrated consistent earning power (future projections are of no 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).

The larger the company, the greater will be our interest: We would like to make an acquisition in the $3-5 billion range. *We are not interested, however, in receiving suggestions about purchases we might make in the general stock market.*

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.

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. A line from a country song expresses our feeling about new ventures, turnarounds, or auction-like sales: "When the phone don't ring, you'll know it's me."

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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, 1996 and 1995, and the related consolidated statements of earnings and cash flows for each of the three years in the period ended December 31, 1996. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Berkshire Hathaway Inc. and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

March 7, 1997

Deloitte Touche Tohmatsu International

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

	December 31, 1996	December 31, 1995 *
ASSETS		
Cash and cash equivalents	$ 1,339.8	$ 2,703.8
Investments:		
Securities with fixed maturities	6,446.9	1,423.2
Equity securities	27,750.6	21,017.6
Receivables	1,523.2	718.9
Inventories	619.6	601.1
Assets of finance businesses	968.9	756.7
Property, plant and equipment	1,034.2	333.3
Goodwill of acquired businesses	3,110.3	672.0
Other assets	616.0	484.8
	$43,409.5	$28,711.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Losses and loss adjustment expenses	$ 6,274.4	$ 3,698.6
Unearned premiums	1,183.5	374.1
Accounts payable, accruals and other liabilities	2,556.8	1,039.1
Income taxes, principally deferred	6,837.6	4,849.5
Borrowings under investment agreements and other debt	1,944.4	1,061.7
Liabilities of finance businesses	851.4	685.2
	19,648.1	11,708.2
Minority shareholders' interests	335.1	264.5
Shareholders' equity:		
Common Stock: **		
Class A Common Stock, $5 par value, 1,376,188 and 1,381,308 shares issued; 1,206,120 and 1,193,512 shares outstanding	6.9	6.9
Class B Common Stock, $0.1667 par value, 783,755 shares issued and outstanding in 1996	0.1	—
Capital in excess of par value	2,274.1	1,001.7
Unrealized appreciation of investments, net	12,143.9	9,220.7
Retained earnings	9,032.7	6,544.1
	23,457.7	16,773.4
Less: Cost of 170,068 and 187,796 Class A common shares in treasury	31.4	34.7
Total shareholders' equity	23,426.3	16,738.7
	$43,409.5	$28,711.4

* *Restated - See Notes to Consolidated Financial Statements.*

** *Class B Common Stock has economic rights equal to one-thirtieth (1/30) of the economic rights of Class A Common Stock. Accordingly, on an equivalent Class A Common Stock basis, there are 1,232,245 shares outstanding at December 31, 1996 versus 1,193,512 outstanding at December 31, 1995.*

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	1996	1995 *	1994 *
Revenues:			
Insurance premiums earned	$4,117.8	$ 957.5	$ 923.2
Sales and service revenues	3,061.2	2,755.9	2,351.9
Interest, dividend and other investment income	811.9	629.2	519.0
Income from finance businesses	25.3	26.6	24.9
Realized investment gain	2,484.1	194.1	91.3
	10,500.3	4,563.3	3,910.3
Cost and expenses:			
Insurance losses and loss adjustment expenses	3,089.5	612.0	565.3
Insurance underwriting expenses	797.6	325.0	228.0
Cost of products and services sold	1,884.0	1,706.7	1,450.0
Selling, general and administrative expenses	861.9	759.6	599.6
Goodwill amortization	61.7	16.3	13.8
Interest expense	99.7	59.3	60.1
Other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock	—	—	268.5
	6,794.4	3,478.9	3,185.3
Earnings before income taxes and minority interest	3,705.9	1,084.4	725.0
Income taxes	1,196.8	276.2	163.3
Minority interest	20.5	13.3	8.7
Net earnings	$2,488.6	$ 794.9	$ 553.0
Average shares outstanding **	1,205,257	1,187,102	1,177,750
Net earnings per share **	$2,065	$670	$470

* *Restated - See Notes to Consolidated Financial Statements.*

** *Average shares outstanding for 1996 include average Class A Common shares and average Class B Common shares determined on an equivalent Class A Common Stock basis. Net earnings per share shown above represents net earnings per Class A Common share. Net earnings per Class B Common share is equal to one-thirtieth (1/30) of such amount or $69 per share for 1996.*

See accompanying Notes to Consolidated Financial Statements

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

	Year Ended December 31,		
	1996	**1995**	**1994**
Cash flows from operating activities:			
Net income	$2,488.6	$ 794.9	$ 553.0
Adjustments to reconcile net income to cash flows from operating activities:			
Realized investment gain	(2,484.1)	(194.1)	(91.3)
Other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock	—	—	268.5
Depreciation and amortization	151.6	75.7	62.5
Changes in assets and liabilities before effects from business acquisitions:			
Losses and loss adjustment expenses	352.1	268.6	274.1
Deferred charges re reinsurance assumed	51.8	51.0	25.3
Unearned premiums	(8.8)	66.9	(8.5)
Receivables	(127.1)	(35.4)	(49.8)
Accounts payable, accruals and other liabilities	558.3	228.2	210.5
Income taxes	221.9	(29.9)	(252.4)
Other	55.7	(98.0)	(62.8)
Net cash flows from operating activities	1,260.0	1,127.9	929.1
Cash flows from investing activities:			
Purchases of securities with fixed maturities	(2,464.7)	(273.9)	(2,485.8)
Purchases of equity securities	(1,423.4)	(1,459.9)	(3,050.0)
Proceeds from sales of securities with fixed maturities	277.5	669.7	1,772.1
Proceeds from redemptions and maturities of securities with fixed maturities	791.9	954.6	85.9
Proceeds from sales of equity securities	1,531.0	1,352.7	1,466.8
Loans and investments originated in finance businesses	(577.1)	(381.2)	(246.8)
Principal collection on loans and investments originated in finance businesses	351.5	363.0	332.4
Acquisitions of businesses, net of cash acquired	(1,975.3)	—	—
Other	(19.2)	(11.4)	(23.2)
Net cash flows from investing activities	(3,507.8)	1,213.6	(2,148.6)
Cash flows from financing activities:			
Proceeds from borrowings of finance businesses	285.1	265.7	208.6
Proceeds from other borrowings	1,604.3	1,232.7	1,225.3
Repayments of borrowings of finance businesses	(427.3)	(232.1)	(390.5)
Repayments of other borrowings	(1,170.0)	(1,151.7)	(1,387.7)
Net proceeds from issuance of Class B Common Stock	565.0	—	—
Other	(3.5)	(1.5)	(0.9)
Net cash flows from financing activities	853.6	113.1	(345.2)
Increase (decrease) in cash and cash equivalents	(1,394.2)	2,454.6	(1,564.7)
Cash and cash equivalents at beginning of year	2,744.5	289.9	1,854.6
Cash and cash equivalents at end of year *	$1,350.3	$2,744.5	$ 289.9
* *Cash and cash equivalents at end of year are comprised of the following:*			
Finance businesses	*$ 10.5*	*$ 40.7*	*$ 16.0*
Other	*1,339.8*	*2,703.8*	*273.9*
	$1,350.3	*$2,744.5*	*$ 289.9*

See accompanying Notes to Consolidated Financial Statements

BERKSHIRE HATHAWAY INC.
and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1996

(1) Significant accounting policies and practices

(a) Nature of operations and basis of consolidation

Berkshire Hathaway Inc. ("Berkshire" or "Company") is a holding company owning subsidiaries engaged in a number of diverse business activities. The most important of these is the property and casualty insurance business conducted on both a direct and reinsurance basis. Further information regarding this business and Berkshire's other reportable business segments is contained in Note 15.

The accompanying Consolidated Financial Statements include the accounts of Berkshire consolidated with accounts of all its subsidiaries. Intercompany accounts and transactions have been eliminated. The accompanying prior year financial statements have been restated from the amounts previously reported in the Company's Consolidated Financial Statements included in its Annual Report for the year ended December 31, 1995. See 1(b) below for further information.

(b) Restatement

As more fully discussed in Note 2, on January 2, 1996, GEICO Corporation ("GEICO") became a wholly-owned subsidiary of Berkshire. Prior to January 2, 1996, Berkshire owned approximately 51% of the outstanding common stock of GEICO. Previously the investment in GEICO common stock had been classified as an available-for-sale security and was carried in Berkshire's Consolidated Balance Sheet at fair value.

Generally accepted accounting principles require that prior year financial statements be restated when control of a business is obtained on a "step-by-step" basis. Accordingly, the accompanying Consolidated Financial Statements for 1995 and 1994 have been restated to account for Berkshire's previous investment in GEICO common stock under the equity method. Berkshire's proportionate share of GEICO's net income reduced by amortization of related goodwill is included in the Consolidated Statements of Earnings as a component of interest, dividends and other investment income. The principal effect of the restatement was to decrease shareholders' equity as of December 31, 1995 by $478.4 million from the amount reported in Berkshire's Consolidated Financial Statements included in its Annual Report for the year ended December 31, 1995.

(c) Use of estimates in preparation of financial statements

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results may differ from the estimates and assumptions used in preparing the consolidated financial statements.

(d) 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.

(e) Investments

Management determines the appropriate classifications of investments in securities with fixed maturities and equity securities at the time of purchase and reevaluates such designations as of each balance sheet date. Investments in securities with fixed maturities, except for such securities held by finance businesses, are classified as available-for-sale. Securities with fixed maturities held by finance businesses are classified as held-to-maturity. Investments in equity securities are classified as available-for-sale. Securities with fixed maturities are deemed to be held-to-maturity securities when the Company has the ability and positive intent to hold them to maturity.

Held-to-maturity securities are carried at amortized cost. Available-for-sale securities are stated at fair value, with unrealized gains and losses, net of tax, reported in a separate component of shareholders' equity. Realized gains and losses, which arise when investments are sold (as determined on a specific identification basis), other-than-temporarily impaired or in certain situations when investments are marked-to-market, are included in the Consolidated Statements of Earnings.

(f) Goodwill of acquired businesses

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

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

(f) Goodwill of acquired businesses (continued)

continually reviews the recoverability of the carrying value of goodwill of acquired businesses using the methodology prescribed by Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of."

(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. Generally, the ultimate recoverability of premium acquisition costs is determined without regard to investment income. The unamortized balance of deferred premium acquisition costs is included in other assets.

(h) Deferred charges re reinsurance assumed

The excess of estimated liabilities for claims and claim costs ultimately payable by the Insurance Group over consideration received with respect to retroactive property/casualty reinsurance contracts that provide for indemnification of insurance risk, other than structured settlements, is established as a deferred charge at inception of such contracts. The deferred charges are subsequently amortized using the interest method over the expected settlement periods of the claim liabilities. The unamortized balance is included in other assets and was $337.9 million at December 31, 1996 and $389.7 million at December 31, 1995.

(j) Losses and loss adjustment expenses

Liability for unpaid losses and loss adjustment expenses represents the aggregate of such obligations of members of the Insurance Group with respect to: (i) prospective property/casualty insurance and reinsurance contracts, (ii) retroactive property/casualty reinsurance contracts that provide for indemnification of insurance risk, other than structured settlements, and (iii) reinsurance contracts providing for periodic payments with respect to settled claims ("structured settlements"). Except for structured settlement liabilities which are stated at discounted present values, the liability for unpaid losses and loss adjustment expenses is at the aggregate of estimated ultimate payment amounts.

Ultimate payment amounts with respect to prospective contracts are determined from (i) individual case estimates, (ii) estimates of incurred but not reported losses, based on past experience, and (iii) reports of losses from ceding insurers.

Ultimate payment amounts with respect to retroactive reinsurance contracts that provide for indemnification of insurance risk, other than structured settlements, are established for financial reporting purposes at maximum limits of indemnification under the contracts. (See also 1*(h)* above related to deferred charges re reinsurance assumed.)

Liabilities under structured settlement contracts are established when the contracts are entered into, at the then present value of the actuarially determined ultimate payment amount discounted at the prevailing market interest rate. Annual accretions to the liabilities are charged to losses incurred. This accounting policy also applies to annuity reserves and policyholder liabilities which are included in the liabilities of finance businesses.

(k) Insurance premiums

Insurance premiums for prospective insurance and non-property catastrophe reinsurance policies are recognized as revenues ratably over their terms with unearned premiums computed on a monthly or daily pro rata basis. Premiums for catastrophe excess of loss reinsurance coverages are deferred until the earlier of a loss occurrence or policy expiration. Consideration received for structured settlements is accounted for as premiums earned at the inception of the contracts. Premiums earned are stated net of amounts ceded to reinsurers.

(m) Reinsurance

Provisions for losses and loss adjustment expenses are reported in the accompanying consolidated statements of earnings after deducting estimates of amounts that will be recoverable under reinsurance contracts. Such recoverables totalled $47 million, $14 million, and $61 million for 1996, 1995 and 1994, respectively. Reinsurance contracts do not relieve the Insurance Group Members of their obligations to indemnify policyholders with respect to the underlying insurance and reinsurance contracts. Losses and loss adjustment expenses recoverable under reinsurance contracts are included in receivables.

Notes to Consolidated Financial Statements *(Continued)*

(2) Business acquisitions — 1996

During 1996, Berkshire consummated mergers with GEICO Corporation ("GEICO") and FlightSafety International, Inc. ("FlightSafety"). Each of these mergers was accounted for by the purchase method. The excess of the purchase cost of each business over the fair value of net assets acquired as of the respective merger dates is recorded as goodwill of acquired businesses and will subsequently be amortized over forty years. The aggregate amount of goodwill applicable to these acquisitions was approximately $2.5 billion. Additional information concerning each merger is provided below.

(a) GEICO

On January 2, 1996, GEICO became a wholly-owned subsidiary as a result of the merger of an indirect wholly-owned subsidiary of Berkshire with and into GEICO. GEICO, through its subsidiaries, is a multiple line property and casualty insurer, the principal business of which is underwriting private passenger automobile insurance.

The merger was consummated pursuant to an Agreement and Plan of Merger (the "GEICO Agreement") dated August 25, 1995. Pursuant to the GEICO Agreement, each issued and outstanding common share of GEICO, except shares held by Berkshire subsidiaries and GEICO, was converted into the right to receive $70 per share, or an aggregate amount of $2.3 billion. The amount of the merger consideration was based upon 33,284,733 outstanding shares held by the public on the merger date.

