June 29, 2010

Americas: Insurance

Goldman Sachs

Initiating on Berkshire Hathaway (BRK.A, BRK.B) with a Buy rating

Valuation disconnect at a multi-decade high

We initiate coverage of Berkshire Hathaway (BRK.A/BRK.B) with a Buy rating, as the disconnect between the market value of the stock and the intrinsic value of the business is close to a multi-decade high. With the recent inclusion of Berkshire in the S&P 500 and Russell indices and increased investor focus, we attempt to provide a framework for how to invest in the stock. In our view, the company is a unique collection of assets that over time earns a return on those assets – and as such should be valued accordingly.

Transformation: Key shifts in value mix

Post the acquisition of Burlington Northern, we estimate close to half of Berkshire's intrinsic value will be derived from "operating" entities (as opposed to "securities investments"). This accomplishes two key things, in our view: (a) it reduces the long-term reliance on senior management's equity investing decisions, and (b) provides greater clarity into the source of future value for the company as a whole.

Structural growth in largest segments

Structurally, Berkshire's earnings will benefit from the ongoing shift in consumers' **auto insurance** buying habits (via the direct-to-consumer GEICO subsidiary), the continuing change in the way goods are transported across the country (via the **large intermodal operations** at Burlington Northern), and the enduring growth in **energy and power demand** (via MidAmerican).

Levered to cyclical economic recovery

Cyclically, the non-insurance entities are tied to GDP growth and to a lesser extent, industrial production. Thus, as the economy continues to emerge from its cyclical downturn, we would expect earnings to grow at a faster rate than what appears to be currently discounted in the stock.

Price targets and risks

Our 12-month intrinsic value-based price target is $152,000 for BRK.A and $101 for BRK.B, implying over 25% upside. Key risks include an economic downturn, insured catastrophes, and management succession.

WHAT IS BERKSHIRE HATHAWAY?

Business Segments	% GAAP Earnings
Reinsurance	33%
Railroad	22%
Manufacturing & Services	17%
Auto Insurance	12%
Utilities	9%
Other Non-Insurance	6%
Other Insurance	1%
TOTAL	100%

SOURCE: Goldman Sachs Research estimates.

Berkshire Hathaway and its affiliates paid $5 billion in October 2008 to acquire 10% Cumulative Perpetual Preferred Stock with a total liquidation preference of $5 billion and warrants to purchase 43.5 million shares of common stock of The Goldman Sachs Group, Inc

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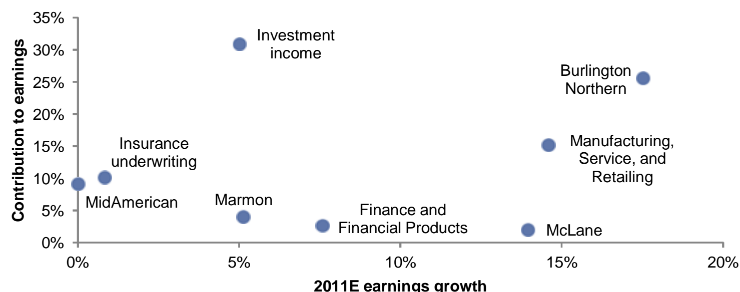
Berkshire Hathaway: A segment snapshot

Exhibit 1: An under-appreciated growth story - Snapshot of operating unit contribution



Segment	2009	2010E	2011E	2012E
Insurance underwriting	1,559	1,790	1,805	1,657
% growth	*(44%)*	*15%*	*1%*	*(8%)*
Investment income	5,173	5,225	5,486	5,651
% growth	*10%*	*1%*	*5%*	*3%*
Burlington Northern	-	3,489	4,543	5,013
% growth	*na*	*na*	*18%*	*10%*
MidAmerican Utilities	1,528	1,635	1,631	1,682
% growth	*(48%)*	*7%*	*(0%)*	*3%*
Marmon (manufacturing and services conglomerate)	686	681	716	738
% growth	*(6%)*	*(1%)*	*5%*	*3%*
McLane (foodservice supply chain company)	344	317	362	401
% growth	*25%*	*(8%)*	*14%*	*11%*
Manufacturing, Service, and Retailing	1,028	2,360	2,704	3,047
% growth	*(66%)*	*130%*	*15%*	*13%*
Finance and Financial Products	781	444	478	515
% growth	*(1%)*	*(43%)*	*8%*	*8%*
Consolidated pre-tax earnings	**11,099**	**15,942**	**17,725**	**18,703**
% growth	***(27%)***	***44%***	***11%***	***6%***

SEGMENT	DRIVERS TO EARNINGS
Insurance underwriting	Commercial insurance underwriting cycle; Profitable growth at GEICO; International and life reinsurance opportunities
Investment income	Dividend income: investment company profitability and dividend payouts; Interest income: reinvestment rates
Burlington Northern	Recovery in volume growth; Growth in intermodal (truck-to-rail) shifts; Exposure to Asian trade and West coast ports
MidAmerican	Rate cases driving incremental revenue; Capital expenditures increasing net PP&E/ rate base; Power demand growth
Marmon	Revenue growth: new distribution contracts/ increased customer business activity; Maintaining stable margins: fuel cost pass-through
McLane	Economic and industrial growth given the segment's diverse portfolio of 130 manufacturing and service companies
Manufacturing, Service, Retailing	Rebound in NetJets performance; consumer spending; Industrial production
Finance and Financial Products	Manufactured housing market financing and end-demand; Investment income returns; interest income; Leasing market trends

Source: Goldman Sachs Research estimates, company data,

Initiating on Berkshire Hathaway with a Buy rating

We initiate coverage of Berkshire Hathaway with a Buy rating, as the current disconnect between the stock price and the intrinsic value per share is close to a multi-decade high (see Exhibits 4 and 7below). Our twelve-month intrinsic value based price targets of $152,000 and $101 (for the A and B shares, respectively), imply over 25% upside from current levels. Throughout its history, Berkshire has alternately been viewed as a closed-end investment fund, an insurance company that buys whole companies, or some combination of both – albeit with a perceived "premium" to account for its investment track record. In our view, however, Berkshire is a unique collection of assets that over time earns a return on those assets – and as such should be valued accordingly. In this report, we attempt to value those assets and in turn provide a framework for how to invest in the stock.

As part of our analysis of Berkshire Hathaway, we believe there are three key takeaways for investors:

1. **Transformation:** While historically there have been essentially no other companies with business models similar to Berkshire, we find that the conglomerate has started to evolve over the past few years into one whose value will be more defined in the future by its consolidated operating entities as opposed to its equity investments. The acquisitions of MidAmerican, Burlington Northern, and Marmon have significantly altered the Berkshire landscape. This accomplishes two key things, in our view: (a) it reduces the reliance on senior management's equity investing decisions, and (b) provides greater clarity into the source of future value for the company as a whole.

2. **One-of-a-kind Insurance Model:** There are no other insurance companies similar to the combined group of insurers owned by Berkshire Hathaway. To be sure, the types of risks – for the most part – are the same risks underwritten by many other insurance and reinsurance companies. Furthermore, Berkshire's historical "insurance profitability" track record is not significantly better than the industry average. However, it is Berkshire management's ability to invest the float for total return (as opposed to simply managing for yield) that has created such a significant disconnect in value between Berkshire and its peers over time. With billions of dollars held in cash at all times ($22.7 billion at 1Q 2010) to protect against the "catastrophic insurance scenario", Berkshire can invest more in equities and other asset classes than any other insurer.

3. **Competitive Advantage:** Within the non-insurance operations, there is a common theme of significant competitive advantage. Each business – whether it is McLane, PacifiCorp, Fruit of the Loom, or NetJets – is one of the top market share leaders in either its industry or geography. With a wide enough "moat" in each company, there is theoretically greater long-term confidence in the earnings capability for each franchise. At worst the non-insurance operations should grow with the economy and at best should compound returns greater than their respective industries.

Berkshire: Both a structural and cyclical growth story

As we will show in this report, Berkshire Hathaway is both a structural and cyclical growth story. Structurally, Berkshire's earnings will benefit from the ongoing shift in consumers' auto insurance buying habits (via the direct-to-consumer GEICO subsidiary), the continuing change in the way goods are transported across the country (via the large intermodal operations at Burlington Northern), and the enduring growth in energy and power demand (via the MidAmerican utilities). Cyclically, Berkshire's non-insurance entities are largely tied to GDP growth and to a lesser extent industrial production; certain smaller components are also levered to the housing market and as such we forecast a more subdued recovery for these businesses. However, as the economy continues to emerge from its cyclical downturn, we would expect aggregated earnings to grow at a faster rate than what appears to be currently discounted in the stock

The Big Things: 5 key things investors should focus on

Berkshire Hathaway is a large, diverse, complex set of businesses. However, much like any other company, there are a few key things that will matter for the fundamentals and consequently the stock. We highlight them as follows:

1. **The commercial insurance cycle**: The commercial insurance industry is in the middle of what is likely to be a long pricing soft cycle. As we have shown in previous research, things have to get worse before they get better given the significant abundance of capital (and thus capacity) within the commercial insurance industry (see our report "Keeping it simple" on Jan 13, 2010). However, given Berkshire's insurance operations do not face the same incentives to grow top-line often found in other insurance companies (given BRK's ability to lever other parts of the business for earnings contribution), we would expect Berkshire's insurance operations most exposed to US commercial lines to continue to shrink in the face of heightened competition. That said, when the turn in insurance pricing occurs, an uplift to both earnings and float would help drive the stock higher given no such turn is currently factored into our numbers.

2. **Growth in auto insurance**: The direct-to-consumer auto insurance market – of which GEICO is a leader – continues to grow rapidly. Based on continued structural shifts in consumers' buying habits, we estimate GEICO's policy base could double within the next ten years. As a frame of reference, GEICO's market share increased from 3% to 8% in the past thirteen years, as more drivers have become comfortable buying auto insurance online or over the phone. As we show below, GEICO's policy growth has closely tracked the growth in internet-savvy Echo Boomers (i.e. children of Baby Boomers) as a percentage of the driving population – suggesting a continuation of recent growth as this demographic trend continues.

3. **Industrial production**: Many of Berkshire's businesses are closely tied to the cyclical recovery of the macro economic environment. As fiscal stimulus (including associated multiplier effects) and the inventory re-stocking cycle moderate, our economists see real GDP growth (at 2.5% in 1Q2010) peaking in the middle of this year at 3.4% and trailing down in the mid 2% range going forward. Berkshire's most GDP-sensitive businesses should receive a boost in the near term, with earnings growing at a steady rate mirroring economic growth in the longer term. We look at industrial production as a proxy for growth of Berkshire's other manufacturing businesses which are largely tied to the production of durable goods and apparel. Similar to GDP, our economists see industrial production peaking at 6.7% in 2Q and moderating to 4.3% in 2011.

4. **Railroad operating leverage**: As industrial production continues to improve, we would expect Burlington Northern (BNSF) to get significant operating leverage on growing volumes. We believe BNSF may be able to increase operating margins to 30% from current 24% levels within the next ten years. Railroads have recently benefitted from strong incremental margins as volumes have returned and better operations have enabled the companies to improve asset utilization. In addition, we would expect high barriers of entry to lead to inflation-plus pricing, which should continue to provide a margin boost.

