To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 1991 was $2.1 billion, or 39.6%. Over the last 27 years (that is, since present management took over) our per-share book value has grown from $19 to $6,437, or at a rate of 23.7% compounded annually.

The size of our equity capital - which now totals $7.4 billion - makes it certain that we cannot maintain our past rate of gain or, for that matter, come close to doing so. As Berkshire grows, the universe of opportunities that can significantly influence the company's performance constantly shrinks. When we were working with capital of $20 million, an idea or business producing $1 million of profit added five percentage points to our return for the year. Now we need a $370 million idea (i.e., one contributing over $550 million of pre-tax profit) to achieve the same result. And there are many more ways to make $1 million than to make $370 million.

Charlie Munger, Berkshire's Vice Chairman, and I have set a goal of attaining a 15% average annual increase in Berkshire's intrinsic value. If our growth in *book* value is to keep up with a 15% pace, we must earn $22 billion during the next decade. Wish us luck - we'll need it.

Our outsized gain in book value in 1991 resulted from a phenomenon not apt to be repeated: a dramatic rise in the price-earnings ratios of Coca-Cola and Gillette. These two stocks accounted for nearly $1.6 billion of our $2.1 billion growth in net worth last year. When we loaded up on Coke three years ago, Berkshire's net worth was $3.4 billion; now our Coke stock alone is worth more than that.

Coca-Cola and Gillette are two of the best companies in the world and we expect their earnings to grow at hefty rates in the years ahead. Over time, also, the value of our holdings in these stocks should grow in rough proportion. Last year, however, the valuations of these two companies rose far faster than their earnings. In effect, we got a double-dip benefit, delivered partly by the excellent earnings growth and even more so by the market's reappraisal of these stocks. We believe this reappraisal was warranted. But it can't recur annually: We'll have to settle for a single dip in the future.

A Second Job

In 1989 when I - a happy consumer of five cans of Cherry Coke daily - announced our purchase of $1 billion worth of Coca-Cola stock, I described the move as a rather extreme example of putting our money where my mouth was. On August 18 of last year, when I was elected Interim Chairman of Salomon Inc, it was a different story: I put my mouth where our money was.

You've all read of the events that led to my appointment. My decision to take the job carried with it an implicit but important message: Berkshire's operating managers are so outstanding that I knew I could materially reduce the time I was spending at the company and yet remain confident that its economic progress would not skip a beat. The Blumkins, the Friedman family, Mike Goldberg, the Heldmans, Chuck Huggins, Stan Lipsey, Ralph Schey and Frank Rooney (CEO of H.H. Brown, our latest acquisition, which I will describe later) are all masters of their operations and need no help from me. My job is merely to treat them right and to allocate the capital they generate.

Neither function is impeded by my work at Salomon.

The role that Charlie and I play in the success of our operating units can be illustrated by a story about George Mira, the one-time quarterback of the University of Miami, and his coach, Andy Gustafson. Playing Florida and near its goal line, Mira dropped back to pass. He spotted an open receiver but found his right shoulder in the unshakable grasp of a Florida linebacker. The right-handed Mira thereupon switched the ball to his other hand and threw the only left-handed pass of his life - for a touchdown. As the crowd erupted, Gustafson calmly turned to a reporter and declared: "Now that's what I call coaching."

Given the managerial stars we have at our operating units, Berkshire's performance is not affected if Charlie or I slip away from time to time. You should note, however, the "interim" in my Salomon title. Berkshire is my first love and one that will never fade: At the Harvard Business School last year, a student asked me when I planned to retire and I replied, "About five to ten years after I die."

Sources of Reported Earnings

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

A large amount of additional information about these businesses is given on pages 33-47, where you also will find our segment earnings reported on a GAAP basis. However, we will not in this letter discuss each of our non-insurance operations, as we have in the past. Our businesses have grown in number - and will continue to grow - so it now makes sense to rotate coverage, discussing one or two in detail each year.