As of the merger date, subsidiaries of Berkshire owned 34,250,000 common shares of GEICO, which were acquired in years prior to 1981 at an aggregate cost of $45.7 million. Up to the merger date, neither Berkshire nor its subsidiaries had acquired any shares of GEICO common stock since 1980. However, Berkshire's ownership percentage, due to intervening stock repurchases by GEICO, gradually increased from about 33% in 1980 to almost 51% immediately prior to the merger date.

(b) FlightSafety

On December 23, 1996, FlightSafety became a wholly-owned subsidiary as a result of the merger of FlightSafety with and into a subsidiary of Berkshire. FlightSafety provides high technology training to operators of aircraft and ships throughout the world.

The merger was consummated pursuant to an Agreement and Plan of Merger dated October 14, 1996 (the "FlightSafety Agreement") between Berkshire and FlightSafety. Pursuant to the FlightSafety Agreement, aggregate consideration of approximately $1.5 billion was paid to FlightSafety shareholders consisting of $769.0 million in cash, 17,728 shares of Berkshire's Class A common stock and 112,655 shares of Berkshire's Class B common stock.

The results of operations for each of these entities are included in Berkshire's consolidated results of operations from the effective dates of each of the mergers (GEICO — January 2, 1996 and FlightSafety — December 23, 1996). The following table sets forth certain consolidated statement of earnings data for the years ended December 31, 1996 and 1995, as if the GEICO and FlightSafety mergers had been consummated on the same terms at the beginning of 1995. Dollar amounts are in millions, except per share amounts.

	1996	1995
Insurance premiums earned	$ 4,117.8	$3,744.5
Sales and service revenues	3,416.5	3,081.6
Total revenues	10,823.5	7,640.9
Net income	2,515.0	833.8
Earnings per equivalent Class A common share	2,051	690

(3) Business acquisitions — 1995

During 1995, the Company consummated mergers with Helzberg's Diamond Shops, Inc. ("Helzberg's") and R.C. Willey Home Furnishings ("R.C. Willey") by reissuing 15,762 shares of its common stock (subsequently redesignated Class A Common Stock) held in treasury in exchange for 100% of the common stock of each of these companies. Helzberg's consists of a chain of 186 jewelry stores operating in 28 states and R.C. Willey, through its seven locations, is the dominant retailer of home furnishings in Utah.

Each of these mergers was accounted for by the purchase method and, accordingly, the operating results of these businesses are included in the Company's consolidated results of operations from the effective dates of the mergers (Helzberg's — April 30, 1995; R.C. Willey — June 29, 1995). Had the results of these businesses been included commencing with operations at the beginning of 1994, the reported results would not have been materially affected.

(4) **Investments in securities with fixed maturities**

The amortized cost and estimated fair values as of December 31, 1996 and 1995, of investments in securities with fixed maturities are as follows (in millions):

December 31, 1996	*Amortized Cost*	*Gross Unrealized Gains*	*Gross Unrealized Losses*	*Estimated Fair Value*
Bonds:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$2,618.8	$ 4.0	$ (5.7)	$2,617.1
Obligations of states, municipalities and political subdivisions	2,502.0	32.4	(1.8)	2,532.6
Corporate bonds	22.0	—	—	22.0
Redeemable preferred stocks	584.3	275.9	(4.3)	855.9
Mortgage-backed securities	415.2	6.1	(2.0)	419.3
	$6,142.3	$318.4	$(13.8)	$6,446.9

December 31, 1995	*Amortized Cost*	*Gross Unrealized Gains*	*Gross Unrealized Losses*	*Estimated Fair Value*
Bonds:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 80.9	$ 2.2	$ —	$ 83.1
Obligations of states, municipalities and political subdivisions	346.4	17.2	(0.5)	363.1
Redeemable preferred stocks	682.5	153.4	(2.9)	833.0
Mortgage-backed securities	138.3	5.9	(0.2)	144.0
	$1,248.1	$178.7	$ (3.6)	$1,423.2

Amounts above exclude securities with fixed maturities held by finance businesses. See note 7.

Redeemable preferred stocks include 358,000 shares of USAir Group, Inc. Series A Cumulative Convertible Preferred Stock ("USAir Preferred Shares"). The USAir Preferred Shares were acquired in 1989 for $358 million. If not called or converted prior to August 7, 1999, the USAir Preferred Shares are mandatorily redeemable by USAir Group, Inc. ("USAir") at $1,000 per share ($358 million in the aggregate), plus accrued dividends.

During the five years ended December 31, 1994, USAir reported aggregate losses of approximately $2.4 billion. In 1994, USAir announced it was suspending the payment of dividends. Consequently, prior to the end of 1994, Berkshire management concluded that an other-than-temporary decline in the value of USAir Preferred shares had arisen. The 1994 Consolidated Statement of Earnings includes a pre-tax charge of $268.5 million to reflect the decline.

While USAir returned to profitability during 1995, it continued the suspension of dividends until the second half of 1996 when dividend payments of $47 million were received. Such amount is included in the 1996 Consolidated Statement of Earnings under the caption "Interest, dividend and other investment income." An additional dividend payment of $30 million was received in January, 1997 and dividends of approximately $17 million remain in arrears.

Berkshire management has estimated the fair value of USAir Preferred shares to be $322.2 million at December 31, 1996. The increase of $232.7 million in the estimated fair value over the amount recorded at December 31, 1994, is included as a component of the increases during 1995 and 1996 in unrealized appreciation of investments.

Shown below are the amortized cost and estimated fair values of the above securities at December 31, 1996, by contractual maturity dates. Actual maturities will differ from contractual maturities because issuers of certain of the securities retain early call or prepayment rights. Amounts are in millions.

	Amortized Cost	*Estimated Fair Value*
Due in one year or less	$2,073.2	$2,085.0
Due after one year through five years	2,481.9	2,750.5
Due after five years through ten years	1,022.8	1,039.8
Due after ten years	149.2	152.3
	5,727.1	6,027.6
Mortgage-backed securities	415.2	419.3
	$6,142.3	$6,446.9

Notes to Consolidated Financial Statements *(Continued)*

(5) Investments in equity securities

Aggregate data with respect to the consolidated investment in equity securities are shown below (in millions):

December 31, 1996	Cost	*Unrealized Gains*	*Carrying Value ****
Common stock of:			
American Express Company [(a)]	$1,392.7	$ 1,401.6	$ 2,794.3
The Coca-Cola Company	1,298.9	9,226.1	10,525.0
The Walt Disney Company	1,533.2	183.6	1,716.8
Federal Home Loan Mortgage Corporation	449.7	1,323.1	1,772.8
The Gillette Company	600.0	3,132.0	3,732.0
McDonald's Corporation	1,265.3	103.1	1,368.4
Wells Fargo & Company	553.9	1,413.0	1,966.9
All other equity securities	2,058.3	1,816.1*	3,874.4
	$9,152.0	$18,598.6	$27,750.6

December 31, 1995	Cost	*Unrealized Gains*	*Carrying Value ****
Common stock of:			
American Express Company [(a)]	$1,392.7	$ 653.6	$ 2,046.3
Capital Cities/ABC, Inc. [(b)]	345.0	2,122.5	2,467.5
The Coca-Cola Company	1,298.9	6,126.1	7,425.0
Federal Home Loan Mortgage Corporation	260.1	783.9	1,044.0
GEICO Corporation [(c)]	1,175.8	—	1,175.8
The Gillette Company	600.0	1,902.0	2,502.0
Wells Fargo & Company	423.7	1,043.2	1,466.9
All other equity securities	1,680.0	1,210.1**	2,890.1
	$7,176.2	$13,841.4	$21,017.6

* *Represents gross unrealized gains $1,838.5 less gross unrealized losses $22.4.*

** *Represents gross unrealized gains $1,302.1 less gross unrealized losses $92.0.*

*** *Represents market value for all investments in equity securities except for GEICO Corporation. See footnote (c) which follows.*

(a) American Express Company

Common shares of American Express Company ("AXP") owned by Berkshire and its subsidiaries possessed approximately 10.5% of the voting rights of all AXP shares outstanding at December 31, 1996. The shares are held subject to various agreements with certain insurance and banking regulators which, among other things, prohibit Berkshire from (i) seeking representation on the Board of Directors of AXP (Berkshire may agree, if it so desires, at the request of management or the Board of Directors of AXP to have no more than one representative stand for election to the Board of Directors of AXP) and (ii) acquiring or retaining shares that would cause its ownership of AXP voting securities to equal or exceed 17% of the amount outstanding (should Berkshire have a representative on the board of directors, such amount is limited to 15%). In connection therewith, Berkshire has entered into an agreement with AXP which became effective when Berkshire's ownership interest in AXP voting securities reached 10% and will remain effective so long as Berkshire owns 5% or more of AXP's voting securities. The agreement obligates Berkshire, so long as Harvey Golub is chief executive officer of AXP, to vote its shares in accordance with the recommendations of AXP's Board of Directors. Additionally, subject to certain exceptions, Berkshire has agreed not to sell AXP common shares to any person who owns 5% or more of AXP voting securities or seeks to control AXP, without the consent of AXP.

(b) Capital Cities/ABC, Inc.

On January 4, 1996, shareholders of Capital Cities/ABC, Inc. ("Capital Cities") and The Walt Disney Company ("Disney") approved an agreement and plan of merger by and between Disney and Capital Cities. In March 1996, Berkshire received approximately 21 million shares of Disney common stock and $1.2 billion in cash in exchange for the common shares of Capital Cities.

(c) GEICO Corporation

The cost and carrying value of the investment in GEICO common stock as of December 31, 1995 represents Berkshire's cost plus its share of GEICO's undistributed accumulated earnings and unrealized appreciation on investments. See Notes 1(b) and 2 for additional information.

(6) **Realized investment gains (losses)**

Realized gains (losses) from sales and redemptions of investments are summarized below (in millions):

	1996	*1995*	*1994*
Equity securities —			
Gross realized gains	$2,379.1 *	$109.9	$185.7
Gross realized losses	(36.4)	(14.2)	(96.9)
Securities with fixed maturities and other investments —			
Gross realized gains	144.6	100.8	6.8
Gross realized losses	(3.2)	(2.4)	(4.3)
	$2,484.1	$194.1	$ 91.3

* *In March 1996 Disney completed its acquisition of Capital Cities. Subsidiaries of Berkshire received aggregate consideration $2.5 billion, which included cash of $1.2 billion and common shares of Disney with a value of $1.3 billion. Gross realized gains from sales of equity securities includes a gain of $2.2 billion relating to Disney's acquisition of Capital Cities.*

(7) **Finance businesses**

Berkshire's finance businesses are comprised of commercial and consumer finance companies and an annuity business. Assets and liabilities of Berkshire's finance businesses are summarized below (in millions):

	Dec. 31, 1996	*Dec. 31, 1995*
Assets		
Cash and cash equivalents	$ 10.5	$ 40.7
Installment loans and other receivables	215.9	185.9
Fixed maturity investments [(a)]	742.4	529.4
Other	0.1	0.7
	$968.9	$756.7
Liabilities		
Borrowings under investment agreements [(b)]	$281.8	$403.6
6 ¾% Notes, due 2001	99.5	—
8 ⅛% Notes, payable in 1996	—	120.0
Annuity reserves and policyholder liabilities	434.8	116.7
Other	35.3	44.9
	$851.4	$685.2

(a) *At December 31, 1996 and 1995, mortgage-backed securities of $601.6 and $336.0 respectively were included in this caption. Estimated fair values and gross unrealized gains and losses as of December 31, 1996 and 1995, are as follows (in millions):*

	Amortized Cost	*Gross Unrealized Gains*	*Gross Unrealized Losses*	*Estimated Fair Value*
1996	*$742.4*	*$25.2*	*$ (4.8)*	*$762.8*
1995	*529.4*	*29.0*	*(1.0)*	*557.4*

(b) *Borrowings under investment agreements are made pursuant to contracts with terms generally ranging from six months to thirty years and at fixed interest rates ranging from 4% to 7%. Payments of amounts outstanding at December 31, 1996, are expected to be required no earlier than as follows (in millions):*

1997	*1998*	*1999*	*2000*	*2001*	*After 2001*
$211.9	*$2.0*	*$3.3*	—	—	*$64.6*

Income from finance businesses for each of the past three years is summarized below (in millions):

	1996	1995	1994
Revenues			
Interest on loans	$ 38.8	$ 38.4	$ 37.4
Interest and dividend income	54.4	39.2	34.8
Annuity premiums earned	259.5	75.2	36.0
	352.7	152.8	108.2
Cost and expenses			
Interest expense	30.3	28.9	31.7
Annuity benefits and expenses	276.7	80.8	37.6
General and administrative expenses	20.4	16.5	14.0
	327.4	126.2	83.3
	$ 25.3	$ 26.6	$ 24.9

Notes to Consolidated Financial Statements *(Continued)*

(8) Unpaid losses and loss adjustment expenses

Supplemental data with respect to unpaid losses and loss adjustment expenses of property/casualty insurance subsidiaries (in millions):

	1996	1995	1994
Unpaid losses and loss adjustment expenses:			
Balance at beginning of year	$5,923.9*	$3,430.0	$3,155.9
Less ceded liabilities and deferred charges	645.0*	573.9	597.9
Net balance	5,278.9*	2,856.1	2,558.0
Incurred losses recorded:			
Current accident year	3,179.7	556.5	505.1
All prior accident years	(90.2)	55.5	60.2
Total incurred losses	3,089.5	612.0	565.3
Payments with respect to:			
Current accident year	1,484.9	43.6	50.9
All prior accident years	1,194.9	246.2	216.3
Total payments	2,679.8	289.8	267.2
Unpaid losses and loss adjustment expenses:			
Net balance at end of year	5,688.6	3,178.3	2,856.1
Plus ceded liabilities and deferred charges	585.8	520.3	573.9
Balance at end of year **	$6,274.4	$3,698.6	$3,430.0

* *Includes GEICO balances as of the acquisition date.*

** *Unpaid losses and loss adjustment expenses include liabilities established with respect to retroactive reinsurance contracts that provide for indemnification of insurance risk. These liabilities aggregated $1,263.6, $1,283.5, and $1,296.0 at December 31, 1996, 1995 and 1994 respectively. Related deferred charges were established with respect to these contracts and are reported as other assets. Also included in unpaid losses and loss adjustment expenses are discounted structured settlement reinsurance liabilities, which totalled $217.2, $221.7, and $231.3 at December 31, 1996, 1995 and 1994 respectively.*

Incurred losses "all prior accident years" reflects the amount of estimation error charged or credited to earnings in each year. In addition, this amount includes amortization of deferred charges re reinsurance assumed and accretion of discounted structured settlement liabilities. The use of estimates is inherent in the process of establishing unpaid losses and loss expenses. Additional information will be revealed over time and those estimates and assumptions will be revised resulting in gains or losses in the period made.