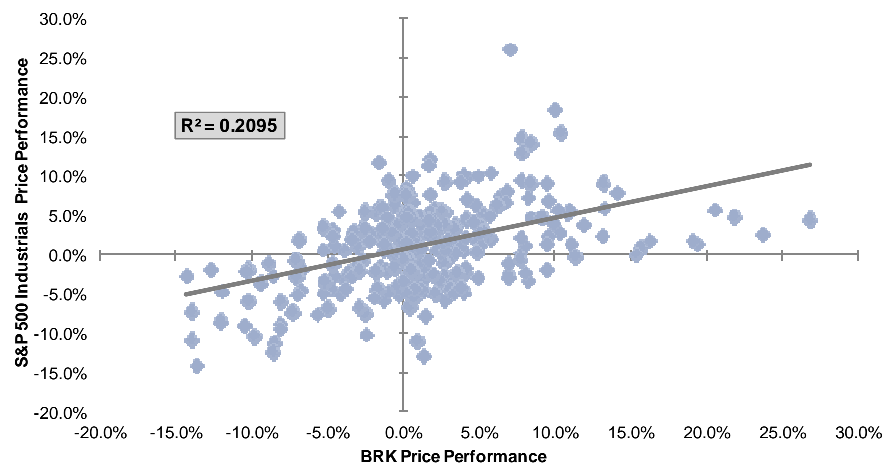
5. **A turn-around at NetJets**: Despite NetJets' dominance in the fractional jet ownership market, profitability has not met expectations. In the eleven years that Berkshire has owned NetJets it has recorded an aggregate pre-tax loss of $157 million, including a $711 million loss in 2009. As a result of these disappointing financial results, management made a leadership change and took aggressive restructuring actions. As a result of recent changes, we expect the unit to return to profitability in 2010 (with 1Q results of $57mn pre-tax earnings already helping to show signs of the turn-around). Given the large loss in 2009, even a 1Q run-rate annualized for the year (~$240mn) would imply almost a billion dollar year-over-year change in NetJets' contribution to earnings.

The Stock: Liquidity is no longer an issue

As part of Berkshire's acquisition of Burlington Northern earlier this year, two key technical events occurred: (1) shareholders approved a 50 for 1 stock split of the Class B shares (defined below); and (2) the stock was added to the S&P 500 index. We note the following key points as it relates to the stock:

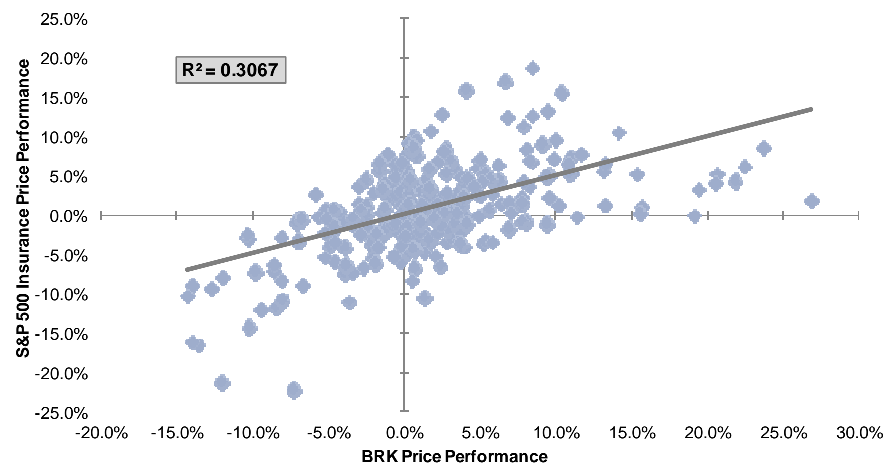
- There are two classes of Berkshire Hathaway stock: A shares and B shares. The Class B common stock possesses dividend and distribution rights equal to 1/1,500 of such rights of Class A common stock. Furthermore, each Class A common share is entitled to one vote per share while each Class B share only possesses voting rights equivalent to 1/10,000 of the voting rights of the Class A shares.
- As of March 31, 2010, there were 1,008,469 Class A shares outstanding and 957,957,221 Class B shares outstanding (and thus there are 1,647,107 shares outstanding on a Class A common stock equivalent basis).
- Historically, the relatively few number of total shares outstanding prevented the stock from being included in the major indices; however, with the shares now included in the indices (and accordingly many investors' relevant benchmarks), we believe more investors will begin to perform due diligence on the stock.
- As it relates to the S&P 500, Berkshire is now 1.31% of the index – or #14 in the index (#4 financial firm) with a market cap of approximately $195 billion.
- Lastly, although Berkshire is viewed as part insurance company, part industrial company, and part investment fund, we find no clear technical driver to the shares from a "sector" point of view.

Exhibit 2: Berkshire Hathaway monthly price performance vs. Industrial index



Source:

Exhibit 3: Berkshire Hathaway monthly price performance vs. Insurance index



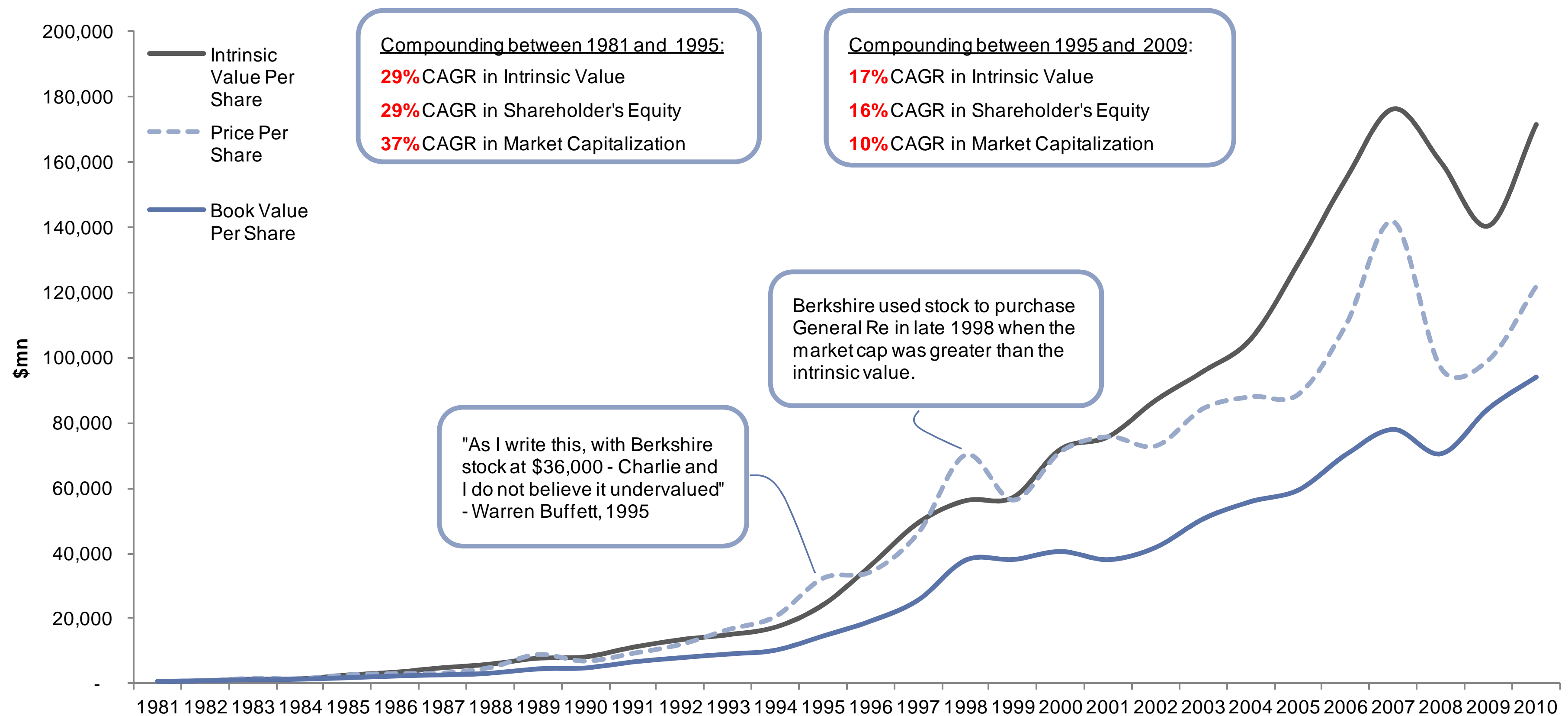
Source:

Valuation: Buy Berkshire with a margin of a safety

Focus on intrinsic value

In our view, there are three key ways to value Berkshire Hathaway: (1) shareholder's equity, (2) earnings, and (3) intrinsic value. Given the fairly unique nature of Berkshire, we ascribe the most relevancy to the last of the three – intrinsic value – and simply assess the first two (shareholder's equity and earnings) as guideposts on the potential future path of the stock. We derive our 12-month price targets of $152,000 and $101 (for the A and B shares, respectively), based on our assessment of intrinsic value. Below we discuss each of the valuation metrics and their relevancy in more detail:

Exhibit 4: The Art of Compounding



Source: Goldman Sachs Research, company data

(1) Intrinsic Value

While Berkshire is a unique set of assets, we believe intrinsic value can be calculated in a manner similar to other companies. In our view the company is a collection of assets which earns a return on those assets over time - and thus the present value of such returns should equal the intrinsic value. Using historical drivers of returns (i.e. historical operating profits, market value of investments, interest rates, etc.) we can assess how Berkshire's stock has tracked a derived intrinsic value over time. Importantly, however, the company has a long track record of producing significantly above-average returns on its assets and thus – while previous investment returns are no guarantee of future performance – we believe it is appropriate to factor above-average yields into intrinsic value. Specifically, we assess the intrinsic value as comprised of three main components:

1. **The value of the investment portfolio** (minus the insurance liabilities). This would be akin to a "book value" metric for other financial institutions. In other words, after liquidating the assets and having repaid all of the insurance obligations, the remainder would be the value left for shareholders.

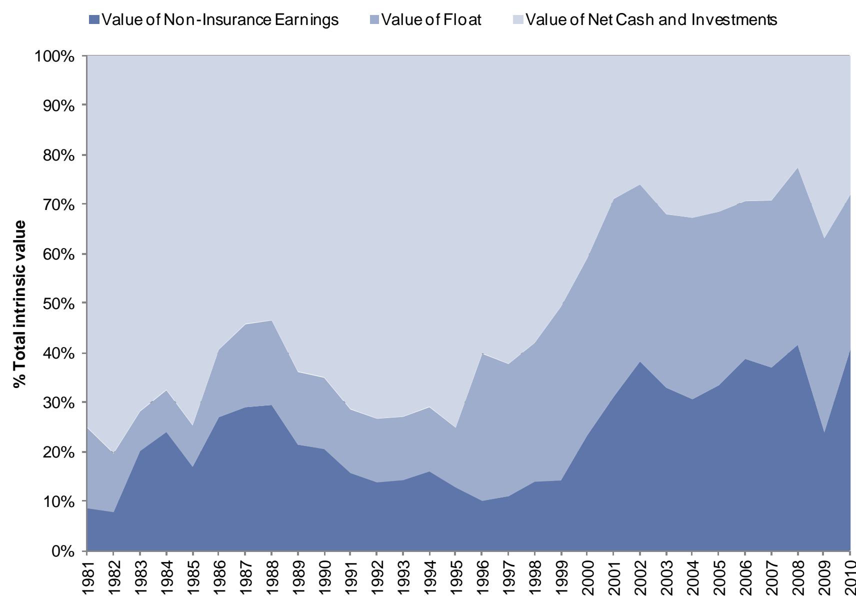
2. **The value of the float** within the insurance operations. Float is the amount of funds an insurance company holds for future obligations and which can be invested for its own account. We ascribe a value to the float based on estimated future returns and growth. We will describe this analysis in more detail within the Insurance section below, however we would note this is the most unique component to the value of Berkshire, as there are few, if any, financial institutions with a track record of generating similar levels of consistent returns (see Exhibits 11-14 below).

3. **The value of the non-insurance operating businesses**. Outside of insurance, Berkshire owns majority stakes in a wide array of businesses. While the underlying operations are very diverse (i.e. railroads, utilities, carpet manufacturers, and even Dairy Queen), the businesses tend to share a common characteristic in that almost all maintain leading market share for either their industry or their geography. This is important when ascribing an intrinsic or long-term value to the operations, as the risk of obsolescence for the majority of the operations is considerably lower than other individual companies within the market. The idea of a real competitive advantage – or "moat" – suggests that at worst the companies will grow with the economy and at best will continue to compound returns at a rate higher than their peers. When valuing the non-insurance operations of Berkshire, we utilize a discounted cash flow model by aggregating expected earnings and applying a modest (and declining) 3-year growth rate and then a terminal growth rate of 2.5%.