	(000s omitted)			
	Pre-Tax Earnings		*Berkshire's Share of Net Earnings (after taxes and minority interests)*	
	1991	*1990*	*1991*	*1990*
Operating Earnings:				
Insurance Group:				
Underwriting	$(119,593)	$ (26,647)	$ (77,229)	$ (14,936)
Net Investment Income	331,846	327,047	285,173	282,613
H. H. Brown (acquired 7/1/91)	13,616	---	8,611	---
Buffalo News	37,113	43,954	21,841	25,981
Fechheimer	12,947	12,450	6,843	6,605
Kirby	35,726	27,445	22,555	17,613
Nebraska Furniture Mart	14,384	17,248	6,993	8,485
Scott Fetzer Manufacturing Group	26,123	30,378	15,901	18,458
See's Candies	42,390	39,580	25,575	23,892
Wesco - other than Insurance	12,230	12,441	8,777	9,676
World Book	22,483	31,896	15,487	20,420
Amortization of Goodwill	(4,113)	(3,476)	(4,098)	(3,461)

Other Purchase-Price Accounting Charges	(6,021)	(5,951)	(7,019)	(6,856)
Interest Expense*	(89,250)	(76,374)	(57,165)	(49,726)
Shareholder-Designated Contributions	(6,772)	(5,824)	(4,388)	(3,801)
Other	77,399	58,310	47,896	35,782
Operating Earnings	400,508	482,477	315,753	370,745
Sales of Securities	192,478	33,989	124,155	23,348
Total Earnings - All Entities	$ 592,986	$ 516,466	$ 439,908	$ 394,093

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

"Look-Through" Earnings

We've previously discussed look-through earnings, which consist of: (1) the operating earnings reported in the previous section, plus; (2) 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.

I've told you that over time look-through earnings must increase at about 15% annually if our intrinsic business value is to grow at that rate. Indeed, since present management took over in 1965, our look-through earnings have grown at almost the identical 23% rate of gain recorded for book value.

Last year, however, our look-through earnings did not grow at all but rather declined by 14%. To an extent, the decline was precipitated by two forces that I discussed in last year's report and that I warned you would have a negative effect on look-through earnings.

First, I told you that our media earnings - both direct and look-through - were "sure to decline" and they in fact did. The second force came into play on April 1, when the call of our Gillette preferred stock required us to convert it into common. The after-tax earnings in 1990 from our preferred had been about $45 million, an amount somewhat higher than the combination in 1991 of three months of dividends on our preferred plus nine months of look-through earnings on the common.

Two other outcomes that I did not foresee also hurt look-through earnings in 1991. First, we had a break-even result from our interest in Wells Fargo (dividends we received from the company were offset by negative retained earnings). Last year I said that such a result at Wells was "a low-level possibility - not a likelihood." Second, we recorded significantly lower - though still excellent - insurance profits.

The following table shows you how we calculate look-through earnings, although I warn you that the figures are necessarily very rough. (The dividends paid to us by these investees have been included in the operating earnings itemized on page 6, mostly under "Insurance Group: Net Investment Income.")

Berkshire's Major Investees	Berkshire's Approximate Ownership at Yearend		Berkshire's Share of Undistributed Operating Earnings (in millions)	
	1991	1990	1991	1990
Capital Cities/ABC Inc.	18.1%	17.9%	$ 61	$ 85

The Coca-Cola Company	7.0%	7.0%	69	58
Federal Home Loan Mortgage Corp.	3.4%(1)	3.2%(1)	15	10
The Gillette Company	11.0%	---	23(2)	---
GEICO Corp.	48.2%	46.1%	69	76
The Washington Post Company	14.6%	14.6%	10	18
Wells Fargo & Company	9.6%	9.7%	(17)	19(3)
Berkshire's share of undistributed earnings of major investees			$230	$266
Hypothetical tax on these undistributed investee earnings			(30)	(35)
Reported operating earnings of Berkshire			316	371
Total look-through earnings of Berkshire			$516	$602

(1) Net of minority interest at Wesco
(2) For the nine months after Berkshire converted its preferred on April 1
(3) Calculated on average ownership for the year

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We also believe that investors can benefit by focusing on their own look-through earnings. To calculate these, they should determine the underlying earnings attributable to the shares they hold in their portfolio and total these. The goal of each investor should be to create a portfolio (in effect, a "company") that will deliver him or her the highest possible look-through earnings a decade or so from now.

An approach of this kind will force the investor to think about long-term business prospects rather than short-term stock market prospects, a perspective likely to improve results. It's true, of course, that, in the long run, the scoreboard for investment decisions is market price. But prices will be determined by future earnings. In investing, just as in baseball, to put runs on the scoreboard one must watch the playing field, not the scoreboard.

A Change in Media Economics and Some Valuation Math

In last year's report, I stated my opinion that the decline in the profitability of media companies reflected secular as well as cyclical factors. The events of 1991 have fortified that case: The economic strength of once-mighty media enterprises continues to erode as retailing patterns change and advertising and entertainment choices proliferate. In the business world, unfortunately, the rear-view mirror is always clearer than the windshield: A few years back no one linked to the media business - neither lenders, owners nor financial analysts - saw the economic deterioration that was in store for the industry. (But give me a few years and I'll probably convince myself that I did.)