(9) Borrowings under investment agreements and other debt

Liabilities reflected for this balance sheet caption are as follows (in millions):

	Dec. 31, 1996	*Dec. 31, 1995*
Borrowings under investment agreements	$ 865.3	$ 878.9
1% Senior Exchangeable Notes Due 2001	454.6	—
Other debt	624.5	182.8
	$1,944.4	$1,061.7

Borrowings under investment agreements are made pursuant to contracts with terms generally ranging from three months to forty years and calling for interest payable, normally semiannually, at fixed rates ranging from 3% to 9% per annum. The borrowings are senior unsecured debt obligations of the Company.

On December 2, 1996, Berkshire received net proceeds of $447.1 million from the issuance of $500 million principal amount of 1% Senior Exchangeable Notes, due December 2, 2001 (the "Exchange Notes"). Under certain conditions, on the last trading day of January, April, July and October from January 1997 through July 2001, each $1,000 principal amount Exchange Note, is convertible at the option of the holder into 17.65 shares of Salomon Inc common stock ("Salomon Stock"). Upon such conversion, Berkshire, at its option, may elect to redeem the Exchange Notes for an equivalent cash value of the Salomon Stock. Beginning on December 2, 1999, under certain conditions, the Exchange Notes are convertible into 17.65 shares

(9) Borrowings under investment agreements and other debt *(Continued)*
of Salomon Stock at the option of the Company. Upon conversion, Berkshire may elect to redeem the Exchange Notes for an equivalent cash value of the Salomon Stock. In all other circumstances, Berkshire will pay the principal amount at maturity. At December 31, 1996, Berkshire subsidiaries owned common and preferred stock of Salomon possessing about 18% of the total voting power of that company.

No materially restrictive covenants are included in any of the various debt agreements. Payments of amounts outstanding at December 31, 1996, are expected to be required no earlier than as follows (in millions):

1997	1998	1999	2000	2001	After 2001
$130.8	$125.1	$ 54.3	$ 15.8	$474.0	$1,144.4

(10) Income taxes
The liability for income taxes as reflected in the accompanying Consolidated Balance Sheets represent estimates of liabilities as follows (in millions):

	Dec. 31, 1996	*Dec. 31, 1995*
Payable currently	$ (41.1)	$ 86.8
Deferred	6,878.7	4,762.7
	$6,837.6	$4,849.5

The Consolidated Statements of Earnings reflect charges for income taxes as shown below (in millions):

	1996	*1995*	*1994*
Federal	$1,169.9	$252.3	$138.1
State	26.1	22.6	22.1
Foreign	0.8	1.3	3.1
	$1,196.8	$276.2	$163.3
Current	$ 818.9	$331.0	$188.5
Deferred	377.9	(54.8)	(25.2)
	$1,196.8	$276.2	$163.3

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, 1996 and 1995, are shown below (in millions):

	1996	*1995*
Deferred tax liabilities:		
Relating to unrealized appreciation of investments	$6,620.6	$4,908.5
Other	860.9	157.0
	7,481.5	5,065.5
Deferred tax assets	(602.8)	(302.8)
Net deferred tax liability	$6,878.7	$4,762.7

Charges for income taxes are reconciled to hypothetical amounts computed at the federal statutory rate in the table shown below (in millions):

	1996	*1995*	*1994*
Net earnings before income taxes	$3,705.9	$1,084.4	$ 725.0
Hypothetical amounts applicable to above computed at the federal statutory rate	$1,297.1	$ 379.5	$ 253.8
Decreases, resulting from:			
Tax-exempt interest income	(41.7)	(10.6)	(14.6)
Dividends received deduction	(90.3)	(86.3)	(81.2)
Goodwill amortization	21.6	5.7	4.8
State income taxes, less federal income tax benefit	17.0	14.7	14.4
Other differences, net	(6.9)	(26.8)	(13.9)
Total income taxes	$1,196.8	$ 276.2	$ 163.3

Notes to Consolidated Financial Statements *(Continued)*

(11) Shareholders' equity accounts

Changes in capital accounts of the Company during the two years ended December 31, 1996, are shown in the table below. Dollar amounts are in millions, except per share amounts.

	Class A Common $5 Par Value		Class B Common $0.1667 Par Value		Capital in in Excess of Par Value	Class A Common in Treasury	
	Shares	Dollars	Shares	Dollars	Dollars	Shares	Dollars
Balance December 31, 1994 *	1,381,308	$6.9	—	—	$ 656.1	203,558	$37.6
Common stock issued in connection with acquisitions of businesses					345.6	(15,762)	(2.9)
Balance December 31, 1995	1,381,308	6.9	—	—	1,001.7	187,796	34.7
Common stock issued in connection with acquisitions of businesses			112,655	—	707.5	(17,728)	(3.3)
Common stock issued for cash			517,500	$0.1	564.9		
Conversions of Class A Common to Class B Common	(5,120)	—	153,600	—			
Balance December 31, 1996	1,376,188	$6.9	783,755	$0.1	$2,274.1	170,068	$31.4

* *There were no changes in the Company's capital accounts during 1994.*

On May 6, 1996, Berkshire shareholders approved a recapitalization plan which created a new class of common stock, designated as Class B Common Stock. In connection therewith, Berkshire's then existing common stock was redesignated as Class A Common Stock. Each share of Class A Common Stock is convertible, at the option of the holder, into thirty shares of Class B Common Stock. Class B Common Stock is not convertible into Class A Common Stock.

On May 8, 1996, Berkshire completed an initial public offering of 517,500 shares of Class B Common Stock. Berkshire received net proceeds from the offering of $565.0 million. Since the Class B Common shares are equivalent to one-thirtieth (1/30) of the economic rights of Class A Common shares, the issuance of the Class B Common Stock was equivalent to the issuance of 17,250 Class A Common shares or approximately 1.4% of Class A Common shares outstanding at the time of the issuance of Class B Common shares.

Changes in unrealized appreciation of investments, net during the three years ended December 31, 1996 were as follows, in millions:

	Year ending December 31,		
	1996	1995	1994
Balance at beginning of year	$ 9,220.7	$ 5,276.9	$ 4,318.6
Increase in unrealized appreciation included in carrying value of investments	4,604.0	6,177.1	1,486.5
Increase in deemed applicable deferred income taxes	(1,629.1)	(2,176.2)	(518.3)
Increase in minority interest in unrealized appreciation	(51.7)	(57.1)	(9.9)
Balance at end of year	$12,143.9	$ 9,220.7	$ 5,276.9

Changes in retained earnings during the three years ended December 31, 1996 were as follows, in millions:

	Year ending December 31,		
	1996	1995	1994
Balance at beginning of year	$ 6,544.1	$ 5,749.2	$ 5,196.2
Net earnings	2,488.6	794.9	553.0
Balance at end of year	$ 9,032.7	$ 6,544.1	$ 5,749.2

(12) Dividend restrictions - Insurance subsidiaries

Payments of dividends by Insurance Group members are restricted by insurance statutes and regulations. Without prior regulatory approval in 1997, Berkshire can receive up to approximately $2.5 billion as dividends from insurance subsidiaries.

Combined shareholders' equity of insurance subsidiaries determined pursuant to statutory accounting rules (Statutory Surplus as Regards Policyholders) was approximately $26.1 billion at December 31, 1996. This amount exceeded by approximately $5.2 billion the corresponding amount determined on the basis of generally accepted accounting principles; the difference principally represents deferred income tax assets and liabilities and deferred charges re reinsurance assumed recognized for financial reporting purposes but not for statutory reporting purposes.

(13) Fair values of financial instruments

Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" ("SFAS 107"), requires certain fair value disclosures. Fair value disclosures are required for most investment securities as well as other contractual assets and liabilities. Certain financial instruments, including insurance contracts, were excluded from SFAS 107 disclosure requirements due to perceived difficulties in measuring fair value. Accordingly, an estimation of fair value was not made with respect to unpaid losses and loss adjustment expenses.

In determining fair value, the Company used quoted market prices when available. For instruments where quoted market prices were not available, the Company used independent pricing services or appraisals by the Company's management. Those services and appraisals reflected the estimated present values utilizing current risk adjusted market rates of similar instruments.

Considerable judgement is necessarily required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

The carrying values of cash and cash equivalents, receivables and accounts payable, accruals and other liabilities are deemed to be reasonable estimates of their fair values. The estimated fair values of the Company's other financial instruments as of December 31, 1996 and 1995, are as follows (in millions):

	Carrying Value		Estimated Fair Value	
	1996	1995	1996	1995
Investments in securities with fixed maturities	$ 6,446.9	$ 1,423.2	$ 6,446.9	$ 1,423.2
Investments in equity securities	27,750.6	21,017.6	27,750.6	22,235.0
Assets of finance businesses	968.9	756.7	997.8	792.3
Borrowings under investment agreements and other debt	1,944.4	1,061.7	1,937.9	1,095.0
Liabilities of finance businesses	851.4	685.2	852.0	704.4

(14) 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 millions, except per share amounts.

1996	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues	$ 4,139.7	$ 1,914.8	$ 2,015.3	$ 2,430.5
Earnings:				
Excluding realized investment gain	$ 160.2	$ 193.7	$ 201.4	$ 328.1
Realized investment gain (loss)	1,508.5*	(2.5)	62.6	36.6
Net earnings	$ 1,668.7	$ 191.2	$ 264.0	$ 364.7
Earnings per equivalent Class A common share:				
Excluding realized investment gain	$ 134.23	$ 160.91	$ 166.34	$ 270.52
Realized investment gain (loss)	1,263.92*	(2.08)	51.70	30.17
Net earnings	$1,398.15	$ 158.83	$ 218.04	$ 300.69

* *Includes $1.4 billion ($1,143.68/share), net of taxes, related to gain arising from The Walt Disney Company's acquisition of Capital Cities/ABC, Inc. See Notes 5 and 6.*

1995	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues	$ 944.0	$ 1,018.4	$ 1,107.2	$ 1,493.7
Earnings:				
Excluding realized investment gain	$ 143.9	$ 140.3	$ 151.3	$ 234.4
Realized investment gain (loss)	(4.7)	51.7	43.2	34.8
Net earnings	$ 139.2	$ 192.0	$ 194.5	$ 269.2
Earnings per equivalent Class A common share:				
Excluding realized investment gain	$ 122.22	$ 118.54	$ 126.78	$ 196.56
Realized investment gain (loss)	(4.03)	43.71	36.18	29.16
Net earnings	$ 118.19	$ 162.25	$ 162.96	$ 225.72

Notes to Consolidated Financial Statements *(Continued)*

(15) Business Segment Data

Berkshire identified seven business segments for purposes of 1996 reporting pursuant to Statement of Financial Accounting Standards No. 14. These include the property and casualty insurance business (The Insurance Segment) conducted on both a direct and reinsurance basis through a number of subsidiaries. Included in this segment is GEICO Corporation, the seventh largest auto insurer in the United States and National Indemnity Company, one of the world's leading providers of catastrophe excess of loss reinsurance. Berkshire's six separately conducted non-insurance business segments are as follows:

Business identity and headquarters	Segment	Activity
See's Candies South San Francisco, CA	Candy	Manufacture and distribution at retail and by catalog solicitation
World Book Chicago, IL	Encyclopedias and other reference materials	Publication and marketing, principally by the direct sales method
Kirby, Douglas and Cleveland Wood Divisions of The Scott Fetzer Company Cleveland, OH	Home cleaning systems	Manufacture and sale principally to distributors
Nebraska Furniture Mart and R.C. Willey Home Furnishings Omaha, NE and Salt Lake City, UT	Home furnishings	Retailing
Buffalo News Buffalo, NY	Newspaper	Publication of a daily and Sunday newspaper
H. H. Brown Shoe Co., Lowell Shoe, Inc. and Dexter Shoe Companies Greenwich, CT, Hudson, NH and Dexter, ME	Shoes	Manufacture, importing and distribution at wholesale and retail

The business segments identified above were responsible in 1996 for 86% of Berkshire's consolidated revenues. Other businesses activities that contributed for 1996, in the aggregate, 11% of Berkshire's consolidated revenues, were as follows:

Business identity	Product/Service/Activity
Adalet - PLM	Explosion proof electrical enclosures, cable couplers and terminations
BHR	Real estate management
Berkshire Hathaway Credit Corporation	Commercial financing
Berkshire Hathaway Life Insurance Co.	Annuities
Blue Chip Stamps	Marketing motivational services
Borsheim's	Retailing fine jewelry
Campbell Hausfeld	Air compressors, air tools, painting systems, pressure washers, welders and generators
Carefree	Comfort and convenience products for the recreational vehicle industry
Fechheimer Bros. Co.	Uniforms and accessories
FlightSafety International	High technology training to operators of aircraft and ships
France	Appliance controls; ignition and sign transformers
Halex	Zinc die cast conduit fittings and other electrical construction materials
Helzberg's Diamond Shops	Retailing fine jewelry
Meriam	Pressure and flow measurement devices
Northland	Fractional horsepower electric motors
Powerwinch	Marine and general purpose winches, windlasses, and hoists
Precision Steel Products	Steel service center
Quikut	Cutlery for home and sporting goods markets
ScottCare	Cardiopulmonary rehabilitation and monitoring equipment
Scott Fetzer Financial Group	Commercial and consumer finance companies
Scot Labs	Cleaning and maintenance chemicals
Stahl	Custom service bodies, flatbed bodies, cranes and tool boxes for trucks
Wayne	Furnace burners; sump, utility and sewage pumps
Wesco Financial	Real estate management
Western Enterprises	Medical and industrial compressed gas fittings and regulators
Western Plastics	Molded plastic components

(15) Business Segment Data *(Continued)*

A disaggregation of Berkshire's consolidated data for each of the three most recent years is presented in the tables which follow on this and the following page. Amounts are in millions.