Other key points to note:

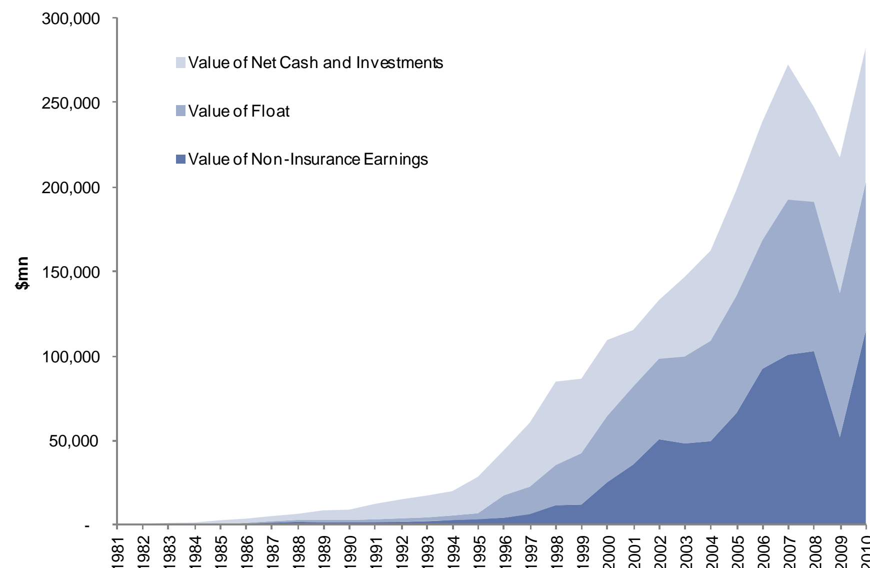
- Historically, the majority of the value derived from Berkshire has been sourced from the insurance operations – i.e. components one and two above. However, post the Burlington Northern acquisition, the contribution from non-insurance earnings will be larger than at any previous time in BRK's history. We believe this is likely a concerted effort by current management over the past few years to allow for the "investing" component of BRK's value to become less of a variable in the future – and thereby reducing the risk of lower investment returns impacting the value of Berkshire in the future (see Exhibits 5 and 6 below).

Exhibit 5: The value of non-insurance has increased vs. investments
Estimated contribution to intrinsic value over time



Source: Goldman Sachs Research, company data.

Exhibit 6: Intrinsic value has risen significantly in recent years
$ value of intrinsic value



Source: Goldman Sachs Research, company data

- When we back-test our intrinsic value (as seen in Exhibit 4 above), we can show that comments or actions (as highlighted in the exhibit) made by Berkshire are consistent with the relationship depicted between intrinsic value and the market value ascribed to Berkshire stock. For example, in 1998, **when Berkshire purchased General Re with stock, our analysis clearly shows the market value of the stock exceeded the intrinsic value of the company** – thus, making the acquisition with “share currency” a significant value addition to the overall shares (ignoring however the future liability problems that General Re wound up disclosing).
- When we back-test our intrinsic value model, we use a market cost of equity – i.e. the 10-year risk free rate and an applied equity risk premium for the US stock market. Not surprisingly, **the general declining cost of capital over the past 30 years has helped to raise the value of Berkshire** as well as the market.
- While Berkshire can be shown to be largely impacted by cyclical industrial forces within the US, we note that **the dual-nature of the operations (i.e. insurance and non-insurance) allows for uncorrelated value creation opportunities**. In other words, despite the recent recession’s negative impact on the future cash flows of the non-insurance businesses, the continued increase in insurance float (and the corresponding high-yielding investments made with that float) helped to mute the negative impact on the overall value of Berkshire.

Exhibit 7: How we calculate Intrinsic Value

» The intrinsic value (IV) derived in our analysis is comprised of three central components of value: (1) Value of Net Investments + (2) Value of Float + (3) Value of Non-Insurance Operations. We use current market value for the investments and subtract the insurance company liabilities. For the valuation of Float and the Non-Insurance Operations, we essentially forecast future returns and discount the cash flows back to today - with assumptions based on historical averages.

» For the historical estimates we hold expected rates of return constant (based on adjusted averages) and vary the discount rate based on the corresponding period's 10-year treasury rate and equity risk premium. We use historical earnings from non-insurance businesses as a proxy for dividends from operations. Lastly, we use historical period-ending market value of investments and the corresponding period's insurance liabilities.

$$IV_{BRK} = MV_{Investments} + PV_{Float} + PV_{Non-InsuranceOperations}$$

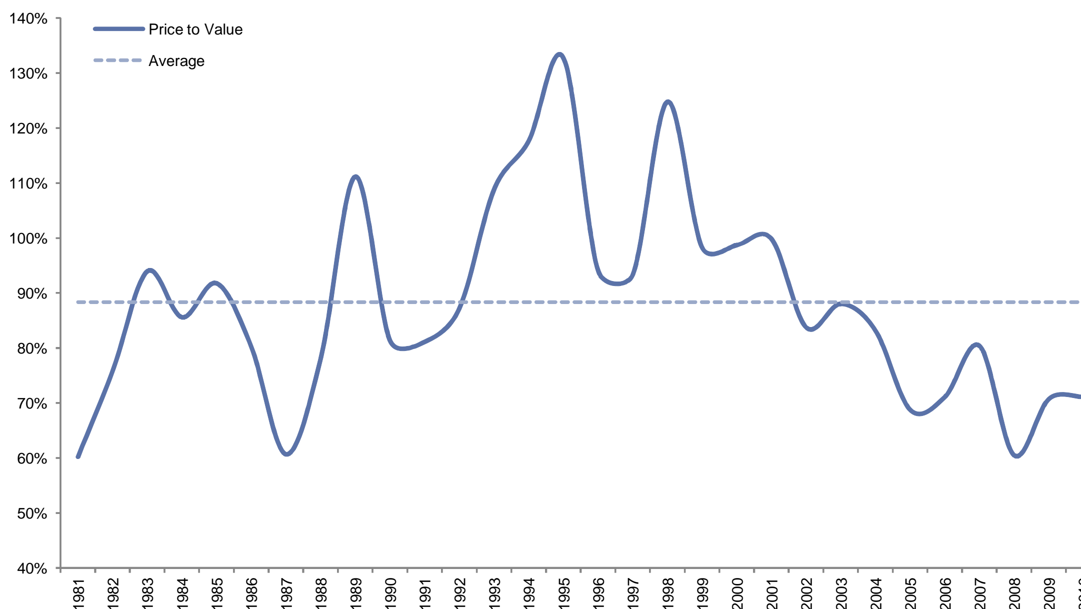
$$MV_{Investments} = MV_{Equities+Bonds+Cash} - Float - Debt$$

$$PV_{Float} = \underbrace{\frac{Float_G * (R_G - C_G)}{(k_e - g_G)}}_{\text{GEICO}} + \underbrace{\frac{Float_{GR} * (R_{GR} - C_{GR})}{(k_e - g_{GR})}}_{\text{GenRe}} + \underbrace{\frac{Float_O * (R_O - C_O)}{(k_e - g_O)}}_{\text{Other}}$$

where R = Investment Return, C = Expected Cost, k = discount rate and g = forecasted growth

$$PV_{Non-InsOps} = \frac{D_1}{(1+k_e)} + \frac{D_2}{(1+k_e)^2} + \frac{D_3/(k_e - g_{\text{Terminal}})}{(1+k_e)^2}$$

ASSUMPTIONS:			($mn)
Investments:			
Current Market Value of Investments			145,982
Current Insurance Liabilities			(66,640)
Value of Investments			**79,342**
Float:	**GEICO (G)**	**GenRe (GR)**	**Other (O)**
Expected Float	9,998	21,014	31,910
Investment Return (a/t) (R)	14.0%	5.5%	7.5%
Forecasted Growth (g)	4.0%	0.0%	2.0%
Expected Cost (C)	-3.0%	3.0%	0.0%
Discount Rate (k_e)	8.1%	8.1%	8.1%
Value of Float	**41,734**	**6,508**	**39,412**
Non-Insurance Operations:	**2011**	**2012**	**Terminal**
Earnings	6,050	6,591	6,756
Terminal Growth			2.5%
Discount Rate (k_e)			8.1%
Value of Non-Insurance Operations			**115,046**
Total Intrinsic Value			**282,042**
Shares (Class A)			1.647
Total Intrinsic Value per Share			171,235
Average Multiple to Intrinsic Value			89%
Target Intrinsic Value per A Share			**152,399**



Source: Goldman Sachs Research estimates

(2) Shareholder's Equity

The starting point for most investors in assessing the value of an insurance company (and most other financial stocks) is to gauge the potential changes in book value per share. As it relates to Berkshire, however, we note the following key points:

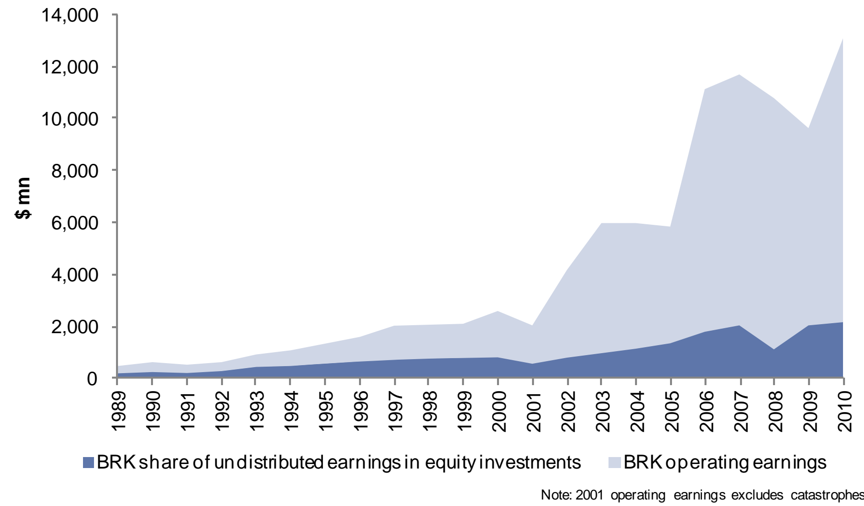
- While we focus on book value for our insurance coverage universe, **we believe it is a less important metric for Berkshire given the significant allocation to non-insurance operating sources of value**. The increase in market value of Berkshire's operating entities over the years is not reflected simply by combining invested capital and retained earnings – thus, while book value may serve as a measure of liquidation value, it ignores any increased value created within the operating businesses during the many years of ownership. We discuss the competitive advantages of Berkshire's many operating businesses in segments below.
- The company's stated goal remains increasing book value per share at a rate higher than the S&P 500's gain (or loss). By all measures, BRK's historical performance has been impressive—in the 45 years since management took over in 1965, BVPS has grown at a rate of 20.3% compounded annually. And while book value growth should track intrinsic value growth over the long-run, we believe it is much less useful in assessing the value of Berkshire Hathaway than for other financial services companies.