The fact is that newspaper, television, and magazine properties have begun to resemble *businesses* more than *franchises* in their economic behavior. Let's take a quick look at the characteristics separating these two classes of enterprise, keeping in mind, however, that many operations fall in some middle ground and can best be described as weak franchises or strong businesses.

An economic franchise arises from a product or service that: (1) is needed or desired; (2) is thought by its customers to have no close substitute and; (3) is not subject to price regulation. The existence of all three conditions will be demonstrated by a company's ability to regularly price its product or service aggressively and thereby to earn high rates of return on capital. Moreover, franchises can tolerate mis-management. Inept managers may diminish a franchise's profitability, but they cannot inflict mortal damage.

In contrast, "a business" earns exceptional profits only if it is the low-cost operator or if supply of its product or service is tight. Tightness in supply usually does not last long. With superior management, a company may maintain its status as a low-cost operator for a much longer time, but even then unceasingly faces the possibility of competitive attack. And a business, unlike a franchise, can be killed by poor management.

Until recently, media properties possessed the three characteristics of a franchise and consequently could both price aggressively and be managed loosely. Now, however, consumers looking for information and entertainment (their primary interest being the latter) enjoy greatly broadened choices as to where to find them. Unfortunately, demand can't expand in response to this new supply: 500 million American eyeballs and a 24-hour day are all that's available. The result is that competition has intensified, markets have fragmented, and the media industry has lost some - though far from all - of its franchise strength.

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The industry's weakened franchise has an impact on its value that goes far beyond the immediate effect on earnings. For an understanding of this phenomenon, let's look at some much over-simplified, but relevant, math.

A few years ago the conventional wisdom held that a newspaper, television or magazine property would forever increase its earnings at 6% or so annually and would do so *without the employment of additional capital*, for the reason that depreciation charges would roughly match capital expenditures and working capital requirements would be minor. Therefore, reported earnings (before amortization of intangibles) were also freely-distributable earnings, which meant that ownership of a media property could be construed as akin to owning a perpetual annuity set to grow at 6% a year. Say, next, that a discount rate of 10% was used to determine the present value of that earnings stream. One could then calculate that it was appropriate to pay a whopping $25 million for a property with current after-tax earnings of $1 million. (This after-tax multiplier of 25 translates to a multiplier on pre-tax earnings of about 16.)

Now change the assumption and posit that the $1 million represents "normal earning power" and that earnings will bob around this figure cyclically. A "bob-around" pattern is indeed the lot of most businesses, whose income stream grows only if their owners are willing to commit more capital (usually in the form of retained earnings). Under our revised assumption, $1 million of earnings, discounted by the same 10%, translates to a $10 million valuation. Thus a seemingly modest shift in assumptions reduces the property's valuation to 10 times after-tax earnings (or about 6 1/2 times pre-tax earnings).

Dollars are dollars whether they are derived from the operation of media properties or of steel mills. What in the past caused buyers to value a dollar of earnings from media far higher than a dollar from steel was that the earnings of a media property were expected to constantly grow (without the business requiring much additional capital), whereas steel earnings clearly fell in the bob-around category. Now, however, expectations for media have moved toward the bob-around model. And, as our simplified example illustrates, valuations must change dramatically when expectations are revised.

We have a significant investment in media - both through our direct ownership of Buffalo News and our shareholdings in The Washington Post Company and Capital Cities/ABC - and the intrinsic value of this investment has declined materially because of the secular transformation that the industry is experiencing. (Cyclical

factors have also hurt our current look-through earnings, but these factors do not reduce intrinsic value.) However, as our Business Principles on page 2-3 note, one of the rules by which we run Berkshire is that we do not sell businesses - or investee holdings that we have classified as permanent - simply because we see ways to use the money more advantageously elsewhere. (We did sell certain other media holdings sometime back, but these were relatively small.)

The intrinsic value losses that we have suffered have been moderated because the Buffalo News, under Stan Lipsey's leadership, has done far better than most newspapers and because both Cap Cities and Washington Post are exceptionally well-managed. In particular, these companies stayed on the sidelines during the late 1980's period in which purchasers of media properties regularly paid irrational prices. Also, the debt of both Cap Cities and Washington Post is small and roughly offset by cash that they hold. As a result, the shrinkage in the value of their assets has not been accentuated by the effects of leverage. Among publicly-owned media companies, our two investees are about the only ones essentially free of debt. Most of the other companies, through a combination of the aggressive acquisition policies they pursued and shrinking earnings, find themselves with debt equal to five or more times their current net income.