	Revenues			Operating profit before taxes		
	1996	*1995*	*1994*	*1996*	*1995*	*1994*
Identified Segments:						
Insurance	$ 7,133.1	$1,715.7	$1,499.8	$3,189.6	$ 776.5	$ 702.0
Non-insurance businesses	1,922.9	1,775.1	1,620.7	267.2	233.2	261.9
	9,056.0	3,490.8	3,120.5	3,456.8	1,009.7	963.9
Other than identified segments	1,444.3	1,072.5	789.8	342.1	130.7	(178.8)**
Interest expense *				(93.0)	(56.0)	(60.1)
Aggregate consolidated total	$10,500.3	$4,563.3	$3,910.3	$3,705.9	$1,084.4	$ 725.0

* *Amounts of interest expense represent those for borrowings under investment agreements and other debt exclusive of that of finance businesses and interest allocated to certain identified segments.*

** *Includes pre-tax charge of $268.5 million representing an other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock.*

Insurance Segment	Revenues			Operating profit before taxes		
	1996	*1995*	*1994*	*1996*	*1995*	*1994*
Premiums earned: *						
Direct	$3,432.9	$ 287.3	$ 281.1			
Reinsurance assumed	764.0	718.4	688.5			
Reinsurance ceded	(79.1)	(48.2)	(46.4)			
	4,117.8	957.5	923.2			
Underwriting				$ 230.7	$ 19.6	$ 129.0
Goodwill amortization				(42.6)	—	—
Investment income	725.9	577.1	484.6	712.1	575.8	481.0
Realized investment gain	2,289.4	181.1	92.0	2,289.4	181.1	92.0
	$7,133.1	$1,715.7	$1,499.8	$3,189.6	$ 776.5	$ 702.0

* *Premiums written were as follows:*

	1996	*1995*	*1994*
Direct	*$3,465.4*	*$ 294.8*	*$ 271.2*
Reinsurance assumed	*722.7*	*777.9*	*689.9*
Reinsurance ceded	*(82.9)*	*(48.5)*	*(45.6)*
	$4,105.2	*$1,024.2*	*$ 915.5*

Non-Insurance Business Segments	Revenues			Operating profit before taxes		
	1996	*1995*	*1994*	*1996*	*1995*	*1994*
Candy	$ 248.9	$ 233.6	$ 216.1	$ 50.9	$ 49.3	$ 46.6
Encyclopedias, other reference material	119.0	157.9	191.3	10.3	7.4	24.4
Home cleaning systems	253.7	235.6	207.6	62.5	52.6	43.9
Home furnishings	586.6	428.1	245.4	41.0	28.1	16.9
Newspaper	154.2	154.8	150.9	49.8	46.3	53.7
Shoes	560.5	565.1	609.4	52.7	49.5	76.4
	$1,922.9	$1,775.1	$1,620.7	$ 267.2	$ 233.2	$ 261.9

Notes to Consolidated Financial Statements *(Continued)*

(15) Business Segment Data *(Continued)*

Other Than Identified Segments	Revenues 1996	Revenues 1995	Revenues 1994	Operating profit before taxes 1996	Operating profit before taxes 1995	Operating profit before taxes 1994
Other businesses	$1,195.6	$1,021.7	$758.5	$108.5	$ 93.8	$ 72.7
Not identified with specific businesses:						
Interest and dividend income	54.0	37.8	32.0	54.0	37.8	32.0
Realized investment gain (loss)	194.7	13.0	(0.7)	194.7	13.0	(0.7)
All other except interest expense				(15.1)	(13.9)	(282.8)*
	$1,444.3	$1,072.5	$789.8	$342.1	$130.7	$(178.8)

* *Includes pre-tax charge of $268.5 million representing an other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock.*

	Capital expenditures * 1996	Capital expenditures * 1995	Capital expenditures * 1994	Deprec. & amort. of tangible assets 1996	Deprec. & amort. of tangible assets 1995	Deprec. & amort. of tangible assets 1994
Insurance	$12.2	$ 1.2	$ 0.9	$26.3	$ 0.9	$ 0.9
Candy	5.3	5.1	4.1	4.5	4.1	4.1
Encyclopedias, other reference material	—	—	0.1	0.4	1.0	1.4
Home cleaning systems	2.0	0.3	1.0	2.7	3.0	4.2
Home furnishings	21.6	9.2	22.6	10.0	9.7	6.2
Newspaper	1.0	1.8	5.2	2.8	4.9	2.2
Shoes	12.8	13.7	17.9	13.4	12.0	10.2
Other	26.9	22.9	15.3	27.6	24.7	20.4
	$81.8	$54.2	$67.1	$87.7	$60.3	$49.6

* *Excludes expenditures which were part of business acquisitions.*

	Identifiable assets at year-end 1996	Identifiable assets at year-end 1995	Identifiable assets at year-end 1994
Insurance	$36,597.8	$25,280.0	$17,765.6
Candy	74.1	74.5	69.4
Encyclopedias, other reference material	69.8	71.8	75.9
Home cleaning systems	44.3	42.9	42.1
Home furnishings	445.8	427.7	128.4
Newspaper	42.0	45.0	48.4
Shoes	624.4	656.7	672.7
Other	5,511.3	2,112.8	1,807.1
	$43,409.5	$28,711.4	$20,609.6

(16) Supplemental cash flow information

A summary of supplemental cash flow information is presented in the following table (in millions):

	1996	1995	1994
Cash paid during the year for:			
Income taxes	$ 965.9	$ 294.6	$ 411.1
Interest	129.4	83.9	90.6
Non-cash investing and financing activities:			
Liabilities assumed in connection with acquisitions of businesses	4,172.1	248.0	—
Common shares issued in connection with acquisitions of businesses	710.8	348.5	—
Fair value of investments acquired as part of exchanges and conversions	1,618.6	—	—

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 after deducting minority interests and taxes.

	(dollars in millions)		
	1996	1995	1994
Insurance segment, except realized gain	$ 689.6	$ 496.4	$ 487.3
Non-Insurance business segments	163.2	139.4	159.4
Other businesses	63.3	52.0	42.8
Interest expense	(55.7)	(34.9)	(37.3)
Other	23.0	17.0	12.3
Earnings before realized gains and non-recurring charge	883.4	669.9	664.5
Realized gain	1,605.2	125.0	61.1
Non-recurring charge	—	—	(172.6)*
Net earnings	$2,488.6	$ 794.9	$ 553.0

* *As described in Note 4 to the Consolidated Financial Statements, during 1994 the Company recorded a pre-tax charge of $268.5 million ($172.6 million after-tax) as a result of recognizing an other-than-temporary decline in the value of its investment in USAir Group, Inc. Preferred Stock.*

The business segment data (Note 15 to the Consolidated Financial Statements) should be read in conjunction with this discussion.

Insurance Segment

A summary follows of results to Berkshire from the insurance segment for the past three years.

	(dollars in millions)		
	1996	1995	1994
Premiums earned from:			
Direct insurance	$3,360.3	$ 239.9	$ 234.8
Reinsurance assumed	757.5	717.6	688.4
	$4,117.8	$ 957.5	$ 923.2
Underwriting gain (loss) attributable to:			
Direct insurance	$ 238.5	$ 40.6	$ 48.3
Reinsurance assumed	(7.8)	(21.0)	80.7
	230.7	19.6	129.0
Net investment income	712.1	575.8	481.0
Goodwill amortization	(42.6)*	—	—
Pre-tax earnings	900.2	595.4	610.0
Income taxes	203.3	92.0	117.2
Minority interest	7.3	7.0	5.5
Net earnings from insurance, except realized gain	$ 689.6	$ 496.4	$ 487.3

* *Virtually all of the goodwill amortization relates to the amortization of goodwill that arose in connection with the GEICO merger.*

The Berkshire Hathaway Insurance Group engages in both direct insurance and reinsurance of property and casualty risks. In direct insurance activities, Insurance Group members assume defined portions of the risks of loss from persons or organizations that are directly subject to the risks. In reinsurance assumed activities, Insurance Group members assume defined portions of similar or dissimilar risks to that other insurers or reinsurers have subjected themselves in their own insuring activities.

In January 1996, Berkshire acquired control of GEICO Corporation ("GEICO"). The inclusion of the accounts of GEICO dramatically affects the operating results of the Insurance Group.

Management's Discussion *(continued)*

Insurance Segment (continued)

A significant marketing strategy followed by all Insurance Group members is the maintenance of extraordinary capital strength. Statutory surplus as regards policyholders of the Insurance Group increased to approximately $26.1 billion at December 31, 1996. This superior capital strength creates opportunities for Insurance Group members to negotiate and enter into contracts of insurance specially designed to meet unique needs of sophisticated insurance and reinsurance buyers.

For purposes of this Discussion, premiums and losses and loss expenses are stated net of reinsurance ceded.

Direct Insurance Underwriting

A summary follows of the combined underwriting results, stated on the basis of generally accepted accounting principles ("GAAP") of Berkshire's direct insurance businesses.

	(dollars are in millions)					
	1996		1995		1994	
	Amount	%	Amount	%	Amount	%
Premiums written	$3,389.7		$ 247.2		$ 225.7	
Premiums earned	$3,360.3	100.0	$ 239.9	100.0	$ 234.8	100.0
Losses and loss expenses	2,516.6	74.9	90.0	37.5	88.4	37.6
Underwriting expenses	605.2	18.0	109.3	45.6	98.1	41.8
Total losses and expenses	3,121.8	92.9	199.3	83.1	186.5	79.4
Underwriting gain — pre-tax	$ 238.5		$ 40.6		$ 48.3	

As previously indicated, the net underwriting results from direct insurance in 1996 include the results of GEICO. Through its subsidiaries, GEICO provides primarily private passenger automobile coverages to insureds in 48 states and the District of Columbia. GEICO policies are marketed mainly by direct response methods in which customers apply for coverage directly to the company over the telephone or through the mail. This is a significant element in GEICO's strategy to be a low-cost provider of such coverages. In previous years, a relatively small percentage of GEICO's insurance business derived from homeowner's and other non-automobile insurance coverages. In 1995, GEICO entered into an agreement with another major insurance provider that over time will allow it to effectively exit the homeowner's insurance business.

GEICO's underwriting results for 1996 are summarized below. Amounts for 1995 are shown for comparative purposes, although such amounts are not included in Berkshire's Consolidated Financial Statements.

	(dollars are in millions)			
	1996		1995	
	Amount	%	Amount	%
Premiums earned	$ 3,091.6	100.0	$ 2,787.0	100.0
Losses and loss expenses	2,424.9	78.4	2,254.2	80.9
Underwriting expenses	486.7	15.8	440.7	15.8
Total losses and expenses	2,911.6	94.2	2,694.9	96.7
Underwriting gain — pre-tax	$ 180.0		$ 92.1	

Premiums earned in 1996 were $3,091.6 million, up 10.9% from $2,787.0 million in 1995. Premium growth for voluntary auto business was 15.3%, reflecting a 10.1% increase in policies-in-force during the year, changes in the mix of business and very modest rate increases. This growth was partially offset by declines in premiums for residual market auto (unprofitable business assigned to insurers by state regulators that insurers normally would not voluntarily accept) and homeowners insurance business.

Policy growth over the last year was 7.3% in the preferred-risk auto market and 33.5% in the standard and nonstandard auto lines as efforts have been expanded to offer a rate quote to potential customers who do not meet GEICO's preferred-risk underwriting guidelines. Voluntary auto new business sales increased 33.8% over 1995.

Insurance Segment (continued)

Direct Insurance Underwriting (continued)

Losses and loss expenses incurred increased 7.6% to $2,424.9 million in 1996. The loss and loss expense ratio, which measures the portion of premiums earned, paid or reserved for losses and related claims handling expenses, was 78.4% in 1996 compared to 80.9% a year ago. The lower ratio reflects a flattening of average severity trends for auto liability coverages. Underwriting expenses increased 10.4% in 1996 to $486.7 million. The increase reflects additional advertising and other costs related to new business growth.

Berkshire's other direct insurance businesses include National Indemnity Company's traditional motor vehicle business and professional liability/specialty risk operations; five companies referred to as "homestate" operations that principally provide coverages to residents of their home states or branch operations; Central States Indemnity Company, a provider of credit-card credit insurance to individuals through financial institutions; and Kansas Bankers Surety Company, which Berkshire acquired in July 1996, and which is an insurer for primarily small and medium sized banks located in the midwest.

Collectively, these direct insurance businesses produced earned premiums of $268.7 million in 1996, $239.9 million in 1995 and $234.8 million in 1994. Net underwriting gains of these businesses were $58.5 million in 1996, $40.6 million in 1995 and $48.3 million in 1994. The increases in premium volume in recent years have been achieved primarily by the credit-card credit, "homestate," and specialty risk insurance businesses offset by declines in the traditional motor vehicle business. Nearly all of these direct insurance businesses produced net underwriting gains in each of the past three years. However, the net underwriting gains were primarily recorded by the traditional motor vehicle, specialty risk and credit-card credit businesses.

Reinsurance Assumed

Underwriting results for the past three years, stated on a "GAAP" basis with respect to the reinsurance assumed business, are summarized in the following table.

	(dollars in millions)					
	1996		1995		1994	
	Amount	%	Amount	%	Amount	%
Premiums written	$ 715.5		$ 777.0		$ 689.8	
Premiums earned	$ 757.5	100.0	$ 717.6	100.0	$ 688.4	100.0
Losses and loss expenses	572.9	75.6	522.0	72.7	476.9	69.3
Underwriting expenses	192.4	25.4	216.6	30.2	130.8	19.0
Total losses and expenses	765.3	101.0	738.6	102.9	607.7	88.3
Underwriting gain (loss) — pre-tax	$ (7.8)		$ (21.0)		$ 80.7	

Reinsurance premiums earned from catastrophe excess-of-loss policies were $268.0 million in 1996, $260.0 million in 1995 and $447.1 million in 1994. Net underwriting gains from catastrophe policies were $167.0 million in 1996, $152.1 million in 1995 and $240.4 million in 1994. Over the past three years, the only significant catastrophe loss sustained by the Insurance Group resulted from the 1994 earthquake in Northridge, California. As of December 31, 1996, the estimated aggregate claim losses to the Insurance Group from that event were approximately $155 million.

The net underwriting gains earned over the most recent three years from this business should not be considered predictive of future results. Insurance Group members continue to offer and accept catastrophe reinsurance policies that subject the Insurance Group to substantial risk of loss. For instance, in late 1996, the Insurance Group agreed to provide aggregate reinsurance protection of about $1 billion to the newly formed California Earthquake Authority ("CEA"). The coverage will be called upon if the CEA incurs aggregate earthquake losses in excess of about $5 billion during the four year period ending March 31, 2001.

Berkshire's management believes that, eventually, a future catastrophic event will result in a significant loss to the Insurance Group, although the timing and magnitude of loss cannot be predicted. Thus, the periodic underwriting results are subject to extreme volatility. Berkshire's management is willing to accept such volatility, provided there is a reasonable prospect of long-term profitability.