(3) Earnings

We note Berkshire's fairly unique structure in which it holds large stakes in public equities – that are not necessarily consolidated – requires investors to combine the stated GAAP "earnings" with the company's share of the unconsolidated investments' earnings in order to appreciate the true "profit power" of Berkshire. Under current GAAP requirements, ownership of a business in excess of 20% allows for its share of earnings to be reflected into the owner's financial statements; however, for positions less than 20%, the rules for financial presentation allow only for the recognition of any dividend paid. Consider:

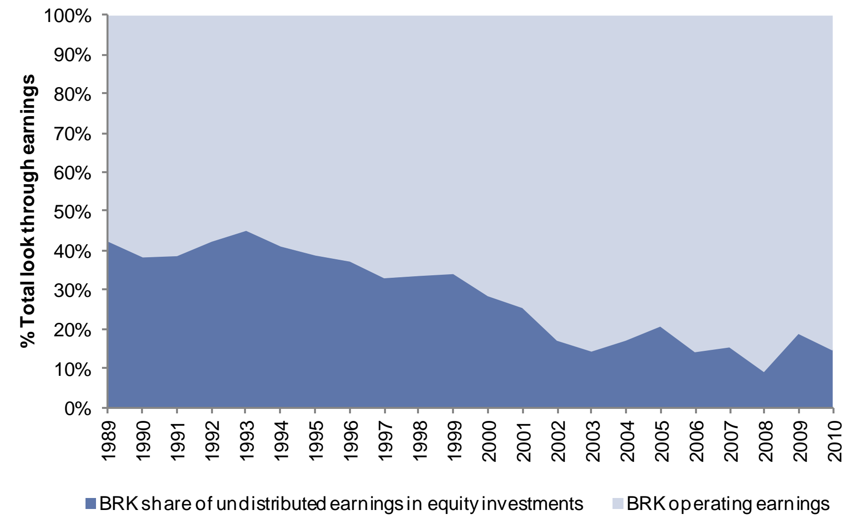
- Berkshire could own 19% of a given company that pays out no dividends and receive no credit within its income statement for its ownership of that investment's earnings power.
- **Thus, we assess the "look through" earnings of Berkshire by combining (1) the operating profits consolidated by Berkshire with (2) Berkshire's share of the earnings achieved by its sub-20% owned investments** (netting out dividends received in order to avoid double counting).
- While we present in Exhibit 8 below our historical assessment of the true earnings power of BRK , we note that we do not place a significant emphasis on this valuation technique going forward given the significant shift in "operating" versus "equity investment based" earnings post the acquisition of Burlington Northern.
- Historically, the share of undistributed earnings from equity investments was a much larger contributor to total look through earnings (averaging approximately ~40% of look through earnings historically compared to ~15% in recent periods).

Exhibit 8: Berkshire's operating earnings have significantly increased…



Source: Goldman Sachs Research, FactSet, company filings

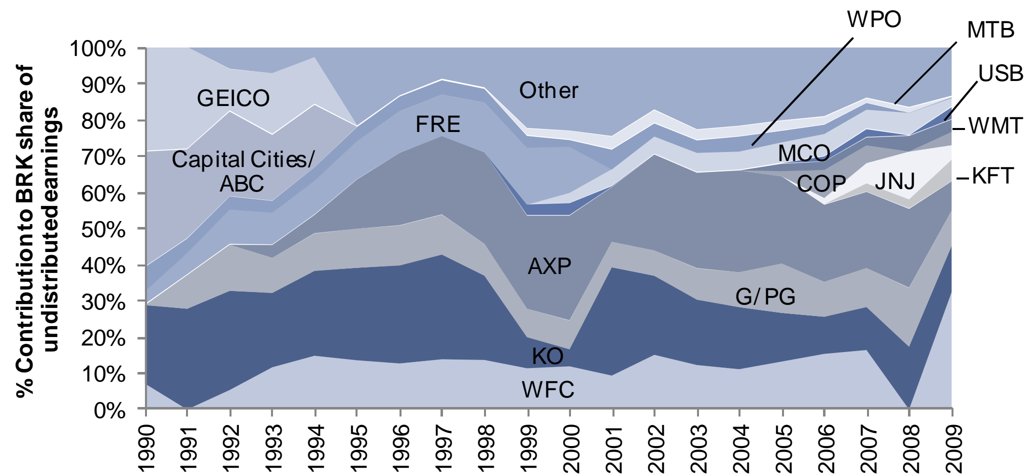
Exhibit 9: …thus the contribution from "equity" earnings has decreased



Source: Goldman Sachs Research, FactSet, company filings

Exhibit 10: The contribution to earnings from "equity investment" sources has been relatively concentrated over time

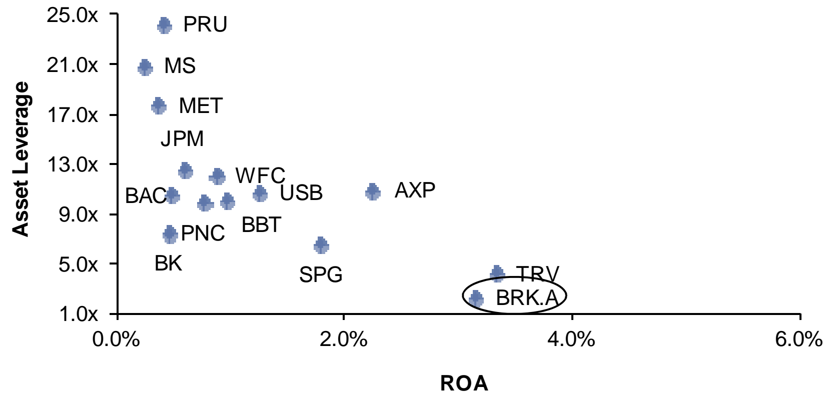
Summary of % contribution to BRK share of undistributed earnings



Source: Goldman Sachs Research, FactSet, company filings

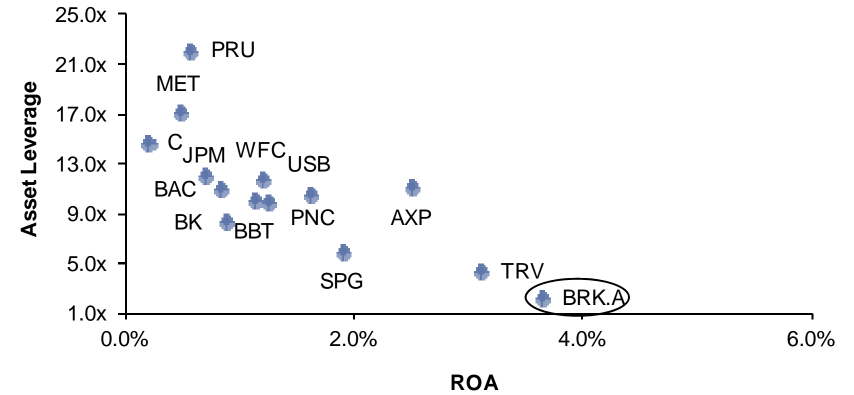
BRK's ROA is higher than other large cap financials ($20bn+ mkt cap) with lower leverage

Exhibit 11: Berkshire's 3-year ROA and asset leverage



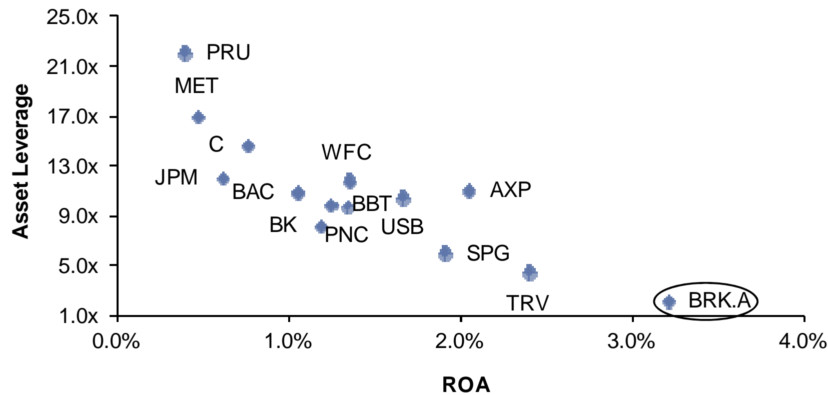
Source: Goldman Sachs Research, FactSet.

Exhibit 12: Berkshire's 5-year ROA and asset leverage



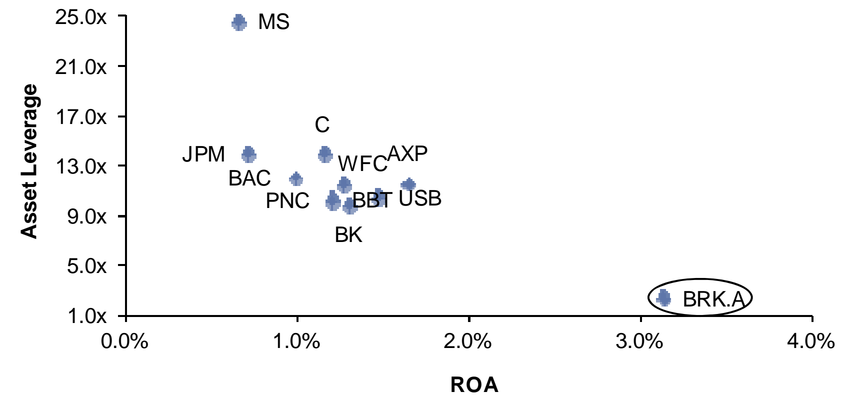
Source: Goldman Sachs Research, FactSet.

Exhibit 13: Berkshire's 10-year ROA and asset leverage



Source: Goldman Sachs Research, FactSet.

Exhibit 14: Berkshire's 20-year ROA and asset leverage



Source: Goldman Sachs Research, FactSet.

Risks to our thesis: The economy, the weather, and management succession

Renewed economic contraction

One of the primary risks to Berkshire's earnings power and intrinsic value is a renewed contraction in the US economy. Our estimates reflect an earnings recovery in a number of Berkshire's non-insurance entities as the economy continues to emerge from its cyclical downturn. Thus any incremental negative economic trends could have an adverse impact on our estimates. A renewed contraction would likely also impact equity markets and therefore Berkshire's equity holdings along with the performance of its derivative contracts in its Finance and Financial Products unit.

However, it is important to note Berkshire has a number of uncorrelated businesses that have competitive advantages in niche markets. Over time these businesses have proven to be more persistent which should enable Berkshire to continue to generate decent earnings and solid cash flow despite an economic contraction.

Catastrophic insurance risk

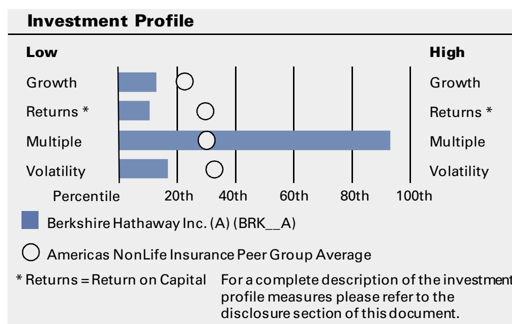
Certain of Berkshire Hathaway's (re)insurance companies are in the business of assuming large and unique risks that include significant catastrophe risk. The company willingly accepts such risks and inherent earnings volatility that its clients do not wish to retain, as long as it believes the long term value of the float derived from held reserves will be profitable (i.e. there is no such thing as a bad risk, only a bad price). Thus, over time, Berkshire's reinsurance entities will experience large and volatile catastrophe losses. In addition, any unfavorable development in loss reserve as well as frequency and severity trends and the pricing and underwriting cycle can impact future profitability.

However, Berkshire's capital position is one of the strongest in the industry, and the overall insurance group maintains generally low operating leverage. In addition, the non-correlating, non-insurance businesses provide Berkshire with earnings power that competitors do not possess, thus overall company profitability is more protected and less sensitive to any one loss event.

Management succession

Historically, a significant proportion of Berkshire's intrinsic value has been derived from current management's investment acumen. The risk to this portion of future value stems from the assumed continued ability to generate above average returns. We would note, however, that management has stated that current chairman Warren Buffett's job would likely be split into two roles upon his retirement: one executive will become CEO and one or more executives will become responsible for the investments. Current management has spoken highly of many of the subsidiary CEOs, although no specific candidate has been disclosed.