The strong balance sheets and strong managements of Cap Cities and Washington Post leave us more comfortable with these investments than we would be with holdings in any other media companies. Moreover, most media properties continue to have far better economic characteristics than those possessed by the average American business. But gone are the days of bullet-proof franchises and cornucopian economics.

Twenty Years in a Candy Store

We've just passed a milestone: Twenty years ago, on January 3, 1972, Blue Chip Stamps (then an affiliate of Berkshire and later merged into it) bought control of See's Candy Shops, a West Coast manufacturer and retailer of boxed-chocolates. The nominal price that the sellers were asking - calculated on the 100% ownership we ultimately attained - was $40 million. But the company had $10 million of excess cash, and therefore the true offering price was $30 million. Charlie and I, not yet fully appreciative of the value of an economic franchise, looked at the company's mere $7 million of tangible net worth and said $25 million was as high as we would go (and we meant it). Fortunately, the sellers accepted our offer.

The sales of trading stamps by Blue Chip thereafter declined from $102.5 million in 1972 to $1.2 million in 1991. But See's candy sales in the same period increased from $29 million to $196 million. Moreover, profits at See's grew even faster than sales, from $4.2 million pre-tax in 1972 to $42.4 million last year.

For an increase in profits to be evaluated properly, it must be compared with the incremental capital investment required to produce it. On this score, See's has been astounding: The company now operates comfortably with only $25 million of net worth, which means that our beginning base of $7 million has had to be supplemented by only $18 million of reinvested earnings. Meanwhile, See's remaining pre-tax profits of $410 million were distributed to Blue Chip/Berkshire during the 20 years for these companies to deploy (after payment of taxes) in whatever way made most sense.

In our See's purchase, Charlie and I had one important insight: We saw that the business had untapped pricing power. Otherwise, we were lucky twice over. First, the transaction was not derailed by our dumb insistence on a $25 million price. Second, we found Chuck Huggins, then See's executive vice-president, whom we instantly put in charge. Both our business and personal experiences

with Chuck have been outstanding. One example: When the purchase was made, we shook hands with Chuck on a compensation arrangement - conceived in about five minutes and never reduced to a written contract - that remains unchanged to this day.

In 1991, See's sales volume, measured in dollars, matched that of 1990. In pounds, however, volume was down 4%. All of that slippage took place in the last two months of the year, a period that normally produces more than 80% of annual profits. Despite the weakness in sales, profits last year grew 7%, and our pre-tax profit margin was a record 21.6%.

Almost 80% of See's sales come from California and our business clearly was hurt by the recession, which hit the state with particular force late in the year. Another negative, however, was the mid-year initiation in California of a sales tax of 7%-8«% (depending on the county involved) on "snack food" that was deemed applicable to our candy.

Shareholders who are students of epistemological shadings will enjoy California's classifications of "snack" and "non-snack" foods:

Taxable "Snack" Foods	Non-Taxable "Non-Snack" Foods
Ritz Crackers	Soda Crackers
Popped Popcorn	Unpopped Popcorn
Granola Bars	Granola Cereal
Slice of Pie (Wrapped)	Whole Pie
Milky Way Candy Bar	Milky Way Ice Cream Bar

What - you are sure to ask - is the tax status of a *melted* Milky Way ice cream bar? In that androgynous form, does it more resemble an ice cream bar or a candy bar that has been left in the sun? It's no wonder that Brad Sherman, Chairman of California's State Board of Equalization, who opposed the snack food bill but must now administer it, has said: "I came to this job as a specialist in tax law. Now I find my constituents should have elected Julia Child."

Charlie and I have many reasons to be thankful for our association with Chuck and See's. The obvious ones are that we've earned exceptional returns and had a good time in the process. Equally important, ownership of See's has taught us much about the evaluation of franchises. We've made significant money in certain common stocks because of the lessons we learned at See's.

H. H. Brown

We made a sizable acquisition in 1991 - the H. H. Brown Company - and behind this business is an interesting history. In 1927 a 29-year-old businessman named Ray Heffernan purchased the company, then located in North Brookfield, Massachusetts, for $10,000 and began a 62-year career of running it. (He also found time for other pursuits: At age 90 he was still joining new golf clubs.) By Mr. Heffernan's retirement in early 1990 H. H. Brown had three plants in the United States and one in Canada; employed close to 2,000 people; and earned about $25 million annually before taxes.