Insurance Segment (continued)

Reinsurance Assumed (continued)

Premiums earned from other property and casualty excess-of-loss and quota-share policies totaled $489.5 million in 1996, $457.6 million in 1995 and $241.3 million in 1994. These policies produced net underwriting losses of $101.0 million in 1996, $97.7 million in 1995 and $82.0 million in 1994. Premiums for non-catastrophe contracts are often based, in part, on time discounting of estimated losses because of assumptions that the reinsurer will not be required to pay for losses under the contracts for extended periods of time. Reserves for unpaid losses and loss expenses are established for financial reporting purposes without recognition of such discounting, thus producing net underwriting losses. Berkshire accepts this business, nevertheless, because of the large amounts of investable policyholder funds (or "float") that it produces.

In addition, underwriting losses from retroactive reinsurance contracts — excess of loss coverage of past loss events — and structured settlement reinsurance providing periodic payments to claimants with respect to settled claims aggregated $73.8 million in 1996, $75.4 million in 1995 and $77.7 million in 1994. Most of these contracts were entered into several years ago and the related losses are expected to be paid over extended time periods. The underwriting losses reflect the recurring recognition of time-value-of-money concepts — accretion of discounted structured settlement liabilities and amortization of deferred charges re reinsurance assumed. The amortization and accretion charges are reported as losses incurred and, because there is no related premium income, as net underwriting losses. See Notes to the Consolidated Financial Statements for more information concerning these charges.

Insurance Segment Investment Income

Following is a summary of Insurance Group net investment income for the past three years.

	(dollars in millions)		
	1996	1995	1994
Investment income before taxes	$ 712.1	$ 575.8	$ 481.0
Applicable income taxes	122.6	84.8	68.9
Applicable minority interest	5.7	5.0	4.7
Investment income after taxes and minority interest	$ 583.8	$ 486.0	$ 407.4

Investment income of the Insurance Group for 1995 and 1994 has been restated to account for the Group's investment in GEICO under the equity method. (See Notes 1 and 2 to the Consolidated Financial Statements.) Accordingly, restated investment income before taxes of the Insurance Group for 1995 and 1994 includes $112.6 million and $97.1 million, respectively, reflecting the Group's equity in the net income of GEICO less a charge for related goodwill amortization. In addition, the Insurance Group's investment income before taxes for 1995 and 1994 includes its share of the net earnings or losses with respect to its investment in common stock of Salomon Inc. For 1995, the Group's equity in net earnings of Salomon was $16.9 million compared to a loss of $32.9 million for 1994. During 1995 when Berkshire's ownership of Salomon dropped below 20 percent of the total voting rights of that company, the Group discontinued applying the equity method.

Investment income excluding the aforementioned equity method amounts was $712.1 million in 1996, $446.3 million in 1995 and $416.8 million in 1994. Investment income in 1996 includes $227.2 million from the consolidation of the investment results of GEICO. The Insurance Group members continue to generate significant levels of investment income, reflecting large amounts of invested assets. Increases in invested assets derive from reinvested earnings and additional capital contributed to the Insurance Group — approximately $3.3 billion over the past three years and increases in the amount of "float," an approximation of the net policyholder funds held. "Float" represents the sum of unpaid losses and loss adjustment expenses, unearned premiums and other liabilities to policyholders less the aggregate of premiums receivable, reinsurance balances receivable, deferred acquisition costs, deferred charges re reinsurance assumed and prepaid income taxes. The acquisition of GEICO increased float by $2.6 billion and at December 31, 1996, total float approximated $6.9 billion.

Insurance Segment Investment Income (continued)

Income tax expense related to investment income, as a percentage of investment income before taxes was 17.2% in 1996, 14.7% in 1995 and 14.3% in 1994. Investment income in each of these years includes substantial amounts of interest on municipal obligations and dividends from equity investments that are effectively taxed at rates below the full statutory federal rate.

Non-Insurance Business Segments

A summary follows of results to Berkshire from these identified business segments for the past three years.

	(dollars in millions)					
	1996		1995		1994	
	Amount	%	Amount	%	Amount	%
Revenues	$1,922.9	100.0	$ 1,775.1	100.0	$1,620.7	100.0
Cost and expenses	1,655.7	86.1	1,541.9	86.9	1,358.8	83.9
Operating profit	267.2	13.9	233.2	13.1	261.9	16.1
Income taxes	101.6	5.3	91.8	5.2	100.3	6.2
Minority Interest	2.4	0.1	2.0	0.1	2.2	0.1
Contribution to net earnings	$ 163.2	8.5	$ 139.4	7.8	$ 159.4	9.8

A comparison of revenues and operating profits between 1996, 1995 and 1994 for each of the six identifiable non-insurance business segments follows.

	(dollars in millions) Revenues			(dollars in millions) Operating Profits			Operating Profit as a % of Revenues		
Segment	1996	1995	1994	1996	1995	1994	1996	1995	1994
Candy	$ 248.9	$ 233.6	$ 216.1	$ 50.9	$ 49.3	$ 46.6	20.4	21.1	21.6
Encyclopedias, other reference materials	119.0	157.9	191.3	10.3	7.4	24.4	8.7	4.7	12.8
Home cleaning systems	253.7	235.6	207.6	62.5	52.6	43.9	24.6	22.3	21.1
Home furnishings	586.6	428.1	245.4	41.0	28.1	16.9	7.0	6.6	6.9
Newspaper	154.2	154.8	150.9	49.8	46.3	53.7	32.3	29.9	35.6
Shoes	560.5	565.1	609.4	52.7	49.5	76.4	9.4	8.8	12.5
	$1,922.9	$1,775.1	$1,620.7	$267.2	$233.2	$261.9			

1996 compared to 1995

Revenues from the six identifiable non-insurance business segments of $1,922.9 million increased $147.8 million (8.3%) from the prior year. The overall operating profit from these business segments of $267.2 million increased $34.0 million (14.6%). The following is a discussion of significant matters impacting comparative results for each of the non-insurance business segments.

Candy

Revenues of the candy segment increased $15.3 million (6.5%) over comparable prior year amounts. Total pounds of candy sold increased about 4.3%. Substantially all of the volume increase arose from *See's* quantity order, mail order and licensee programs. Pounds sold during 1996 from quantity order and mail order programs increased about 10% over 1995's volume. Operating profits increased $1.6 million (3.3%) over comparable prior year amounts. Somewhat offsetting the favorable impact on profits of increased volume were increased raw material and payroll costs.

Management's Discussion *(continued)*

Non-Insurance Business Segments (continued)

1996 compared to 1995 (continued)

Encyclopedias, Other Reference Materials

Revenues of this segment declined $38.9 million (24.6%) from 1995. The decline continues the trend of reduced sales of printed encyclopedias (*World Book* and *Childcraft*) that began in 1989 when this segment's revenues were in excess of $300 million. Operating profits increased $2.9 million (39.2%) over the comparable prior year amount. During 1996, *World Book* incurred about $5 million of costs in connection with the development of a new CD-ROM product which was introduced in association with IBM in early 1997. In spite of the reduced volume of printed encyclopedia sales and the costs incurred in connection with the new CD-ROM product, operating profits increased in 1996. This achievement was directly related to *World Book* revamping its distribution methods and the successful implementation of cost cutting measures that have significantly reduced fixed costs. While it's too early to assess the impact of the new CD-ROM product, management believes it is taking appropriate measures to assure that *World Book* remains a viable business in both the print and electronic marketplace.

Home Cleaning Systems

Revenues of the home cleaning systems segment (which consists of products sold principally under the *Kirby* name) increased $18.1 million (7.7%) and operating profits increased $9.9 million (18.8%) over comparable prior year amounts. Unit sales volume in foreign markets, which comprise about 27% of total volume, increased about 28%. The significant growth in foreign sales resulted from entering new markets and increased penetration in existing markets. *Kirby* will be introducing a new model both domestically and in foreign markets in 1997. Management expects continued successful results from this segment's businesses.

Home Furnishings

Revenues from this segment increased in 1996 by $158.5 million (37.0%) over the prior year. Substantially all of the revenue increase related to the acquisition on June 29, 1995 of R.C. Willey Home Furnishings ("*R.C. Willey*"). *R.C. Willey*, through its seven retail locations, is the dominant retailer of home furnishings in Utah. Operating profits of $41.0 million were $12.9 million (45.9%) greater in 1996 than in the prior year. *R.C. Willey's* inclusion in this segment's results for a full year in 1996 versus six months in 1995 accounts for about two-thirds of the comparative increase. The remainder of the increase arose primarily from improved margins at Nebraska Furniture Mart.

Newspaper

Operating profits during 1996 of $49.8 million increased $3.5 million (7.6%) over the comparable 1995 amount. These results were obtained in spite of total revenues being slightly lower. In 1995, the cost of newsprint increased dramatically and negatively impacted results. While newsprint costs continued to rise early in 1996, during the second half of 1996 this trend reversed sharply and there were significant price reductions. As a result, 1996's full year newsprint costs were slightly less than comparable 1995 costs. Also favorably impacting the improved comparative results was that during 1995 special one-time charges were recorded to accrue the costs of buying out the contracts of a number of composing room employees, and adjustments were recorded reflecting changes in the periods over which certain data handling and electronic equipment were being depreciated. Excluding 1995's special charges, operating profits were relatively unchanged in 1996 as compared to 1995.

Shoes

Revenues for this segment were down slightly in 1996 as compared to 1995. Operating profits of $52.7 million increased $3.2 million (6.5%). This segment includes H. H. Brown Shoe Company, Inc., Lowell Shoe, Inc. and Dexter Shoe Companies. These businesses, acquired by Berkshire between 1991 and 1993, manufacture and distribute work, dress, casual and athletic footwear. In addition, over 90 retail shoe stores are included in this segment. Management was successful during 1996 in capitalizing on opportunities to more successfully market and distribute the functional footwear products manufactured and distributed by these businesses. Additionally, measures were undertaken that resulted in lowering production and administrative costs. Accordingly, management anticipates further operating profit increases during 1997.

Non-Insurance Business Segments (continued)

<u>*1995 compared to 1994*</u>

Revenues from the non-insurance business segments increased $154.4 million (9.5%) in 1995 as compared to 1994. The most significant revenue increase arose in the "home furnishings" segment where revenues increased $182.7 million (74.4%) over the comparable prior year figures. The acquisition of *R.C. Willey* in mid-1995 accounts for a substantial portion of the comparative revenue increase for this segment. Offsetting this increase were declines in the "encyclopedia, other reference materials" segment and the "shoes" segment. The decline in the "encyclopedias, other reference material" segment was a result of the continuation of a reduction in printed encyclopedia sales. The unfavorable results of the "shoe" segment was consistent with results reported for the entire footwear industry (except for athletic footwear). Operating profits of $233.2 million during 1995 declined $28.7 million (10.9%) from the comparable 1994 amount. Declines from the "encyclopedia, other reference material" and "shoes" segment more than account for the comparative decline.

Business Other Than Identified Segments

	(dollars in millions)		
	1996	1995	1994
Revenues	$1,195.6	$1,021.7	$758.5
Operating profits	$ 108.5	$ 93.8	$ 72.7
Income taxes	43.2	39.5	28.0
Minority interest	2.0	2.3	1.9
Contribution to net earnings	$ 63.3	$ 52.0	$ 42.8

The above represent aggregate data for businesses that numbered 26 in 1996. Revenues from businesses not identified with specific business segments increased by $173.9 million (17.0%) in 1996 as compared to the prior year. Operating profits from this group of businesses increased by $14.7 million (15.7%) in 1996 versus the prior year. The increase in revenues was due primarily to the inclusion of Helzberg's Diamond Shops for a full year in 1996 versus eight months in 1995. Also, several of Scott Fetzer's diversified manufacturing businesses (including Campbell Hausfeld products and Wayne pumps) had significant comparative revenue increases.

Interest Expense and Other

As previously discussed, effective January 2, 1996, the results of GEICO are included in Berkshire's consolidated results. Berkshire's investment in GEICO for years prior to 1996 has been accounted for under the equity method. After-tax interest expense for 1996 includes about $18.5 million of interest costs related to GEICO borrowings that were outstanding at the time of the GEICO merger. Excluding costs related to these borrowings, interest costs were relatively unchanged between years.

Other earnings consist primarily of investment income of Berkshire and its non-insurance subsidiaries offset by Berkshire's corporate costs (including charges related to Berkshire's shareholder designated contribution program). The increase in 1996 as compared to 1995 primarily relates to an increase in interest income earned by Berkshire.

Realized Investment Gain

Realized investment gain has been a recurring element in Berkshire's net earnings for many years. The amount — recorded when investments are sold, other-than-temporarily impaired or in certain situations, as required by GAAP, when investments are marked-to-market with the corresponding gain or loss included in earnings — may fluctuate significantly from period to period, with a meaningful effect upon Berkshire's consolidated net earnings. However, the amount of realized investment gain or loss for any given period has no predictive value, and variations in amount from period to period have no practical analytical value, particularly in view of the net unrealized price appreciation now existing in Berkshire's consolidated investment portfolio.

Management's Discussion *(continued)*

Realized Investment Gain (continued)

The Consolidated Statement of Earnings for 1996 reflects a pre-tax realized investment gain of $2.5 billion ($1.6 billion after tax). Most of this gain resulted from The Walt Disney Company's ("Disney") acquisition of Capital Cities/ABC, Inc. ("Capital Cities"). Prior to the acquisition, subsidiaries of Berkshire owned common stock of Capital Cities that had been acquired in 1986 for an aggregate cost of $345.0 million. In exchange for the Capital Cities common stock, Berkshire subsidiaries received cash and Disney common stock having an aggregate value of $2.5 billion.

While the effect of this transaction is material to the Consolidated Statement of Earnings, the completion of the acquisition had a minimal impact on Berkshire's shareholders' equity. This is due to the fact that Berkshire's investment in Capital Cities had been carried in the prior periods' consolidated financial statements at market value with unrealized gains, net of tax, reported as a separate component of shareholders' equity. As of December 31, 1995, the pre-tax unrealized gain related to Berkshire's investment in Capital Cities was approximately $2.1 billion.

Liquidity and Capital Resources

Berkshire's Consolidated Balance Sheet as of December 31, 1996, reflects continuing capital strength. In the past three years, Berkshire shareholders' equity has increased from approximately $10.1 billion at December 31, 1993, to approximately $23.4 billion at December 31, 1996. In that three-year period, realized and unrealized securities gains increased equity capital by approximately $9.6 billion, and reinvested earnings, other than realized securities gains, were about $2.0 billion.