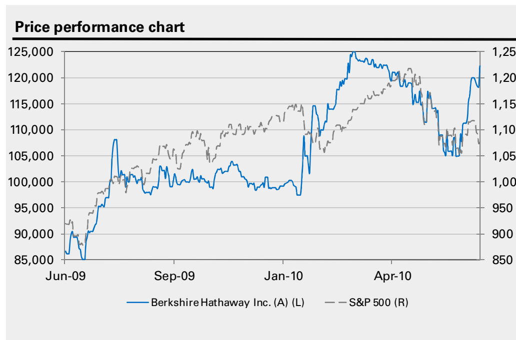
Berkshire Hathaway (BRK.A, BRK.B): Adding to Americas Buy List



Key data	Current
Price ($)	122,300.00
12 month price target ($)	152,000.00
Market cap ($ mn)	201,762.6
Net debt/equity (%)	NM

	12/09	12/10E	12/11E	12/12E
Prems ($ mn) New	**27,884.0**	**30,063.6**	**30,834.5**	**31,839.0**
Prems (-- mn) Old	--	--	--	--
EPS ($) New	**4,879.53**	**6,160.94**	**6,791.53**	**7,133.55**
EPS (--) Old	--	--	--	--
P/E (X)	25.1	19.9	18.0	17.1
P/B (X)	NM	NM	NM	NM

	3/10	6/10E	9/10E	12/10E
EPS ($)	1,389.47	1,534.77	1,653.35	1,578.35



Share price performance (%)	3 month	6 month	12 month
Absolute	(0.3)	23.7	41.1
Rel. to S&P 500	8.0	29.4	20.6

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/25/2010 close.

Source of opportunity

We initiate coverage of Berkshire Hathaway with a Buy rating, as the disconnect between the market value of the stock and the intrinsic value of the business is close to a multi-decade high.

Catalyst

We expect the catalyst to drive shares higher will be better-than-expected earnings growth. We believe Berkshire is both a structural growth story and levered to cyclical economic recovery. Structurally, Berkshire's earnings will benefit from the ongoing shift in consumers' auto insurance buying habits (via the direct-to-consumer GEICO subsidiary), the continuing change in the way goods are transported across the country (via the large intermodal operations at BNSF), and the enduring growth in energy and power demand (via the MidAmerican utilities).

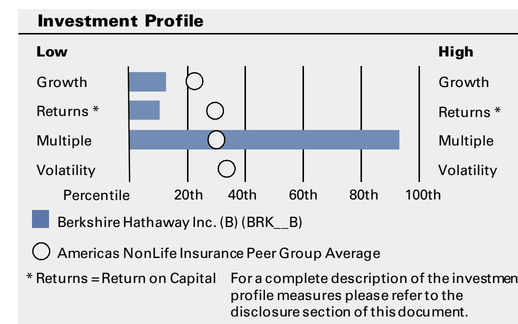
Cyclically, Berkshire's non-insurance entities are largely tied to GDP growth and to a lesser extent industrial production; certain smaller components are also levered to the housing market and as such we forecast a more subdued recovery for these businesses. However, as the country continues to emerge from its cyclical downturn, we would expect aggregated earnings to grow at a faster rate than what appears to be currently discounted in the stock.

Valuation

Our 12-month intrinsic value-based price target is $152,000 for BRK.A and $101 for BRK.B. We note this implies 25% upside for both stocks. We introduce above-consensus EPS estimates of $6,161, $6,972, and $7,134 (A shares) and $4.11, $4.53, and $4.76 (B shares) for 2010, 2011, 2012, respectively.

Key risks

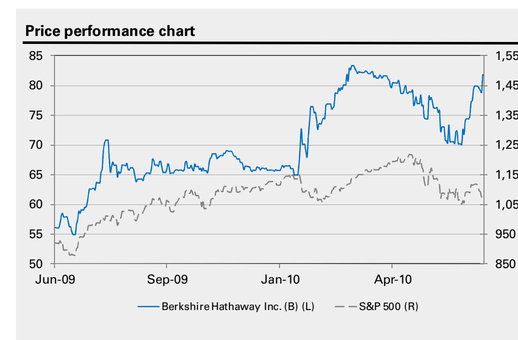
Key risks include an economic downturn, insured catastrophes, and management succession.



Key data	Current
Price ($)	81.90
12 month price target ($)	101.00
Market cap ($ mn)	201,762.6
Net debt/equity (%)	NM

	12/09	12/10E	12/11E	12/12E
Prems ($ mn) New	**27,884.0**	**30,063.6**	**30,834.5**	**31,839.0**
Prems (-- mn) Old	--	--	--	--
EPS ($) New	**3.25**	**4.11**	**4.53**	**4.76**
EPS (--) Old	--	--	--	--
P/E (X)	25.2	19.9	18.1	17.2
P/B (X)	NM	NM	NM	NM

	3/10	6/10E	9/10E	12/10E
EPS ($)	0.93	1.02	1.10	1.05



Share price performance (%)	3 month	6 month	12 month
Absolute	0.2	24.6	46.1
Rel. to S&P 500	8.5	30.3	24.9

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/25/2010 close.

Source: Company data, Goldman Sachs Research estimates, FactSet.

Insurance: Turning liabilities into equity

"Let's start with insurance – since that's where the money is." – *Warren Buffett, 2003 Report to Shareholders*

BRK's Insurance Business: The competitive advantage of being impossible to replicate

"To understand Berkshire, therefore, it is necessary that you understand how to evaluate an insurance company. The key determinants are: (1) the amount of float that the business generates; (2) its cost; and (3) most critical of all, the long-term outlook for both of these factors." *– Warren Buffett, 1999 Letter to Shareholders*

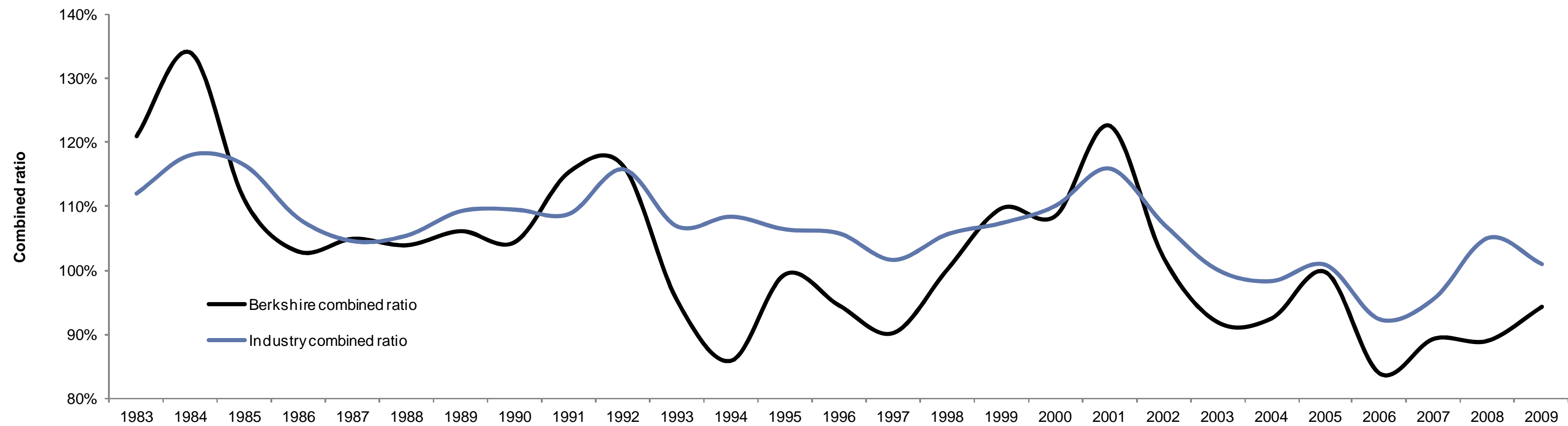
There are no other insurance companies similar to the combined group of insurers owned by Berkshire Hathaway. To be sure, the types of risks – for the most part – are the same risks underwritten by many other insurance and reinsurance companies. Furthermore, Berkshire's historical insurance track record (as measured by the combined ratio – an insurance metric that measures losses and expenses paid out as a percentage of premiums earned) is not significantly better than the industry average. However, **it is the aggregation of the operations and the ability for Berkshire management to invest the float for total return that creates such a significant disconnect in value between Berkshire and its peers.**

And while Berkshire Hathaway has a long track record of generating significantly above-average returns investing its insurance companies' float, it is not solely the investing acumen of management that has allowed for such significant value creation. Consider:

- Insurance is a heavily regulated industry where rating agencies and state regulators require significant capital and reserves to be held against future losses. The "capital charge" against equities is much higher than fixed income investments. However, when Berkshire was relatively small and still developing and growing its business, ratings were not as important. **Thus, Berkshire could invest more heavily in equities than any insurer in today's environment would be able.**
- Then, as the insurance industry evolved, the amount of excess capital Berkshire had built up over the years via investment returns **allowed the rating agencies to ascribe one of the few "AAA" ratings** - which, in turn, further strengthened the market position of Berkshire's insurers. Note, during 2009 all three rating agencies downgraded Berkshire to AA+, however it still maintains one of the highest ratings in the industry.
- With billions of dollars in cash held at all times, **Berkshire is protected against the "tail risk" catastrophic event like no other insurance company**.
- Put simply, if the worst case insurance scenario were to occur, Berkshire would be around to pay its claims the next day – which is not a certainty for almost all other insurers. This security allows for favorable positioning with not only regulators and rating agencies, but also insureds and other clients where the value of a policy placed with a credit such as Berkshire is worth something extra.
- Berkshire is presented with investment opportunities not seen by others. For example, while most insurers in our coverage universe saw new investment yields fall to low single digits in 2008, Berkshire's insurance operations were able to invest over $16 billion in preferred securities yielding 9-10%. Thus, the profit potential for return on insurance capital is higher at Berkshire than any other insurance company.

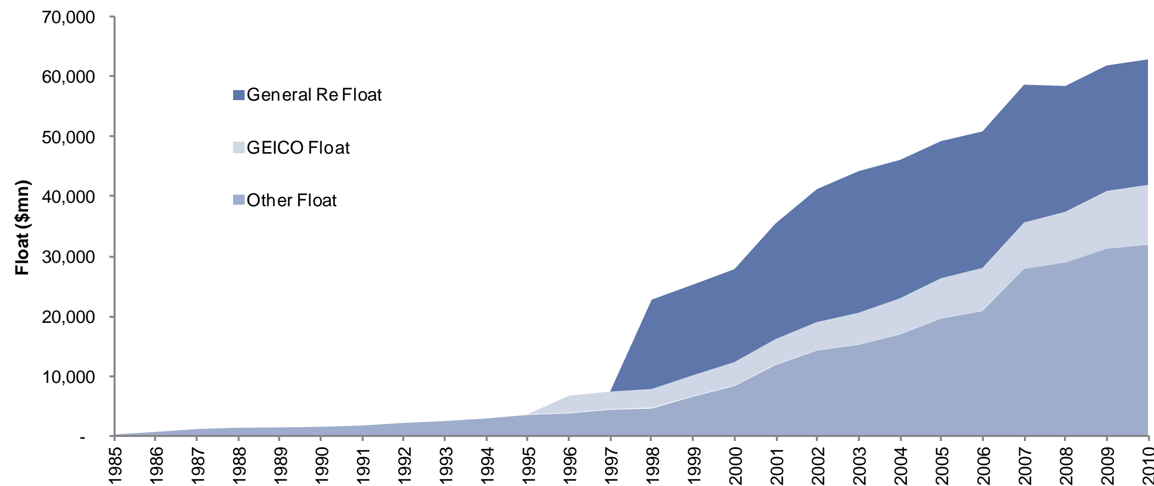
As can be seen in Exhibit 15 below, the aggregated underwriting performance by Berkshire's insurance companies outperforms the underwriting results of the industry on most – but not all – calendar years. And while we continue to believe the management and underwriting capabilities at Berkshire should allow its insurance operations to outperform the industry, the most meaningful take-away from the chart below is that **the average combined ratio since 1983 has been approximately 102% - implying that for every premium dollar received, Berkshire has only paid out $1.02 – while at the same time benefiting from investing those premiums over time at 10-20% annual returns.**

Exhibit 15: Berkshire's combined ratio has outperformed the industry average in most – but not all – of the past 27 years…
Berkshire Hathaway combined ratio vs. the industry