Along the way, Frances Heffernan, one of Ray's daughters, married Frank Rooney, who was sternly advised by Mr. Heffernan before the wedding that he had better forget any ideas he might have about working for his father-in-law. That was one of Mr. Heffernan's few mistakes: Frank went on to become CEO of Melville Shoe (now Melville Corp.). During his 23 years as boss, from 1964 through 1986, Melville's earnings averaged more than 20% on equity and its stock (adjusted for splits) rose from $16 to $960. And a few years after Frank retired, Mr. Heffernan, who had fallen ill,

asked him to run Brown.

After Mr. Heffernan died late in 1990, his family decided to sell the company - and here we got lucky. I had known Frank for a few years but not well enough for him to think of Berkshire as a possible buyer. He instead gave the assignment of selling Brown to a major investment banker, which failed also to think of us. But last spring Frank was playing golf in Florida with John Loomis, a long-time friend of mine as well as a Berkshire shareholder, who is always on the alert for something that might fit us. Hearing about the impending sale of Brown, John told Frank that the company should be right up Berkshire's alley, and Frank promptly gave me a call. I thought right away that we would make a deal and before long it was done.

Much of my enthusiasm for this purchase came from Frank's willingness to continue as CEO. Like most of our managers, he has no financial need to work but does so because he loves the game and likes to excel. Managers of this stripe cannot be "hired" in the normal sense of the word. What we must do is provide a concert hall in which business artists of this class will wish to perform.

Brown (which, by the way, has no connection to Brown Shoe of St. Louis) is the leading North American manufacturer of work shoes and boots, and it has a history of earning unusually fine margins on sales and assets. Shoes are a tough business - of the billion pairs purchased in the United States each year, about 85% are imported - and most manufacturers in the industry do poorly. The wide range of styles and sizes that producers offer causes inventories to be heavy; substantial capital is also tied up in receivables. In this kind of environment, only outstanding managers like Frank and the group developed by Mr. Heffernan can prosper.

A distinguishing characteristic of H. H. Brown is one of the most unusual compensation systems I've encountered - but one that warms my heart: A number of key managers are paid an annual salary of $7,800, to which is added a designated percentage of the profits of the company after these are reduced by a charge for capital employed. These managers therefore truly stand in the shoes of owners. In contrast, most managers talk the talk but don't walk the walk, choosing instead to employ compensation systems that are long on carrots but short on sticks (and that almost invariably treat equity capital as if it were cost-free). The arrangement at Brown, in any case, has served both the company and its managers exceptionally well, which should be no surprise: Managers eager to bet heavily on their abilities usually have plenty of ability to bet on.

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It's discouraging to note that though we have on four occasions made major purchases of companies whose sellers were represented by prominent investment banks, we were in only one of these instances contacted by the investment bank. In the other three cases, I myself or a friend initiated the transaction at some point after the investment bank had solicited its own list of prospects. We would love to see an intermediary earn its fee by thinking of us - and therefore repeat here what we're looking for:

(1) Large purchases (at least $10 million of after-tax earnings),
(2) Demonstrated consistent earning power (future projections are of little interest to us, nor are "turnaround" situations),
(3) Businesses earning good returns on equity while employing little or no debt,
(4) Management in place (we can't supply it),
(5) Simple businesses (if there's lots of technology, we won't understand it),

(6) An offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer - customarily within five minutes - as to whether we're interested. (With Brown, we didn't even need to take five.) We prefer to buy for cash, but will consider issuing stock when we receive as much in intrinsic business value as we give.

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

Charlie and I frequently get approached about acquisitions that don't come close to meeting our tests: We've found that if you advertise an interest in buying collies, a lot of people will call hoping to sell you their cocker spaniels. 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."

Besides being interested in the purchase of businesses as described above, we are also interested in the negotiated purchase of large, but not controlling, blocks of stock comparable to those we hold in Capital Cities, Salomon, Gillette, USAir, Champion, and American Express. We are not interested, however, in receiving suggestions about purchases we might make in the general stock market.

Insurance Operations

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

	Yearly Change in Premiums Written (%)	*Combined Ratio After Policyholder Dividends*	*Yearly Change in Incurred Losses (%)*	*Inflation Rate Measured by GDP Deflator (%)*
1981	3.8	106.0	6.5	10.0
1982	3.7	109.6	8.4	6.2
1983	5.0	112.0	6.8	4.0
1984	8.5	118.0	16.9	4.5
1985	22.1	116.3	16.1	3.7
1986	22.2	108.0	13.5	2.7
1987	9.4	104.6	7.8	3.1
1988	4.4	105.4	5.5	3.9
1989	3.2	109.2	7.7	4.4
1990 (Revised)	4.4	109.6	4.8	4.1
1991 (Est.)	3.1	109.1	2.9	3.7

The combined ratio represents total insurance costs (losses incurred plus expenses) compared to revenue from premiums: A ratio below 100 indicates an underwriting profit, and one above 100 indicates a loss. The higher the ratio, the worse the year. When the investment income that an insurer earns from holding policyholders' funds ("the float") is taken into account, a combined ratio in the 107 - 111 range typically produces an overall break-even result, exclusive of earnings on the funds provided by shareholders.