BERKSHIRE HATHAWAY INC.

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

	1996	1995 *	1994 *	1993 *	1992 *
Revenues:					
Insurance premiums earned	$ 4,117.8	$ 957.5	$ 923.2	$ 650.7	$ 664.3
Sales and service revenues	3,061.2	2,755.9	2,351.9	1,962.9	1,774.4
Interest and dividend income	811.9	629.2	519.0	520.7	485.5
Income from finance businesses	25.3	26.6	24.9	22.2	20.7
Realized investment gain [1]	2,484.1[2]	194.1	91.3	546.4	89.9
Total revenues	$10,500.3	$ 4,563.3	$ 3,910.3	$ 3,702.9	$ 3,034.8
Earnings:					
Before realized investment gain and cumulative effect of accounting change	$ 883.4	$ 669.9	$ 491.9[3]	$ 520.2[4]	$ 400.8
Realized investment gain [1]	1,605.2[2]	125.0	61.1	356.7	59.6
Cumulative effect of change in accounting for income taxes	—	—	—	(33.3)	—
Net earnings	$ 2,488.6	$ 794.9	$ 553.0	$ 843.6	$ 460.4
Earnings per share:					
Before realized investment gain and cumulative effect of accounting change	$ 732.96	$ 564.31	$ 417.66[3]	$ 449.90[4]	$ 349.59
Realized investment gain [1]	1,331.83[2]	105.30	51.88	308.50	51.98
Cumulative effect of change in accounting for income taxes	—	—	—	(28.80)	—
Net earnings	$2,064.79	$ 669.61	$ 469.54	$ 729.60	$ 401.57
Year-end data:					
Total assets	$43,409.5	$28,711.4	$20,609.6	$18,697.5	$15,721.5
Borrowings under investment agreements and other debt [5]	1,944.4	1,061.7	810.7	972.4	1,154.7
Shareholders' equity	23,426.3	16,738.7	11,651.5	10,140.2	8,132.9
Class A equivalent common shares outstanding, in thousands	1,232	1,194	1,178	1,178	1,149
Shareholders' equity per outstanding Class A equivalent share	$ 19,011	$ 14,025	$ 9,893	$ 8,610	$ 7,081

* *Restated - See Note 1(b) to Consolidated Financial Statements.*

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[1] *The amount of realized investment gain/loss for any given period has no predictive value, and variations in amount from period to period have no practical analytical value, particularly in view of the unrealized appreciation now existing in Berkshire's consolidated investment portfolio.*

[2] *In March 1996, The Walt Disney Company completed its acquisition of Capital Cities/ABC, Inc. A pre-tax realized gain related to this transaction of $2.2 billion ($1.4 billion after-tax) is included in 1996's results.*

[3] *Includes a charge of $172.6 million representing an other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock.*

[4] *Includes a charge of $53.6 million representing the effect of the change in U.S. Federal income tax rates on deferred taxes applicable to unrealized appreciation.*

[5] *Excludes borrowings of finance businesses.*

BERKSHIRE HATHAWAY INC.

SHAREHOLDER-DESIGNATED CONTRIBUTIONS

The Company has conducted this program of corporate giving during each of the past sixteen 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
1990	$6	97.3%	$ 5,823,672	2,600
1991	$7	97.7%	$ 6,772,024	2,630
1992	$8	97.0%	$ 7,634,784	2,810
1993	$10	97.3%	$ 9,448,370	3,110
1994	$11	95.7%	$10,419,497	3,330
1995	$12	96.3%	$11,558,616	3,600
1996	$14	97.2%	$13,309,044	3,910

* *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 1997, the notice will be mailed on or about September 15 **to Class A shareholders of record reflected in our Registrar's records as of the close of business August 31, 1997,** and shareholders will be given until **November 15** to respond.

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

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BERKSHIRE HATHAWAY INC.

COMBINED FINANCIAL STATEMENTS

BUSINESS GROUPS

Berkshire's consolidated data is rearranged in the presentations on the following six pages into four categories, corresponding to the way Mr. Buffett and Mr. Munger think about Berkshire's businesses. The presentations may be helpful to readers in making estimates of Berkshire's intrinsic value.

The presentations in this section do not conform in all respects to generally accepted accounting principles. Principal departures from GAAP relate to accounting treatment for assets acquired in business acquisitions, although students and practitioners of accounting will recognize others.

Opinions of Berkshire's independent auditors were not solicited for this data. The four-category presentations in no way fell within their purview.

BERKSHIRE HATHAWAY INC.

INSURANCE GROUP

Berkshire's insurance businesses are comprised of three operating groups of subsidiaries. The largest group (in terms of premium volume) is GEICO Corporation ("GEICO") whose business was merged with another Berkshire subsidiary at the beginning of 1996. Prior to that date, Berkshire subsidiaries owned approximately 51% of the then outstanding capital stock of GEICO. GEICO, through its subsidiaries, is a multiple line property and casualty insurer the principal business of which is writing private passenger automobile insurance. Currently the seventh largest auto insurer in the U.S., GEICO's voluntary auto policy count grew 10% during the twelve months ended December 31, 1996. At the same time, outstanding underwriting results continued to be generated.

The Berkshire Hathaway Reinsurance Division provides treaty and limited facultative reinsurance to other property/casualty insurers and reinsurers. Berkshire is one of the world's leading providers of catastrophe excess of loss reinsurance. Berkshire's unparalled capital strength has enabled it to offer dollar coverages of a magnitude far in excess of its competitors.

Berkshire's third group of businesses underwrite miscellaneous forms of direct insurance. National Indemnity Company and other affiliated entities underwrite multiple lines of traditional insurance for primarily commercial accounts. The "Homestate Group" companies underwrite various commercial coverages for risks in an increasing number of selected states. Cypress Insurance Company provides workers' compensation insurance to employers in California and more recently in six other states. Central States Indemnity Company issues credit insurance distributed through credit card issuers nationwide In addition, in mid-1996, Kansas Bankers Surety Company, an insurer for primarily small and medium sized banks located in the midwest, was acquired by a Berkshire subsidiary.

The Berkshire Hathaway Insurance Group maintains capital strength at unparalleled high levels. Statutory surplus as regards policyholders of the Insurance Group increased to about $26 billion at December 31, 1996. The obvious margins of safety thus provided to insureds of the Group are particularly persuasive in marketing of individually negotiated insurance and reinsurance contracts.

Combined financial statements of the Insurance Group — unaudited and not fully adjusted to conform to Generally Accepted Accounting Principles — are presented on the following page.

BERKSHIRE HATHAWAY INC.

INSURANCE GROUP

Balance Sheets

(dollars in millions)

	December 31, 1996	December 31, 1995
Assets		
Investments:		
Fixed maturities at market	$ 5,462.4	$ 1,368.5
Equity securities at market:		
American Express Company	2,731.8	2,000.5
Capital Cities/ABC, Inc.	—	2,405.8
The Coca-Cola Company	10,499.7	7,407.2
The Walt Disney Company	1,680.2	—
Federal Home Loan Mortgage Corporation	1,772.8	1,044.0
GEICO Corporation	—	2,393.2
The Gillette Company	3,732.0	2,502.0
McDonalds Corporation	1,356.2	504.9
Wells Fargo & Company	1,916.8	1,426.8
Other	3,862.1	2,363.4
	33,014.0	23,416.3
Cash and cash equivalents	513.7	2,328.9
Deferred costs	437.5	410.6
Other	1,022.0	314.5
	$34,987.2	$26,470.3
Liabilities		
Losses and loss adjustment expenses	$ 6,274.4	$ 3,698.6
Unearned premiums	1,183.5	374.1
Funds held under reinsurance assumed	449.6	379.0
Policyholder liabilities and other accruals	802.0	238.9
Income taxes, principally deferred	6,611.8	5,483.3
	15,321.3	10,173.9
Equity		
Minority shareholders'	258.1	196.4
Berkshire shareholders'	19,407.8	16,100.0
	19,665.9	16,296.4
	$34,987.2	$26,470.3

Statements of Earnings

(dollars in millions)

	1996	1995	1994
Premiums written	$4,105.2	$1,024.2	$ 915.5
Premiums earned	$4,117.8	$ 957.5	$ 923.2
Losses and loss expenses	3,089.5	612.0	565.3
Underwriting expenses	806.2	325.0	228.0
Total losses and expenses	3,895.7	937.0	793.3
Underwriting gain — pre-tax	222.1	20.5	129.9
Net investment income*	726.2	501.6	419.4
Realized investment gain	2,289.8	181.1	92.0
Other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock	—	—	(261.0)
Earnings before income taxes	3,238.1	703.2	380.3
Income tax expense	1,006.6	149.0	51.7
	2,231.5	554.2	328.6
Minority interest	7.6	7.5	4.3
Net earnings	$2,223.9	$ 546.7	$ 324.3
** Net investment income is summarized below:*			
Dividends	*$418.4*	*$385.0*	*$362.4*
Interest	*321.9*	*99.6*	*92.2*
Equity in unremitted net earnings (loss) of Salomon Inc.	—	*18.3*	*(31.7)*
Investment expenses	*(14.1)*	*(1.3)*	*(3.5)*
	$726.2	*$501.6*	*$419.4*

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 the following:

Operation	*Product/Service/Activity*
Adalet - PLM	Explosion proof electrical enclosures, cable couplers and terminations
Blue Chip Stamps	Marketing motivational services
Borsheim's	Retailing fine jewelry
Buffalo News	Daily and Sunday newspaper
Campbell Hausfeld	Air compressors, air tools, painting systems, pressure washers, welders and generators
Carefree	Comfort and convenience products for the recreational vehicle industry
Cleveland Wood Products	Vacuum cleaner brushes and bags
Dexter Shoe Companies	Dress, casual and athletic shoes
Douglas Products	Specialty and cordless vacuum cleaners
Fechheimer Bros. Co.	Uniforms and accessories
FlightSafety	High technology training to operators of aircraft and ships
France	Appliance controls; ignition and sign transformers
H. H. Brown Shoe Co.	Work shoes, boots and casual footwear
Halex	Zinc die cast conduit fittings and other electrical construction materials
Helzberg's Diamond Shops	Retailing fine jewelry
Kirby	Home cleaning systems
Lowell Shoe, Inc.	Women's and nurses' shoes
Meriam	Pressure and flow measurement devices
Nebraska Furniture Mart	Retailing home furnishings
Northland	Fractional horsepower electric motors
Powerwinch	Marine and general purpose winches, windlasses, and hoists
Precision Steel Products	Steel service center
Quikut	Cutlery for the home and sporting goods markets
ScottCare	Cardiopulmonary rehabilitation and monitoring equipment
Scot Labs	Cleaning and maintenance chemicals
See's Candies	Boxed chocolates and other confectionery products
Stahl	Custom steel service bodies, flatbed bodies, cranes and tool boxes for trucks
Wayne	Furnace burners; sump, utility and sewage pumps
Western Enterprises	Medical and industrial compressed gas fittings and regulators
Western Plastics	Molded plastic components
R.C. Willey Home Furnishings	Retailing home furnishings
World Book	Printed and multimedia encyclopedias and other reference materials

BERKSHIRE HATHAWAY INC.

MANUFACTURING, PUBLISHING AND RETAILING BUSINESSES

Balance Sheets
(dollars in millions)

	December 31, 1996	December 31, 1995
Assets		
Cash and cash equivalents	$ 61.1	$ 124.5
Accounts receivable	563.1	454.7
Inventories	578.7	556.0
Properties and equipment	863.2	285.5
Other	97.9	34.3
	$ 2,164.0	$ 1,455.0
Liabilities		
Accounts payable, accruals and other	$ 523.3	$ 398.3
Income taxes	126.9	20.1
Term debt and other borrowings	193.3	150.6
	843.5	569.0
Equity		
Minority shareholders'	51.6	39.5
Berkshire shareholders'	1,268.9	846.5
	1,320.5	886.0
	$ 2,164.0	$ 1,455.0

Statements of Earnings
(dollars in millions)

	1996	1995	1994
Revenues:			
Sales and service revenues	$3,061.9	$2,755.9	$2,351.9
Interest income	38.8	25.1	9.1
	3,100.7	2,781.0	2,361.0
Cost and expenses:			
Cost of products and services sold	1,875.7	1,698.4	1,442.9
Selling, general and administrative expenses	832.1	741.4	578.5
Interest on debt	15.3	9.1	3.7
	2,723.1	2,448.9	2,025.1
Earnings from operations before income taxes	377.6	332.1	335.9
Income tax expense	138.3	126.4	122.3
	239.3	205.7	213.6
Minority interest	5.1	4.5	4.9
Net earnings	$ 234.2	$ 201.2	$ 208.7

This presentation reflects the results of operations of Helzberg's Diamond Shops, R.C. Willey Home Furnishings and FlightSafety International from their respective dates of acquisition (Helzberg's — April 30, 1995; Willey — June 29, 1995; FlightSafety — December 23, 1996). Accordingly, while the 1996 balance sheet includes the assets and liabilities of FlightSafety as of December 31, 1996, the statement of earnings for 1996 includes FlightSafety's operating results for only the last eight days of the year.

Purchase 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 57.

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

BERKSHIRE HATHAWAY INC.

FINANCE BUSINESSES

Scott Fetzer Financial Group, Inc., Berkshire Hathaway Credit Corporation and *Berkshire Hathaway Life Insurance Co. of Nebraska* make up Berkshire's finance businesses.

Balance Sheets
(dollars in millions)

	December 31,	
	1996	1995
Assets		
Cash and cash equivalents	$ 10.5	$ 40.7
Fixed maturity investments	742.4	529.4
Installment and other receivables	228.4	195.7
Deferred tax assets	22.5	14.2
Other	0.1	0.7
	$1,003.9	$ 780.7
Liabilities		
Borrowings under investment agreements and other debt	$ 381.3	$ 523.6
Annuity reserves and policyholder liabilities	434.8	116.7
Accounts payable, accruals and other	123.9	76.5
	940.0	716.8
Equity		
Berkshire shareholders'	63.9	63.9
	$1,003.9	$ 780.7

Statements of Earnings
(dollars in millions)

	1996	1995	1994
Revenues:			
Interest and fees on loans and financed receivables	$ 38.8	$ 37.9	$ 37.8
Interest and dividends on investment securities	54.9	43.7	35.4
Annuity premiums earned	259.5	75.2	36.0
	353.2	156.8	109.2
Expenses:			
Interest expense	32.6	38.7	35.5
Annuity benefits and underwriting expenses	276.7	80.8	37.7
General and administrative	20.8	16.5	13.9
	330.1	136.0	87.1
Earnings from operations before income taxes	23.1	20.8	22.1
Income tax expense	8.2	8.2	7.5
Net earnings	$ 14.9	$ 12.6	$ 14.6

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 51 to 56).