Source: Goldman Sachs Research, company data

Exhibit 16: ….while the float has increased dramatically
Components of float historically



Source: Goldman Sachs Research, company data

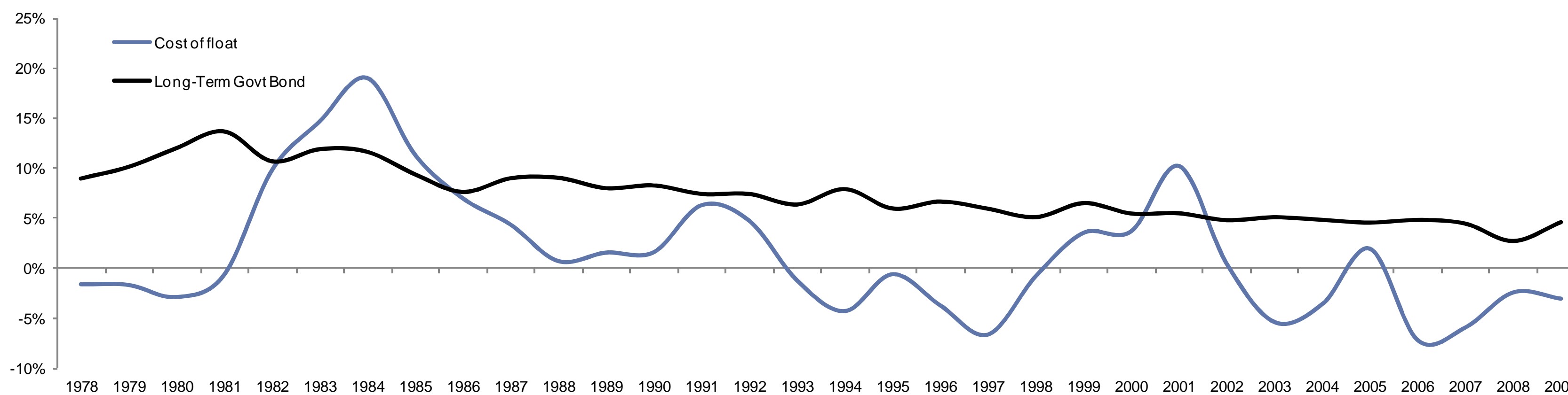
The Power of Float: collect-now, pay-later

THE VALUE OF FLOAT
If you were to invest a certain sum of borrowed capital – where the cost of such funds was zero, there was no "callability" to the funds by the lender, and the entirety of the investment returns accrued to your benefit – you would want to maximize the amount of borrowed capital. This is essentially the value proposition for being a shareholder in Berkshire Hathaway – where the float is the borrowed capital.

Put simply, float is the amount of money held by insurers on behalf of other parties – the majority of which is typically funds held to pay future claims. With premiums often collected well before losses are paid, the insurer can invest these funds for its own account. Additionally, for longer-tail lines of business, the timing differential can be decades long. Thus, while any given year will see its share of claim payments go up or down, the amount of float held by an insurer will stay relatively steady to its premium in-take. **Thus, for an insurer that is not shrinking, the float can take the form of permanent capital**.

- When valuing Berkshire, we believe it is important to ascribe a value to the float. We believe that the amount of investable capital held by an above-average investor has a tangible value. There are two important distinctions, however:
    - **The cost of funds**: Over time, **there is only value to the float if the investment returns exceed the cost of funds** – which for an insurer would be the underwriting profit or loss. As an industry, insurance companies have historically operated at an underwriting loss (i.e. the premiums were less than the combined expenses and claims). Thus, it is Berkshire's proven ability and stated willingness to focus on profitability (as opposed to growth) in its insurance operations that has allowed the cost of its float to be essentially zero over its multi-decade history. This is also one of the reasons we do not ascribe a value to the float generated by the other insurance companies in our industry, where the track record to assess historical profitability is for most companies too short of a time frame.
    - **The "callability" of funds:** "borrowed funds" can only be truly invested if there is limited ability for the lender to call the funds. This is what distinguishes BRK's model from that of a "levered" investment fund – i.e. the funds, for the most part, cannot be redeemed by the lenders (i.e. the policyholders). The one caveat to this however is a catastrophic insurance scenario in which some portion of the float would need to be returned to policyholders. However, as we noted in the section above, BRK's billions of dollars of cash on hand helps to protect against this scenario.

Exhibit 17: Berkshire has leveraged its insurance underwriting profitability to reduce "borrowing costs"



Source: Goldman Sachs Research, company filings, FactSet

GEICO: The low-cost advantage

GEICO: 12% of total GAAP earnings

"A company holding a low-cost advantage must pursue an unrelenting foot-to-the-floor strategy. And that's just what we do at GEICO." – *Warren Buffett, 2004 Letter to Shareholders*

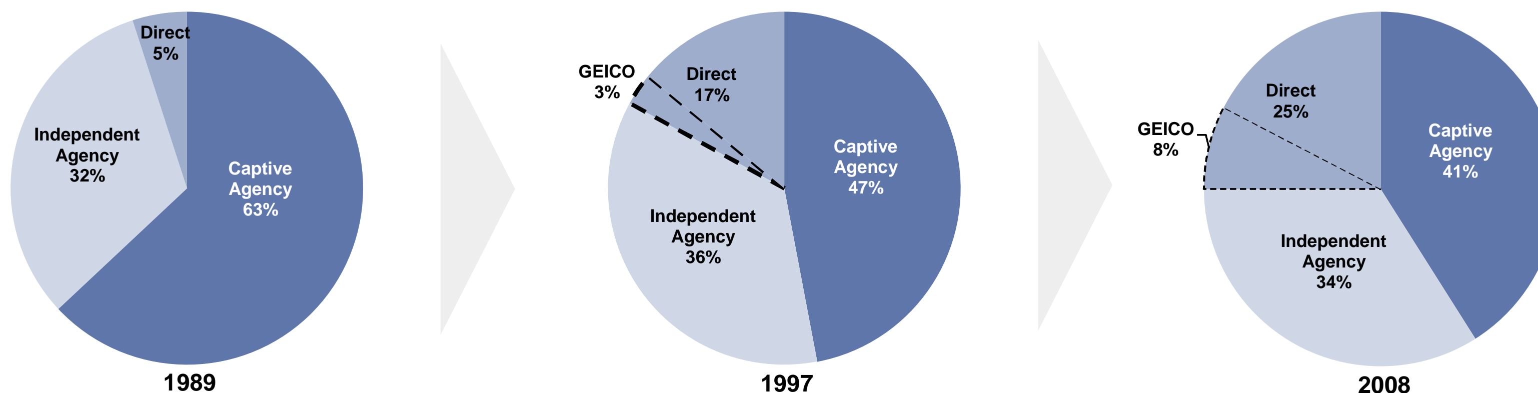
With a 10-year average combined ratio of 94% and an average pre-tax return on float of 23%, GEICO is one of the most profitable insurance companies in the United States. Its direct-to-consumer, low-cost business model creates an explicit price advantage versus its larger, agent-driven, expense-laden competitors. This competitive advantage, combined with the strategy of creating an advertising-driven brand has allowed GEICO to become the 3rd largest auto insurer in the US – up from 6th in 1996.

GEICO does two things exceptionally better than most of its peers: (1) profitably grow its customer base, and (2) invest its float at significantly above average returns.

1. Profitable Growth: Low-cost advantage (direct to consumer) + Secular changes in buying habits (internet) = market share gains

   - In most areas of insurance, above-average growth is not a profitable long-term strategy (given the perceived "under-priced" nature of achieving such growth). Personal auto, however, is a different story given the short-tail nature of the liabilities, thus eliminating most of the potentially optimistic assumptions embedded in long-tail insurance pricing during soft markets and therefore forcing a relatively more stable pricing environment.
   - In other words, when you know the profitability of the business being written relatively soon, you must price appropriately. This is important because it forces companies to compete on expenses and risk selection. Thus, with a structural advantage in expenses (via its non-agency model), GEICO and the direct channel of distribution have seen significant market share gains over the past two decades (as can be seen in Exhibit 18 below).

Exhibit 18: The direct channel (GEICO, Progressive) has been growing faster than any other channel, gaining share from captive agencies (Allstate, State Farm)
Personal auto market share by distribution channel



Source: Goldman Sachs Research, A.M. Best, SNL

- By selling direct to consumer, without traditional agents or branch offices, the company can pass savings along to customers with discounted insurance premiums.
- Additionally, its expense advantage allows for increased advertising spend and resulting customer awareness and loyalty in a relatively commodity-like product business.
- **This is important because extending the "life" of a customer in a model with significant up-front costs (i.e. advertising) significantly increases the present value of that customer**. See Exhibit 19 below.
    - As can be seen below, the after-tax return on invested capital is between 30% and 40%.
    - However, if we were to substitute an expense ratio more typical of a bricks-and-mortar, agent-based insurer (i.e. Allstate, State Farm, etc), we find the ROIC drops to only 10%.
    - Additionally, if we drop the persistency to 50% from 80%, the ROIC falls by half.
    - We note the "Year 1" all-in combined ratio (i.e. including advertising) is greater than 116%. Thus, as it relates to the reported GAAP combined ratios for companies such as GEICO and Progressive – where growth via advertising has been a dominant theme – we believe it is important for investors to assess the impact of the "new business" combined ratio on the blended figures and the corresponding higher yields in later years.

Exhibit 19: The direct model yields attractive returns on capital on a present value basis, and benefits from extending policyholder life

New Business	
Policies ($mn)	2.5
Rate ($ / policy)	$1,400
Premium Written ($mn)	3,500
Assumptions	
Persistency	80.0%
Loss Ratio	77.0%
Ongoing Expense Ratio	12.5%
Tax Rate	35%
Cost of New Business	
Advertising ($mn)	800
Leverage (Prem/Capital)	2.5x
Capital Deployed ($mn)	1,400
Total Invested Capital	2,200
After-tax ROIC	**36%**

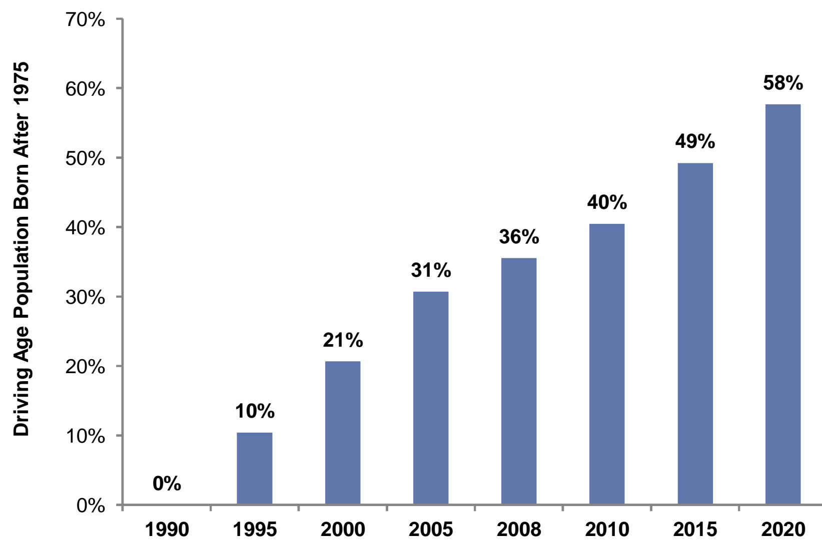
Cash Inflow:	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Premiums	3,500	2,800	2,240	1,792	1,434	1,147	918	734	587	470	376	301
Total	3,500	2,800	2,240	1,792	1,434	1,147	918	734	587	470	376	301
Cash Outflow:												
Claims	2,695	2,156	1,725	1,380	1,104	883	706	565	452	362	289	231
Ongoing Expenses	438	350	280	224	179	143	115	92	73	59	47	38
Underwriting Tax	129	103	82	66	53	42	34	27	22	17	14	11
Total	3,261	2,609	2,087	1,670	1,336	1,069	855	684	547	438	350	280
Net Cash Flow	239	191	153	122	98	78	63	50	40	32	26	21
DCF	217	158	115	84	61	44	32	23	17	12	9	7