For the reasons laid out in previous reports, we expect the industry's incurred losses to grow at close to 10% annually, even in periods when general inflation runs considerably lower. (Over the last 25 years, incurred losses have in reality grown at a still faster rate, 11%.) If premium growth meanwhile materially lags that 10% rate, underwriting losses will mount.

However, the industry's tendency to under-reserve when business turns bad may obscure the picture for a time - and that could well describe the situation last year. Though premiums did not come close to growing 10%, the combined ratio failed to deteriorate as I had expected but instead slightly improved. Loss-reserve data for the industry indicate that there is reason to be skeptical of that outcome, and it may turn out that 1991's ratio should have been worse than was reported. In the long run, of course, trouble awaits managements that paper over operating problems with accounting maneuvers. Eventually, managements of this kind achieve the same result as the seriously-ill patient who tells his doctor: "I can't afford the operation, but would you accept a small payment to touch up the x-rays?"

Berkshire's insurance business has changed in ways that make combined ratios, our own or the industry's, largely irrelevant to our performance. What counts with us is the "cost of funds developed from insurance," or in the vernacular, "the cost of float."

Float - which we generate in exceptional amounts - is the total of loss reserves, loss adjustment expense reserves and unearned premium reserves minus agents balances, prepaid acquisition costs and deferred charges applicable to assumed reinsurance. And the cost of float is measured by our underwriting loss.

The table below shows our cost of float since we entered the business in 1967.

	(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	119.6	1,895.0	6.31%	7.40%

As you can see, our cost of funds in 1991 was well below the U. S. Government's cost on newly-issued long-term bonds. We have in fact beat the government's rate in 20 of the 25 years we have been in the insurance business, often by a wide margin. We have over that time also substantially increased the amount of funds we hold, which counts as a favorable development but only because the cost of funds has been satisfactory. Our float should continue to grow; the challenge will be to garner these funds at a reasonable cost.

Berkshire continues to be a very large writer - perhaps the largest in the world - of "super-cat" insurance, which is coverage that other insurance companies buy to protect themselves against major catastrophic losses. Profits in this business are enormously volatile. As I mentioned last year, $100 million in super-cat premiums, which is roughly our annual expectation, could deliver us anything from a $100 million profit (in a year with no big catastrophe) to a $200 million loss (in a year in which a couple of major hurricanes and/or earthquakes come along).

We price this business expecting to pay out, over the long term, about 90% of the premiums we receive. In any given year, however, we are likely to appear either enormously profitable or enormously unprofitable. That is true in part because GAAP accounting does not allow us to set up reserves in the catastrophe-free years for losses that are certain to be experienced in other years. In effect, a one-year accounting cycle is ill-suited to the nature of this business - and that is a reality you should be aware of when you assess our annual results.

Last year there appears to have been, by our definition, one super-cat, but it will trigger payments from only about 25% of our policies. Therefore, we currently estimate the 1991 underwriting profit from our catastrophe business to have been about $11 million. (You may be surprised to learn the identity of the biggest catastrophe in 1991: It was neither the Oakland fire nor Hurricane Bob, but rather a September typhoon in Japan that caused the industry an insured loss now estimated at about $4-$5 billion. At the higher figure, the loss from the typhoon would surpass that from Hurricane Hugo, the previous record-holder.)

Insurers will always need huge amounts of reinsurance protection for marine and aviation disasters as well as for natural catastrophes. In the 1980's much of this reinsurance was supplied by "innocents" - that is, by insurers that did not understand the risks of the business - but they have now been financially burned beyond recognition. (Berkshire itself was an innocent all too often when I was personally running the insurance operation.) Insurers, though, like investors, eventually repeat their mistakes. At some point - probably after a few catastrophe-scarce years - innocents will reappear and prices for super-cat policies will plunge to silly levels.

As long as apparently-adequate rates prevail, however, we will be a major participant in super-cat coverages. In marketing this product, we enjoy a significant competitive advantage because of our premier financial strength. Thinking insurers know that when "the big one" comes, many reinsurers who found it easy to write policies will find it difficult to write checks. (Some reinsurers can say what Jackie Mason does: "I'm fixed for life - as long as I don't buy anything.") Berkshire's ability to fulfill all its commitments under conditions of even extreme adversity is unquestioned.