Statements of Net Assets
(dollars in millions)

	December 31,	
	1996	1995
Assets		
Cash and cash equivalents	$ 765.0	$ 250.4
Investments:		
Fixed maturities:		
Bonds	942.5	8.2
Preferred stocks	42.0	46.6
Equity securities	199.0	187.1
Unamortized goodwill and other purchase accounting adjustments *	3,149.8	747.6
Deferred tax assets	31.3	2.4
Other	258.8	56.6
	$ 5,388.4	$ 1,298.9
Liabilities		
Accounts payable, accruals and other	$ 816.4	$ 50.6
Income taxes	142.7	94.4
Borrowings under investment agreements and other debt	1,718.2	918.6
	2,677.3	1,063.6
Equity		
Minority shareholders'	25.4	28.6
Berkshire shareholders'	2,685.7	206.7
	2,711.1	235.3
	$ 5,388.4	$ 1,298.9

Statements of Earnings
(dollars in millions)

	1996	1995	1994
Revenues:			
Interest and dividend income	$ 54.6	$ 37.5	$ 31.1
Realized investment gain (loss)	194.7	13.0	(0.7)
	249.3	50.5	30.4
Expenses:			
Corporate administration	5.1	5.3	5.0
Shareholder-designated contributions	13.3	11.6	10.4
Amortization of goodwill and purchase accounting adjustments *	75.7	27.0	22.5
Interest on debt	90.9	55.3	59.4
Other (income) expense	(2.8)	(1.4)	1.7
Other-than-temporary decline in value of investment in USAir Group, Inc. Preferred Stock	—	—	7.5
	182.2	97.8	106.5
Income (loss) before income taxes	67.1	(47.3)	(76.1)
Income tax expense (benefit)	43.7	(13.3)	(22.8)
	23.4	(34.0)	(53.3)
Minority interest	7.8	1.3	(0.5)
Net loss	$ 15.6	$ (35.3)	$ (52.8)

* *Purchase accounting adjustments and goodwill arose in accounting for business acquisitions.*

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

BERKSHIRE HATHAWAY INC.

AN OWNER'S MANUAL*

In June 1996, Berkshire's Chairman, Warren E. Buffett, issued a booklet entitled **"An Owner's Manual"** to Berkshire's Class A and Class B shareholders. The purpose of the manual was to explain Berkshire's broad economic principles of operation. The Owner's Manual is reproduced on the following nine pages.

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INTRODUCTION

Berkshire's recent offering of Class B stock added more than 25,000 shareholders to our rolls. Charlie Munger, Berkshire's Vice Chairman and my partner, and I welcome each of you. As a further greeting, we have prepared this booklet to help you understand our business, goals, philosophy and limitations.

These pages are aimed at explaining our broad principles of operation, not at giving you detail about Berkshire's many businesses. For more detail and a continuing update on our progress, you should look to our annual reports. We will be happy to send a copy of our 1995 report to any shareholder requesting it. In addition, we can also supply you with a compendium of our 1977-95 annual letters.

OWNER-RELATED BUSINESS PRINCIPLES

Berkshire's shareholder count has grown from about 1,200 in the late 1960s to an estimated 70,000 today, with two big spurts contributing heavily to the increase. One jump occurred with the just-completed offering of the Class B shares, and the other took place in 1983, when Blue Chip Stamps merged into Berkshire.

At the time of that merger, I set down 13 owner-related business principles that I thought would help new shareholders understand our managerial approach. As is appropriate for "principles," all 13 remain alive and well today, and they are stated here in italics. A few words have been changed to bring them up-to-date and to each I've added a short commentary.

1. *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 are also, 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.*

   Charlie and I hope that you do not think of yourself as merely owning a piece of paper whose price wiggles around daily and that is a candidate for sale when some economic or political event makes you nervous. We hope you instead visualize yourself as a part owner of a business that you expect to stay with indefinitely, much as you might if you owned a farm or apartment house in partnership with members of your family. For our part, we do not view Berkshire shareholders as faceless members of an ever-shifting crowd, but rather as co-venturers who have entrusted their funds to us for what may well turn out to be the remainder of their lives.

   The evidence suggests that most Berkshire shareholders have indeed embraced this long-term partnership concept. The annual percentage turnover in Berkshire's shares is a small fraction of that occurring in the stocks of other major American corporations, even when the shares I own are excluded from the calculation.

   In effect, our shareholders behave in respect to their Berkshire stock much as Berkshire itself behaves in respect to companies in which it has an investment. As owners of, say, Coca-Cola or Gillette shares, we think of Berkshire as being a non-managing partner in two extraordinary businesses, in which we measure our success by the long-term progress of the companies rather than by the month-to-month movements of their stocks. In fact, we would not care in the least if several years went by in which there was no trading, or quotation of prices, in the stocks of those companies. If we have good long-term expectations, short-term price changes are meaningless for us except to the extent they offer us an opportunity to increase our ownership at an attractive price.

2. *In line with Berkshire's owner-orientation, most of our directors have a major portion of their net worth invested in the company. We eat our own cooking.*

   Charlie's family has 90% or more of its net worth in Berkshire shares; my wife, Susie, and I have more than 99%. In addition, many of my relatives — my sisters and cousins, for example — keep a huge portion of their net worth in Berkshire stock.

   Charlie and I feel totally comfortable with this eggs-in-one-basket situation because Berkshire itself owns a wide variety of truly extraordinary businesses. Indeed, we believe that Berkshire is close to being unique in the quality and diversity of the businesses in which it owns either a controlling interest or a minority interest of significance.

   Charlie and I cannot promise you results. But we can guarantee that your financial fortunes will move in lockstep with ours for whatever period of time you elect to be our partner. We have no interest in large salaries or options or other means of gaining an "edge" over you. We want to make money only when our partners do and in exactly the same proportion. Moreover, when I do something dumb, I want you to be able to derive some solace from the fact that my financial suffering is proportional to yours.

3. *Our long-term economic goal (subject to some qualifications mentioned later) is to maximize Berkshire's 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.*

   Since that was written at yearend 1983, our intrinsic value (a topic I'll discuss a bit later) has increased at an annual rate of about 25%, a pace that has definitely surprised both Charlie and me. Nevertheless the principle just stated remains valid: Operating with large amounts of capital as we do today, we cannot come close to performing as well as we once did with much smaller sums. The best rate of gain in intrinsic value we can even hope for is an average of 15% per annum, and we may well fall far short of that target. Indeed, we think very few large businesses have a chance of compounding intrinsic value at 15% per annum over an extended period of time. So it may be that we will end up meeting our stated goal — being above average — with gains that fall significantly short of 15%.

4. *Our preference would be to reach our 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.*

   As has usually been the case, it is easier today to buy small pieces of outstanding businesses via the stock market than to buy similar businesses in their entirety on a negotiated basis. Nevertheless, we continue to prefer the 100% purchase, and in some years we get lucky: In 1995, in fact, we made three acquisitions. Though there will be dry years also, we expect to make a number of acquisitions in the decades to come, and our hope is that they will be large. If these purchases approach the quality of those we have made in the past, Berkshire will be well served.

   The challenge for us is to generate ideas as rapidly as we generate cash. In this respect, a depressed stock market is likely to present us with significant advantages. For one thing, it tends to reduce the prices at which entire companies become available for purchase. Second, a depressed market makes it easier for our insurance companies to buy small pieces of wonderful businesses — including additional pieces of businesses we already own — at attractive prices. And third, some of those same wonderful businesses, such as Coca-Cola and Wells Fargo, are consistent buyers of their own shares, which means that they, and we, gain from the cheaper prices at which they can buy.

Overall, Berkshire and its long-term shareholders benefit from a sinking stock market much as a regular purchaser of food benefits from declining food prices. So when the market plummets — as it will from time to time — neither panic nor mourn. It's good news for Berkshire.

5. *Because of our 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.*

   To state things simply, we try to give you in the annual report the numbers and other information that really matter. Charlie and I pay a great deal of attention to how well our businesses are doing, and we also work to understand the environment in which each business is operating. For example, is one of our businesses enjoying an industry tailwind or is it facing a headwind? Charlie and I need to know exactly which situation prevails and to adjust our expectations accordingly. We will also pass along our conclusions to you.

   Over time, practically all of our businesses have exceeded our expectations. But occasionally we have disappointments, and we will try to be as candid in informing you about those as we are in describing the happier experiences. When we use unconventional measures to chart our progress — for instance, you will be reading in our annual reports about insurance "float" — we will try to explain these concepts and why we regard them as important. In other words, we believe in telling you how we think so that you can evaluate not only Berkshire's businesses but also assess our approach to management and capital allocation.

6. *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 attempt to offset the shortcomings of conventional accounting by regularly reporting "look-through" earnings (though, for special and nonrecurring reasons, we omitted these from the 1995 Annual Report). The look-through numbers include Berkshire's own reported operating earnings, excluding capital gains and purchase-accounting adjustments (an explanation of which occurs later in this message) plus Berkshire's share of the undistributed earnings of our major investees — amounts that are not included in Berkshire's figures under conventional accounting. From these undistributed earnings of our investees we subtract the tax we would have owed had the earnings been paid to us as dividends. We also exclude capital gains, purchase-accounting adjustments and extraordinary charges or credits from the investee numbers.

   We have found over time that the undistributed earnings of our investees, in aggregate, have been fully as beneficial to Berkshire as if they had been distributed to us (and therefore had been included in the earnings we officially report). This pleasant result has occurred because most of our investees are engaged in truly outstanding businesses that can often employ incremental capital to great advantage, either by putting it to work in their businesses or by repurchasing their shares. Obviously, every capital decision that our investees have made has not benefitted us as shareholders, but overall we have garnered far more than a dollar of value for each dollar they have retained. We consequently regard look-through earnings as realistically portraying our yearly gain from operations.

   In 1992, our look-through earnings were $604 million, and in that same year we set a goal of raising them by an average of 15% per annum to $1.8 billion in the year 2000. Since that time, however, we

have issued additional shares — including the B Shares sold recently — so that we now need look-through earnings of $1.9 billion in 2000 to match the per-share goal we originally were shooting for. This is a tough target but one we still hope to hit.

7. *We use debt sparingly and, when we do borrow, we attempt to structure our loans 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, 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.")*

   The financial calculus that Charlie and I employ would never permit our trading a good night's sleep for a shot at a few extra percentage points of return. I've never believed in risking what my family and friends have and need in order to pursue what they don't have and don't need.

   Besides, Berkshire has access to two low-cost, non-perilous sources of leverage that allow us to safely own far more assets than our equity capital alone would permit: deferred taxes and "float," the funds of others that our insurance business holds because it receives premiums before needing to pay out losses. Both of these funding sources have grown rapidly and now total about $12 billion.

   Better yet, this funding to date has been cost-free. Deferred tax liabilities bear no interest. And as long as we can break even in our insurance underwriting — which we have done, on the average, during our 29 years in the business — the cost of the float developed from that operation is zero. Neither item, of course, is equity; these are real liabilities. But they are liabilities without covenants or due dates attached to them. In effect, they give us the benefit of debt — an ability to have more assets working for us — but saddle us with none of its drawbacks.

   Of course, there is no guarantee that we can obtain our float in the future at no cost. But we feel our chances of attaining that goal are as good as those of anyone in the insurance business. Not only have we reached the goal in the past (despite a number of important mistakes by your Chairman), but have now, with our acquisition of GEICO, materially improved our prospects for getting there in the future.

8. *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.*

   Charlie and I are interested only in acquisitions that we believe will raise the *per-share* intrinsic value of Berkshire's stock. The size of our paychecks or our offices will never be related to the size of Berkshire's balance sheet.

9. *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 continue to pass the test, but the challenges of doing so have grown more difficult. If we reach the point that we can't create extra value by retaining earnings, we will pay them out and let our shareholders deploy the funds.

10. *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.

When we sold the Class B shares, we stated that Berkshire stock was not undervalued — and some people found that shocking. That reaction was not well-founded. Shock should have registered instead had we issued shares when our stock was undervalued. Managements that say or imply during a public offering that their stock is undervalued are usually being economical with the truth or uneconomical with their existing shareholders' money: Owners unfairly lose if their managers deliberately sell assets for 80¢ that in fact are worth $1. We didn't commit that kind of crime in our recent offering and we never will.

11. *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. We are also 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 and the advocates 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 that kind of behavior.*

    We continue to avoid gin rummy behavior. True, we closed our textile business in the mid-1980's after 20 years of struggling with it, but only because we felt it was doomed to run never-ending operating losses. We have not, however, given thought to selling operations that would command very fancy prices nor have we dumped our laggards, though we focus hard on curing the problems that cause them to lag.

12. *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.*

    At Berkshire you will find no "big bath" accounting maneuvers or restructurings nor any "smoothing" of quarterly or annual results. We will always tell you how many strokes we have taken on each hole and never play around with the scorecard. When the numbers are a very rough "guesstimate," as they necessarily must be in insurance reserving, we will try to be both consistent and conservative in our approach.

    We will be communicating with you in several ways. Through the annual report, I try to give all shareholders as much value-defining information as can be conveyed in a document kept to reasonable length. We also try to convey a liberal quantity of condensed but important information in our quarterly reports, though I don't write those (one recital a year is enough). Still another important occasion for communication is our Annual Meeting, at which Charlie and I are delighted to spend five hours or more answering questions about Berkshire. But there is one way we can't communicate: on a one-on-one basis. That isn't feasible given Berkshire's many thousands of owners.

    In all of our communications, we try to make sure that no single shareholder gets an edge: We do not follow the usual practice of giving earnings "guidance" or other information of value to analysts or large shareholders. Our goal is to have all of our owners updated at the same time.

13. *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.*

    Though we continue to be unwilling to talk about specific stocks, we freely discuss our business and investment philosophy. I benefitted enormously from the intellectual generosity of Ben Graham, the greatest teacher in the history of finance, and I believe it appropriate to pass along what I learned from him, even if that creates new and able investment competitors for Berkshire just as Ben's teachings did for him.