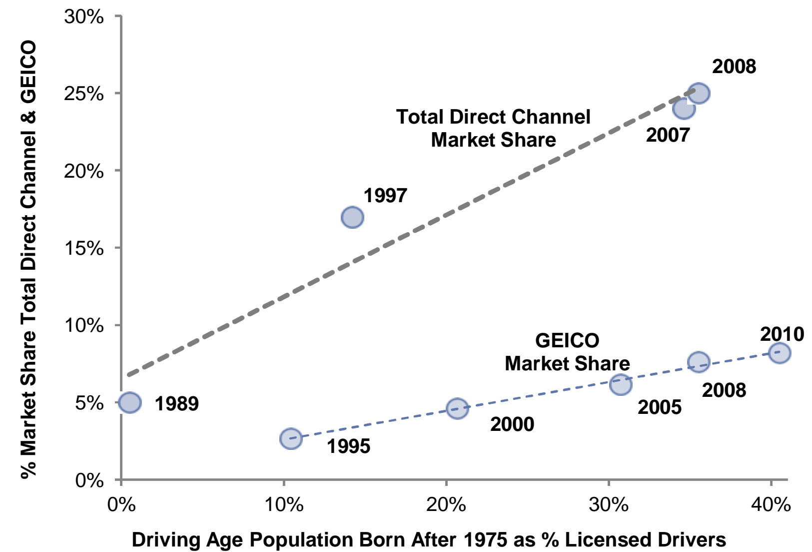
Source: Goldman Sachs Research, company data

Exhibit 20: Secular changes in purchasing habits of auto insurance are driven by demographic shifts: Historical "captive agent" market share will continue to shift to direct-to-consumer models (such as GEICO and Progressive) as the "Echo Boomers" make up a larger and larger percentage of the driving population

Year	Licensed Drivers	Driving age population born after 1975	Driving age population born after 1975 as % licensed drivers	GEICO PIF as % of licensed drivers	GEICO Policies in Force (PIF)
Historical					
1990	167,015	0	0%	na	na
1995	176,628	18,374	10%	1%	2,310
2000	190,625	39,348	21%	2%	4,697
2005	200,665	61,633	31%	3%	6,989
2008	208,321	73,970	36%	4%	9,031
Forecasts					
2010	210,855	85,367	40%	5%	10,528
2015	221,273	108,891	49%	6%	13,648
2020	232,452	134,078	58%	7%	17,043

As the percent of the population born after 1975 increases to almost 60% of licensed drivers-- and thus the online/direct buying trends of the last decade continue-- GEICO's future policy count could exceed 17 million by 2020, almost 2x the current amount





Source: Goldman Sachs Research, U.S. Census Bureau, Federal Highway Administration, Haver Analytics, and company filings.

2. Float Investing: Managing for Total Return

- In addition to a profitable underwriting model, GEICO has a track record of generating significant investment profits. GEICO – as well as the rest of Berkshire Hathaway – manages for total return, i.e. investment income plus the change in value of its invested assets.
- This is a distinct difference between BRK's insurance operations and almost all other insurance companies which typically will invest to maximize their operating income – i.e. make investment decisions based on what maximizes "above the line" income, despite what the best "total value" opportunity may be.

Exhibit 21: GEICO's return on float has been impressive historically
Components of GEICO return on float calculation ($ millions)

Invested Assets:	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Equities	187	1,549	1,713	2,181	2,732	2,549	2,727	3,405	3,648	5,202	6,593	6,586	4,748	6,807
Bonds and Preferreds	3,716	4,293	2,609	4,313	4,119	6,187	6,172	2,298	1,723	604	416	1,368	6,692	8,466
Cash and Other	438	190	2,510	976	1,577	454	1,003	5,485	7,711	9,071	7,885	7,738	3,223	3,535
- Subtract affiliated	(68)	(72)	(79)	(95)	(98)	(110)	(121)	(132)	(141)	(164)	(180)	(196)	(516)	(238)
Total Investments	**4,273**	**5,959**	**6,753**	**7,374**	**8,330**	**9,081**	**9,781**	**11,056**	**12,941**	**14,713**	**14,714**	**15,497**	**14,147**	**18,570**
Adjustments:														
+ Add back dividends	140	80	-	-	-	50	150	1,264	304	30	2,700	524	-	529
- Subtract net income	(318)	(348)	(344)	(251)	8	(503)	(482)	(853)	(1,016)	(1,219)	(1,367)	(1,413)	(193)	(704)
Total Adjustments	**(178)**	**(268)**	**(344)**	**(251)**	**8**	**(453)**	**(332)**	**411**	**(712)**	**(1,189)**	**1,333**	**(889)**	**(193)**	**(175)**
Return:														
Change in Asset Value	n/a	372	450	370	964	298	369	1,685	1,173	582	1,334	(106)	(1,542)	4,247
Investment Income	219	246	278	305	367	396	409	383	326	455	525	595	551	784
Total Return	**n/a**	**617**	**728**	**676**	**1,331**	**693**	**778**	**2,068**	**1,499**	**1,038**	**1,860**	**488**	**(991)**	**5,031**
Float (year-end)	2,809	2,917	3,125	3,444	3,943	4,251	4,678	5,287	5,960	6,692	7,171	7,768	8,454	9,613
Average Float	n/a	2,863	3,021	3,285	3,694	4,097	4,465	4,983	5,624	6,326	6,932	7,470	8,111	9,034
Return on Float	**n/a**	**22%**	**24%**	**21%**	**36%**	**17%**	**17%**	**42%**	**27%**	**16%**	**27%**	**7%**	**-12%**	**56%**

Source: Goldman Sachs Research, company data

Exhibit 22: GEICO maintains dominant market positions
Market share snapshot

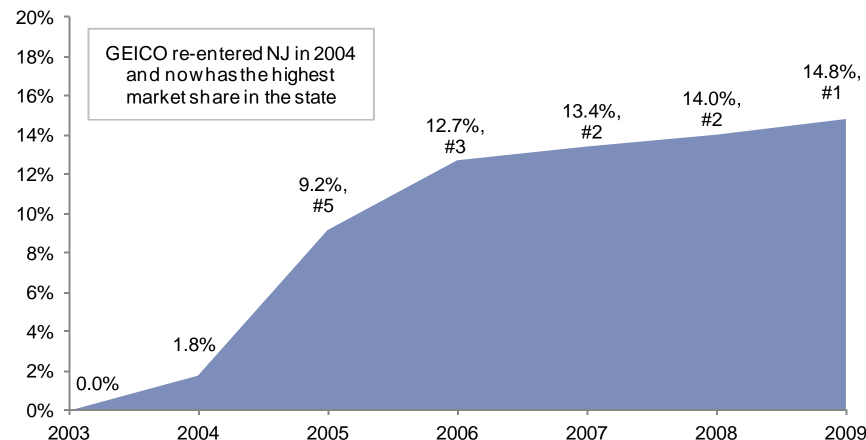
GEICO's top markets by total premium				
State	DPW ($mn)	Market Share %	% GEICO Total	Rank
New York	2,333	23%	17%	1
Florida	1,867	16%	14%	2
California	955	5%	7%	7
Texas	890	7%	7%	5
New Jersey	871	15%	6%	1
Maryland	738	21%	5%	1
Virginia	620	15%	5%	2
Georgia	465	9%	3%	3
Pennsylvania	384	5%	3%	5
North Carolina	328	7%	2%	5

GEICO's top markets by market share				
State	DPW ($mn)	Market Share %	% GEICO Total	Rank
Dist of Columbia	89	35%	1%	1
New York	2,333	23%	17%	1
Hawaii	143	22%	1%	1
Maryland	738	21%	5%	1
Alaska	78	19%	1%	2
Florida	1,867	16%	14%	2
Virginia	620	15%	5%	2
New Jersey	871	15%	6%	1
Connecticut	297	13%	2%	1
Delaware	74	12%	1%	3

Note: DPW is Direct Premiums Written

Source: Goldman Sachs research, SNL

Exhibit 23: NJ as an example of growth: 0% market share to #1 rank in 6 yrs
GEICO market share in NJ

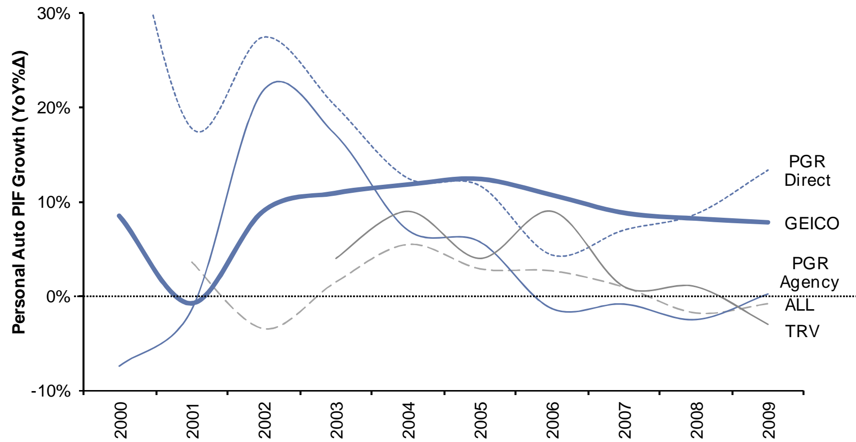


Source: Goldman Sachs research, SNL

What is it? GEICO is the 3rd largest private passenger auto insurer in the United States. It employs a direct to consumer distribution platform and is one of the fastest growing insurers.

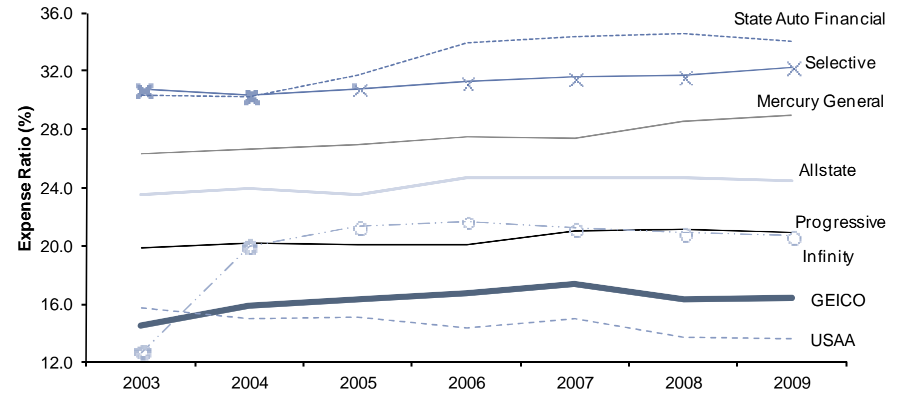
- The company has over 9 millions policyholders and offers insurance in all 50 states. Its top 5 states include: NY, FL, CA, TX, and NJ which account for over 50% of premiums. In addition, the company benefits from strong credit ratings (A++ from A. M. Best).
- GEICO benefits from strong brand awareness and customer loyalty due in part to a significant national advertising campaign. The company reportedly spent over $800mn in advertising in 2009, almost double the amount competitors spent.
- The company maintains a lean organization by dealing with customers directly through phone, mail, and internet channels. It operates just 12 major offices and service centers around the country, contributing to its industry leading low expense ratio.
- In addition to auto insurance, GEICO offers other products such as homeowners, renters, umbrella, and boat insurance though partners and affiliates, as well as its independent personal lines agency, GEICO Insurance Agency operations. This allows GEICO the ability to offer homeowners and other insurance without accepting the underwriting risk, while concentrating on its core auto insurance competency.