Overall, insurance offers Berkshire its greatest opportunities. Mike Goldberg has accomplished wonders with this operation since he took charge and it has become a very valuable asset, albeit one that can't be appraised with any precision.

Marketable Common Stocks

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

Shares	*Company*	*12/31/91* *Cost*	*Market*
		(000s omitted)	
3,000,000	Capital Cities/ABC, Inc.	$ 517,500	$1,300,500
46,700,000	The Coca-Cola Company.	1,023,920	3,747,675
2,495,200	Federal Home Loan Mortgage Corp.	77,245	343,090
6,850,000	GEICO Corp.	45,713	1,363,150
24,000,000	The Gillette Company	600,000	1,347,000
31,247,000	Guinness PLC	264,782	296,755
1,727,765	The Washington Post Company	9,731	336,050
5,000,000	Wells Fargo & Company	289,431	290,000

As usual the list reflects our Rip Van Winkle approach to investing. Guinness is a new position. But we held the other seven stocks a year ago (making allowance for the conversion of our Gillette position from preferred to common) and in six of those we hold an unchanged number of shares. The exception is Federal Home Loan Mortgage ("Freddie Mac"), in which our shareholdings increased slightly. Our stay-put behavior reflects our view that the stock market serves as a relocation center at which money is moved from the active to the patient. (With tongue only partly in check, I suggest that recent events indicate that the much-maligned "idle rich" have received a bad rap: They have maintained or increased their wealth while many of the "energetic rich" - aggressive real estate operators, corporate acquirers, oil drillers, etc. - have seen their fortunes disappear.)

Our Guinness holding represents Berkshire's first significant investment in a company domiciled outside the United States. Guinness, however, earns its money in much the same fashion as Coca-Cola and Gillette, U.S.-based companies that garner most of their profits from international operations. Indeed, in the sense of where they earn their profits - continent-by-continent - Coca-Cola and Guinness display strong similarities. (But you'll never get their drinks confused - and your Chairman remains unmovably in the Cherry Coke camp.)

We continually search for large businesses with understandable, enduring and mouth-watering economics that are run by able and shareholder-oriented managements. This focus doesn't guarantee results: We both have to buy at a sensible price and get business performance from our companies that validates our assessment. But this investment approach - searching for the superstars - offers us our only chance for real success. Charlie and I are simply not smart enough, considering the large sums we work with, to get great results by adroitly buying and selling portions of far-from-great businesses. Nor do we think many others can achieve long-term investment success by flitting from flower to flower. Indeed, we believe that according the name "investors" to institutions that trade actively is like calling someone who repeatedly engages in one-night stands a romantic.

If my universe of business possibilities was limited, say, to private companies in Omaha, I would, first, try to assess the long-term economic characteristics of each business; second, assess the quality of the people in charge of running it; and, third, try to buy into a few of the best operations at a sensible price. I certainly would not wish to own an equal part of every business in town. Why, then, should Berkshire take a different tack when dealing with the larger universe of public companies? And since finding great businesses and outstanding managers is so difficult, why should we discard proven products? (I was tempted to say "the

real thing.") Our motto is: "If at first you do succeed, quit trying."

John Maynard Keynes, whose brilliance as a practicing investor matched his brilliance in thought, wrote a letter to a business associate, F. C. Scott, on August 15, 1934 that says it all: "As time goes on, I get more and more convinced that the right method in investment is to put fairly large sums into enterprises which one thinks one knows something about and in the management of which one thoroughly believes. It is a mistake to think that one limits one's risk by spreading too much between enterprises about which one knows little and has no reason for special confidence. . . . One's knowledge and experience are definitely limited and there are seldom more than two or three enterprises at any given time in which I personally feel myself entitled to put *full* confidence."

Mistake Du Jour

In the 1989 annual report I wrote about "Mistakes of the First 25 Years" and promised you an update in 2015. My experiences in the first few years of this second "semester" indicate that my backlog of matters to be discussed will become unmanageable if I stick to my original plan. Therefore, I will occasionally unburden myself in these pages in the hope that public confession may deter further bumblings. (Post-mortems prove useful for hospitals and football teams; why not for businesses and investors?)