AN ADDED PRINCIPLE

To the extent possible, we would like each Berkshire shareholder to record a gain or loss in market value during his period of ownership that is proportional to the gain or loss in per-share intrinsic value recorded by the company during that holding period. For this to come about, the relationship between the intrinsic value and the market price of a Berkshire share would need to remain constant, and by our preferences at 1-to-1. As that implies, we would rather see Berkshire's stock price at a fair level than a high level. Obviously, Charlie and I can't control Berkshire's price. But by our policies and communications, we can encourage informed, rational behavior by owners that, in turn, will tend to produce a stock price that is also rational. Our it's-as-bad-to-be-overvalued-as-to-be-undervalued approach may disappoint some shareholders. We believe, however, that it affords Berkshire the best prospect of attracting long-term investors who seek to profit from the progress of the company rather than from the investment mistakes of their partners.

INTRINSIC VALUE

Now let's focus on two terms that I mentioned earlier and that you will encounter in future annual reports.

Let's start with intrinsic value, an all-important concept that offers the only logical approach to evaluating the relative attractiveness of investments and businesses. Intrinsic value can be defined simply: It is the discounted value of the cash that can be taken out of a business during its remaining life.

The calculation of intrinsic value, though, is not so simple. As our definition suggests, intrinsic value is an estimate rather than a precise figure, and it is additionally an estimate that must be changed if interest rates move or forecasts of future cash flows are revised. Two people looking at the same set of facts, moreover — and this would apply even to Charlie and me — will almost inevitably come up with at least slightly different intrinsic value figures. That is one reason we never give you our estimates of intrinsic value. What our annual reports do supply, though, are the facts that we ourselves use to calculate this value.

Meanwhile, we regularly report our per-share book value, an easily calculable number, though one of limited use. The limitations do not arise from our holdings of marketable securities, which are carried on our books at their current prices. Rather the inadequacies of book value have to do with the companies we control, whose values as stated on our books may be far different from their intrinsic values.

The disparity can go in either direction. For example, in 1964 we could state with certitude that Berkshire's per-share book value was $19.46. However, that figure considerably overstated the company's intrinsic value, since all of the company's resources were tied up in a sub-profitable textile business. Our textile assets had neither going-concern nor liquidation values equal to their carrying values. Today, however, Berkshire's situation is reversed: Our March 31, 1996 book value of $15,180 *far* understates Berkshire's intrinsic value, a point true because many of the businesses we control are worth much more than their carrying value.

Inadequate though they are in telling the story, we give you Berkshire's book-value figures because they today serve as a rough, albeit significantly understated, tracking measure for Berkshire's intrinsic value. In other words, the percentage change in book value in any given year is likely to be reasonably close to that year's change in intrinsic value.

You can gain some insight into the differences between book value and intrinsic value by looking at one form of investment, a college education. Think of the education's cost as its "book value." If this cost is to be accurate, it should include the earnings that were foregone by the student because he chose college rather than a job.

For this exercise, we will ignore the important non-economic benefits of an education and focus strictly on its economic value. First, we must estimate the earnings that the graduate will receive over his lifetime and subtract from that figure an estimate of what he would have earned had he lacked his education. That gives us an excess earnings figure, which must then be discounted, at an appropriate interest rate, back to graduation day. The dollar result equals the intrinsic economic value of the education.

Some graduates will find that the book value of their education exceeds its intrinsic value, which means that whoever paid for the education didn't get his money's worth. In other cases, the intrinsic value of an education will far exceed its book value, a result that proves capital was wisely deployed. In all cases, what is clear is that book value is meaningless as an indicator of intrinsic value.

PURCHASE-ACCOUNTING ADJUSTMENTS

Next: spinach time. I know that a discussion of accounting technicalities turns off many readers, so let me assure you that a full and happy life can still be yours if you decide to skip this section.

Our recent acquisition of GEICO, however, means that purchase-accounting adjustments of about $60 million will now be charged against our annual earnings as recorded under generally accepted accounting principles (GAAP) and we may well make other acquisitions that will increase this figure in the future. So this is a subject of importance to Berkshire. In our annual reports, also, we will sometimes talk of earnings that we will describe as "before purchase-accounting adjustments." The discussion that follows will tell you why we think earnings of that description have far more economic meaning than the earnings produced by GAAP.

When Berkshire buys a business for a premium over the GAAP net worth of the acquiree — as will usually be the case, since most companies we'd want to buy don't come at a discount — that premium has to be entered on the asset side of our balance sheet. There are loads of rules about just how a company should record the premium. But to simplify this discussion, we will focus on "Goodwill," the asset item to which almost all of Berkshire's acquisition premiums have been allocated. For example, when we recently acquired the half of GEICO we didn't previously own, we recorded goodwill of about $1.6 billion.

GAAP requires goodwill to be amortized — that is, written off — over a period no longer than 40 years. Therefore, to extinguish our $1.6 billion in GEICO goodwill, we will annually take charges of about $40 million against our earnings. This amount is not deductible for tax purposes, so it reduces both our pre-tax and after-tax earnings by $40 million.

In an accounting sense, consequently, our GEICO goodwill will disappear gradually in even-sized bites. But the one thing I can guarantee you is that the *economic* goodwill we have purchased at GEICO will not decline in the same measured way. In fact, my best guess is that the economic goodwill assignable to GEICO will not decline at all, but rather will increase — quite probably in a very substantial way.

I made a similar statement in our 1983 Annual Report about the goodwill attributed to See's Candy, when I used that company as an example in a discussion of goodwill accounting. At that time, our balance sheet carried about $36 million of See's goodwill. We have since been charging about $1 million against earnings every year in order to amortize the asset, and the See's goodwill on our balance sheet is now down to about $23 million. In other words, from an accounting standpoint, See's is now presented as having lost a good deal of goodwill since 1983.

The economic facts could not be more different. In 1983, See's earned about $27 million pre-tax on $11 million of net operating assets; in 1995 it earned $50 million on $5 million of net operating assets. Clearly See's economic goodwill has increased dramatically during the interval rather than decreased. Just as clearly, See's is worth many hundreds of millions of dollars more than its stated value on our books.

We could, of course, be wrong, but we expect GEICO's gradual loss of accounting value to be paired with increases in its economic value. Certainly that has been the pattern at most of our subsidiaries, not just See's. That is why we regularly present our operating earnings in a way that allows you to ignore all purchase-accounting adjustments.

In the future, also, we will adopt a similar policy for look-through earnings, moving to a form of presentation that rids these earnings of the major purchase-accounting adjustments of investees. We will not apply this policy to companies that have only small amounts of goodwill on their books, such as Coca-Cola or Gillette. We will extend it, however, to Wells Fargo and Disney, which have both recently made huge acquisitions and are consequently dealing with exceptionally large goodwill charges.

Before leaving this subject, we should issue an important warning: Investors are often led astray by CEOs and Wall Street analysts who equate depreciation charges with the amortization charges we have just discussed. In no way are the two the same: With rare exceptions, depreciation is an economic cost every bit as real as wages, materials, or taxes. Certainly that is true at Berkshire and at virtually all the other businesses we have studied. Furthermore, we do *not* think so-called EBITDA (earnings before interest, taxes, depreciation and amortization) is a meaningful measure of performance. Managements that dismiss the importance of depreciation — and emphasize "cash flow" or EBITDA — are apt to make faulty decisions, and you should keep that in mind as you make your own investment decisions.

THE MANAGING OF BERKSHIRE

I think it's appropriate that I conclude with a discussion of Berkshire's management, today and in the future. As our first owner-related principle tells you, Charlie and I are the managing partners of Berkshire. But we subcontract all of the heavy lifting in this business to the managers of our subsidiaries. In fact, we delegate almost to the point of abdication: Though Berkshire has about 33,000 employees, only 12 of these are at headquarters.

Charlie and I mainly attend to capital allocation and the care and feeding of our key managers. Most of these managers are happiest when they are left alone to run their businesses, and that is customarily just how we leave them. That puts them in charge of all operating decisions and of dispatching the excess cash they generate to headquarters. By sending it to us, they don't get diverted by the various enticements that would come their way were they responsible for deploying the cash their businesses throw off. Furthermore, Charlie and I are exposed to a much wider range of possibilities for investing these funds than any of our managers could find in his or her own industry.

Most of our managers are independently wealthy, and it's therefore up to us to create a climate that encourages them to choose working with Berkshire over golfing or fishing. This leaves us needing to treat them fairly and in the manner that we would wish to be treated if our positions were reversed.

As for the allocation of capital, that's an activity both Charlie and I enjoy and in which we have acquired some useful experience. In a general sense, grey hair doesn't hurt on this playing field: You don't need good hand-eye coordination or well-toned muscles to push money around (thank heavens). As long as our minds continue to function effectively, Charlie and I can keep on doing our jobs pretty much as we have in the past.

On my death, Berkshire's ownership picture will change but not in a disruptive way: First, only about 1% of my stock will have to be sold to take care of bequests and taxes; second, the balance of my stock will go to my wife, Susan, if she survives me, or to a family foundation if she doesn't. In either event, Berkshire will possess a controlling shareholder guided by the same philosophy and objectives that now set our course.

At that juncture, the Buffett family will not be involved in managing the business, only in picking and overseeing the managers who do. Just who those managers will be, of course, depends on the date of my death.

But I can anticipate what the management structure will be: Essentially my job will be split into two parts, with one executive becoming responsible for investments and another for operations. If the acquisition of new businesses is in prospect, the two will cooperate in making the decisions needed. Both executives will report to a board of directors who will be responsive to the controlling shareholder, whose interests will in turn be aligned with yours.

Were we to need the management structure I have just described on an immediate basis, my family and a few key individuals know who I would pick to fill both posts. Both currently work for Berkshire and are people in whom I have total confidence.

I will continue to keep my family posted on the succession issue. Since Berkshire stock will make up virtually my entire estate and will account for a similar portion of the assets of either my wife or the foundation for a considerable period after my death, you can be sure that I have thought through the succession question carefully. You can be equally sure that the principles we have employed to date in running Berkshire will continue to guide the managers who succeed me.

Lest we end on a morbid note, I also want to assure you that I have never felt better. I love running Berkshire, and if enjoying life promotes longevity, Methuselah's record is in jeopardy.

BERKSHIRE HATHAWAY INC.

COMMON STOCK

General

The Company has two classes of common stock designated Class A Common Stock and Class B Common Stock. Each share of Class A Common Stock is convertible, at the option of the holder, into 30 shares of Class B Common Stock. Shares of Class B Common Stock are not convertible into shares of Class A Common Stock.

Stock Transfer Agent

The Bank of Boston, % Boston EquiServe, P.O. Box 8040, Boston, MA 02266-8040 serves as Transfer Agent and Registrar for the Company's common stock. Correspondence may be directed to Investor Relations, Mail Stop 45-02-64. Certificates for re-issue or transfer should be directed to the Transfer Processing Section, Mail Stop 45-01-05. Notices for conversion and underlying stock certificates should be directed to Corporate Reorganization, Mail Stop 45-02-53. Phone inquiries should be directed to Investor Relations — (617) 575-3100.

Shareholders of record wishing to convert Class A Common Stock into Class B Common Stock should contact Bank of Boston to obtain a "form of conversion notice" and instructions for converting their shares. Shareholders may call Bank of Boston between 9:00 a.m. and 6:00 p.m. Eastern Time to request a "form of conversion notice."

Alternatively, shareholders may notify Bank of Boston in writing. Along with the underlying stock certificate, shareholders should provide Bank of Boston with specific written instructions regarding the number of shares to be converted and the manner in which the Class B shares are to be registered. We recommend that you use certified or registered mail when delivering the stock certificates and written instructions.

If Class A shares are held in "street name", shareholders wishing to convert all or a portion of their holding should contact their broker or bank nominee. It will be necessary for the nominee to make the request for conversion.

Shareholders

The Company had approximately 9,000 record holders of its Class A Common Stock and 6,000 record holders of its Class B Common Stock at March 7, 1997. Record owners included nominees holding at least 220,000 shares of Class A Common Stock and 750,000 shares of Class B Common Stock on behalf of beneficial-but-not-of-record owners.

Price Range of Common Stock

The Company's Class A and Class B Common Stock are listed for trading on the New York Stock Exchange, trading symbol: BRK.A and BRK.B. The following table sets forth the high and low sales prices per share, as reported on the New York Stock Exchange Composite List during the periods indicated:

	Class A *		Class B *	
1996	High	Low	High	Low
First Quarter	$38,000	$29,800	N/A	N/A
Second Quarter	36,000	30,000	$1,220	$ 990
Third Quarter	33,500	30,500	1,117	1,005
Fourth Quarter	36,500	31,000	1,175	1,036

	Class A *	
1995	High	Low
First Quarter	$25,200	$20,250
Second Quarter	24,450	21,500
Third Quarter	30,600	23,400
Fourth Quarter	33,400	28,850

* *Class B Common Stock was first issued on May 8, 1996. At that time Berkshire's then outstanding common stock was redesignated Class A Common Stock.*

Dividends

Berkshire has not declared a cash dividend since 1967.

DIRECTORS

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

CHARLES T. MUNGER, *Vice Chairman of Berkshire*

SUSAN T. BUFFETT

HOWARD G. BUFFETT,
Chairman of the Board of Directors of The GSI Group, a company primarily engaged in the manufacture of agricultural equipment.

MALCOLM G. CHACE, III,
Chairman of the Board of Directors of BankRI, a community bank located in the State of Rhode Island.

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

OFFICERS

WARREN E. BUFFETT, *Chairman and CEO*

CHARLES T. MUNGER, *Vice Chairman*

ROBERT H. BIRD, *Vice President*

MARC D. HAMBURG, *Vice President, Treasurer*

STANFORD LIPSEY, *Vice President*

DANIEL J. JAKSICH, *Controller*

FORREST N. KRUTTER, *Secretary*

REBECCA K. AMICK,
Director of Internal Auditing

JERRY W. HUFTON,
Director of Taxes

MARK D. MILLARD,
Director of Financial Assets

Two compilations of letters from earlier Annual Reports (1977 through 1995) are available upon written request. A two volume set will be furnished to shareholders without charge. Shareholders of record requesting the compilations should provide their name and address as recorded on their stock certificate. Beneficial-but-not-of-record shareholders should include a copy of a broker's statement showing shares held. Non-shareholders may order the two volume set by submitting a written request and a payment to cover production, postage and handling costs of $15.00 for delivery in the United States or $30.00 (in U.S. currency) for delivery outside of the United States. Requests should be submitted to the Company at 3555 Farnam St., Suite 1440, Omaha, NE 68131.

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

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