Typically, our most egregious mistakes fall in the omission, rather than the commission, category. That may spare Charlie and me some embarrassment, since you don't see these errors; but their invisibility does not reduce their cost. In this mea culpa, I am not talking about missing out on some company that depends upon an esoteric invention (such as Xerox), high-technology (Apple), or even brilliant merchandising (Wal-Mart). We will never develop the competence to spot such businesses early. Instead I refer to business situations that Charlie and I can understand and that seem clearly attractive - but in which we nevertheless end up sucking our thumbs rather than buying.

Every writer knows it helps to use striking examples, but I wish the one I now present wasn't quite so dramatic: In early 1988, we decided to buy 30 million shares (adjusted for a subsequent split) of Federal National Mortgage Association (Fannie Mae), which would have been a $350-$400 million investment. We had owned the stock some years earlier and understood the company's business. Furthermore, it was clear to us that David Maxwell, Fannie Mae's CEO, had dealt superbly with some problems that he had inherited and had established the company as a financial powerhouse - with the best yet to come. I visited David in Washington and confirmed that he would not be uncomfortable if we were to take a large position.

After we bought about 7 million shares, the price began to climb. In frustration, I stopped buying (a mistake that, thankfully, I did not repeat when Coca-Cola stock rose similarly during our purchase program). In an even sillier move, I surrendered to my distaste for holding small positions and sold the 7 million shares we owned.

I wish I could give you a halfway rational explanation for my amateurish behavior vis-a-vis Fannie Mae. But there isn't one. What I *can* give you is an estimate as of yearend 1991 of the approximate gain that Berkshire *didn't* make because of your Chairman's mistake: about $1.4 billion.

Fixed-Income Securities

We made several significant changes in our fixed-income portfolio during 1991. As I noted earlier, our Gillette preferred

was called for redemption, which forced us to convert to common stock; we eliminated our holdings of an RJR Nabisco issue that was subject to an exchange offer and subsequent call; and we purchased fixed-income securities of American Express and First Empire State Corp., a Buffalo-based bank holding company. We also added to a small position in ACF Industries that we had established in late 1990. Our largest holdings at yearend were:

	(000s omitted)	
Issuer	Cost of Preferreds and Amortized Value of Bonds	Market
ACF Industries	$ 93,918(2)	$118,683
American Express	300,000	263,265(1)(2)
Champion International	300,000(2)	300,000(1)
First Empire State	40,000	50,000(1)(2)
RJR Nabisco	222,148(2)	285,683
Salomon	700,000(2)	714,000(1)
USAir	358,000(2)	232,700(1)
Washington Public Power Systems	158,553(2)	203,071

(1) Fair value as determined by Charlie and me
(2) Carrying value in our financial statements

Our $40 million of First Empire State preferred carries a 9% coupon, is non-callable until 1996 and is convertible at $78.91 per share. Normally I would think a purchase of this size too small for Berkshire, but I have enormous respect for Bob Wilmers, CEO of First Empire, and like being his partner on any scale.

Our American Express preferred is not a normal fixed-income security. Rather it is a "Perc," which carries a fixed dividend of 8.85% on our $300 million cost. Absent one exception mentioned later, our preferred must be converted three years after issuance, into a maximum of 12,244,898 shares. If necessary, a downward adjustment in the conversion ratio will be made in order to limit to $414 million the total value of the common we receive. Though there is thus a ceiling on the value of the common stock that we will receive upon conversion, there is no floor. The terms of the preferred, however, include a provision allowing us to extend the conversion date by one year if the common stock is below $24.50 on the third anniversary of our purchase.

Overall, our fixed-income investments have treated us well, both over the long term and recently. We have realized large capital gains from these holdings, including about $152 million in 1991. Additionally, our after-tax yields have considerably exceeded those earned by most fixed-income portfolios.

Nevertheless, we have had some surprises, none greater than the need for me to involve myself personally and intensely in the Salomon situation. As I write this letter, I am also writing a letter for inclusion in Salomon's annual report and I refer you to that report for an update on the company. (Write to: Corporate Secretary, Salomon Inc, Seven World Trade Center, New York, NY 10048) Despite the company's travails, Charlie and I believe our Salomon preferred stock increased slightly in value during 1991. Lower interest rates and a higher price for Salomon's common produced this result.

Last year I told you that our USAir investment "should work out all right unless the industry is decimated during the next few years." Unfortunately 1991 was a decimating period for the industry, as Midway, Pan Am and America West all entered bankruptcy. (Stretch the period to 14 months and you can add Continental and TWA.)

The low valuation that we have given USAir in our table

reflects the risk that the industry will remain unprofitable for virtually all participants in it, a risk that is far from negligible. The risk is heightened by the fact that the courts have been encouraging bankrupt carriers to continue operating. These carriers can temporarily charge fares that are below the industry's cost