Exhibit 24: Direct writers' PIF growth has outpaced agency competitors
Standard auto policies in force growth yoy



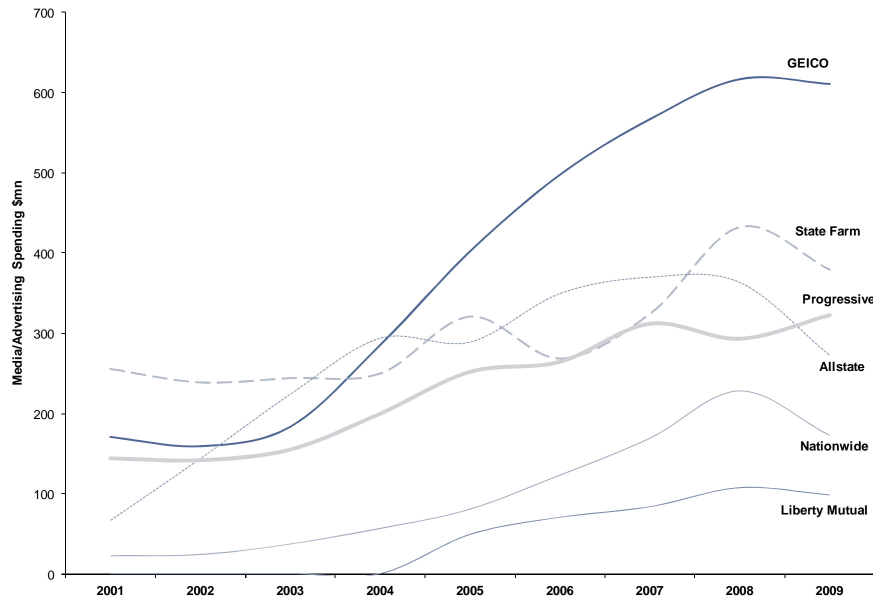
Source: .Goldman Sachs Research, company data

Exhibit 25: Direct model results in industry leading expense ratio
Expense ratios across the personal auto insurance space



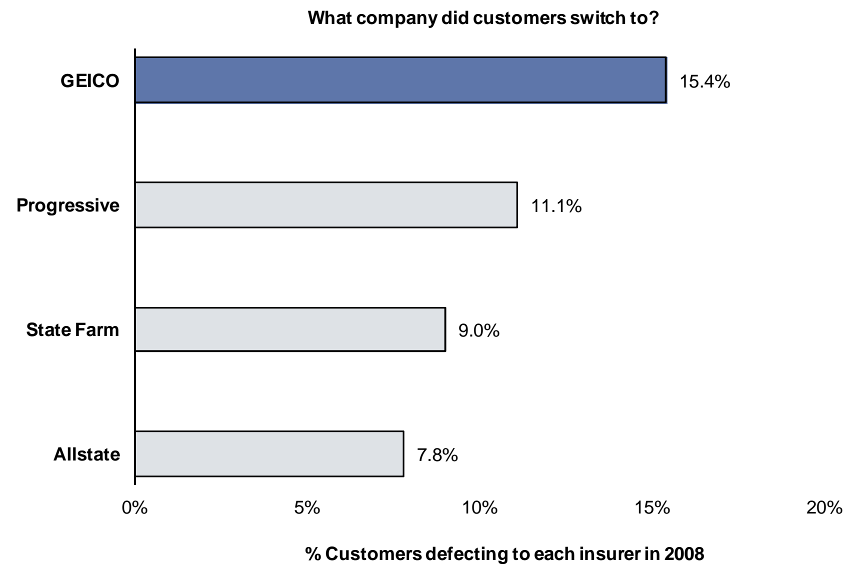
Source: Source: Goldman Sachs Research, SNL DataSource

Exhibit 26: Advertising as an insurance strategy--so easy, a caveman can do it
Media/advertising spend, $mn



Source: Goldman Sachs Research estimates, company filings, TNS Media Intelligence.

Exhibit 27: GEICO benefits from consumer shopping behavior
Auto insurance customer defection trends



Source: JD Power

Berkshire Reinsurance Group (National Indemnity): Size, strength, underwriting prowess

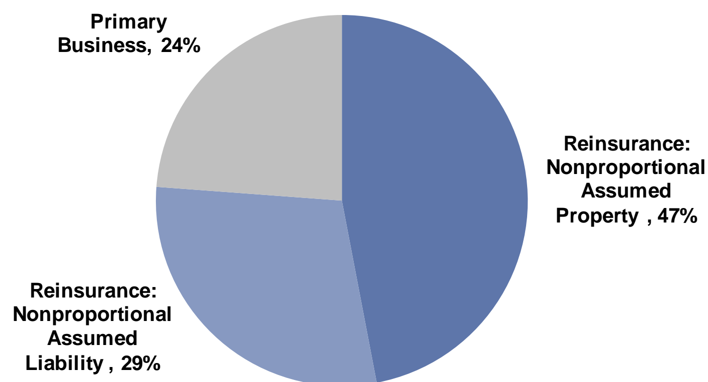
Nat'l Indemnity: 24% of total GAAP earnings

What is it? Led by Ajit Jain, Berkshire's Reinsurance Group is known for underwriting large, unusual, and complex risks. Structurally, National Indemnity Company, along with Columbia Insurance Company, leads the group of insurance subsidiary companies that write business under the Berkshire Hathaway Reinsurance Group (BHRG) umbrella. The National Indemnity Group (NICO) provides both excess and quota-share reinsurance in the following areas: catastrophe excess-of-loss treaty reinsurance contracts, individual risk, and retroactive reinsurance. This business thrives on its ability to quickly quote large and complex risks, with an employee base of approximately 30 people. The company has stated that the ability and willingness to do deals that other insurers cannot translates into a permanent and substantial competitive advantage.

Lumpy premiums and volatile results

Due to the nature of risks assumed this group is subject to lumpy premiums and, given its financial strength, can endure extremely volatile underwriting results. However, due to its significant capital base the group is able to underwrite extremely large and complex risks and has been able to take advantage of significant niche needs in the marketplace for customized solutions. As an example, in 2009 the group disclosed its maximum per occurrence net catastrophe loss was less than $4bn from a New Madrid fault line earthquake. In addition, the company stated that even with a large insurance loss, the substantial earnings power outside insurance would likely allow Berkshire as a whole to remain profitable in any one period.

Exhibit 28: National Indemnity writes a wide mix of (re)insurance business
National Indemnity subgroup 2009 net premiums written



Source: Goldman Sachs Research, SNL

Exhibit 29: Components of National Indemnity Group
Capital snapshot, $mn

2009 Capital and Surplus		Reported	Net
National Indemnity Company	Omaha, Nebraska	38,436	38,436
Columbia Insurance Company	Omaha, Nebraska	8,351	8,351
National Fire & Marine Insurance Company	Omaha, Nebraska	3,356	3,356
National Liability & Fire Insurance Company	Stamford, CT	612	612
National Indemnity Company of the South	Jacksonville, FL	114	-
National Indemnity Company of Mid-America	Coralville, Iowa	48	-
Wesco-Financial Insurance Company	Omaha, Nebraska	2,546	2,546
Berkshire Hathaway Assurance Corporation	Flushing, NY	993	-
		54,455	**53,301**

Source: Goldman Sachs Research, Company filings, SNL

Berkshire Reinsurance Group: Company highlights

Business overview

Catastrophe and Individual Risk: The catastrophe business is the bread and butter for National Indemnity as it leverages its balance sheet to write large and unusual policies. Typical risks include losses from natural catastrophe, terrorism, or aviation events. The business is typically retained and not further reinsured.

Retroactive Reinsurance: "Retro" cover protects cedants from adverse development on claims arising from prior years. Such business is typically written on an excess basis with set limits in place. Key risks in this line include incremental environmental and injury claims. See Equitas and Swiss Re retro agreement discussions below.

Other Multi-line: The company also writes traditional non-catastrophe reinsurance in the Other multi-line segment. This would include the Swiss Re quota share agreement discussed below.

Key transactions

National Indemnity's size, financial strength, and opportunistic underwriting approach has provided it with extraordinary opportunities to both serve clients' unique needs as well as ensure favorable terms. Below, we summarize some recent key transactions that help define who and what National Indemnity is, as the deals speak for themselves in terms of size and complexity.

Equitas: The $7bn deal

In November 2006 National Indemnity entered into a reinsurance agreement with Equitas (the entity set up in 1996 to reinsure and manage pre-1993 non-life liabilities for Lloyd's of London), effective March 2007. The transaction provided $7bn reinsurance coverage in excess of Equitas' reserves of $8.7bn in two phases.

The first phase provided the first $5.7bn reinsurance cover for consideration of substantially all of Equitas' assets (approximately $7bn) and a £72mn contribution from Lloyds. The second phase added $1.3bn of additional reinsurance cover for an additional £ 40mn ($66mn) premium. In 2009 NICO paid $392mn in claims and total reserves stood at $8.2bn at year end 2009.

Swiss Re: Multiple reinsurance agreements and capital investment

In January 2008, National Indemnity entered into a five-year 20% proportional quota share reinsurance agreement for Swiss Re's P&C business. This agreement amounted to $2.4bn and $2.5bn of premiums written for NICO in 2008 and 2009, respectively.

In February 2009, the company entered into a retroactive reinsurance agreement with Swiss Re to assume an aggregate limit of CHF 5 bn of its P&C unpaid losses occurring before January 1, 2009 in excess of a retention of Swiss Re's reported reserves of CHF 59 bn less CHF 2bn. The consideration for this reinsurance agreement was $1.7bn (CHF 2bn).

In March 2009, the company purchased a CHF 3bn ($2.667bn) 12% Convertible Perpetual Capital Instrument issued by Swiss Re with a 12% fixed rate which can be converted into approximately 24.8% of the common shares of Swiss Re. As of year end, this instrument had a carrying value of $3.5bn. We understand Swiss Re intends to exercise its option to redeem the instrument for a 20% premium to the face amount after March 2011.

XL Capital: D&O insurance endorsements

In June 2009, National Indemnity entered an agreement with XL Specialty Insurance Company (XL Insurance) to issue endorsements to Side A Directors & Officers policies. The cut-through endorsement addressed client and broker needs at the time, as it offered clients the option to add an additional layer of protection from the A++ rated NICO, guaranteeing that claims will be paid if XL coverage failed to respond.

The terms of the facility stated that National Indemnity would issue Endorsements with aggregate premiums up to $140mn, with an option to issue Endorsements with additional aggregate premiums up to $100mn, terminating in ten years, with an initial payment obligation purchase with principal amount of $150mn

Florida Hurricane Catastrophe Fund: Lender of last resort during the credit crisis

In 2008, Berkshire entered in to a contract with the Florida Hurricane Catastrophe Fund that for a payment of $224mn, the company would purchase up to $4 billion of revenue bonds issued by the Florida Hurricane Catastrophe Fund Finance Corporation if storms caused more than $25bn in residential damages. The deal was struck as state officials were concerned about the ability for the Fund to meet its liabilities as it might not have been able to borrow sufficient amounts given the tight credit market conditions at the time.

The required amount of losses to trigger the purchase of the bonds was not met and the consideration received was earned as of year end 2008 and included in underwriting results. The liquidity facility was not renewed in 2009.

Berkshire Hathaway Assurance Corp: Opportunistic capital deployment in confidence-strapped environment

In late 2007, Berkshire Hathaway Reinsurance Group formed a monoline financial guarantee insurance company, Berkshire Hathaway Assurance Corporation (BHAC) following problems at other major players. The insurer of tax-exempt bonds issued by state, city, and other local entities was capitalized (approximately $1bn) by National Indemnity and Columbia and ramped up business quickly in 2008, but pulled back from the market in 2009 following declining market conditions.

In 2008 BHAC wrote approximately $15.6 billion of insurance in the secondary market (with 77% of the business already insured and considered “second-to-pay” with rates averaging 3.3%). In addition, BHAC wrote $3.7 billion of primary business for $96mn premium. In total BHAC wrote $590mn in premium in 2008 and $40mn in 2009.

General Reinsurance (Gen Re): A large global provider of reinsurance on a direct basis

GenRe: 10% of total GAAP earnings

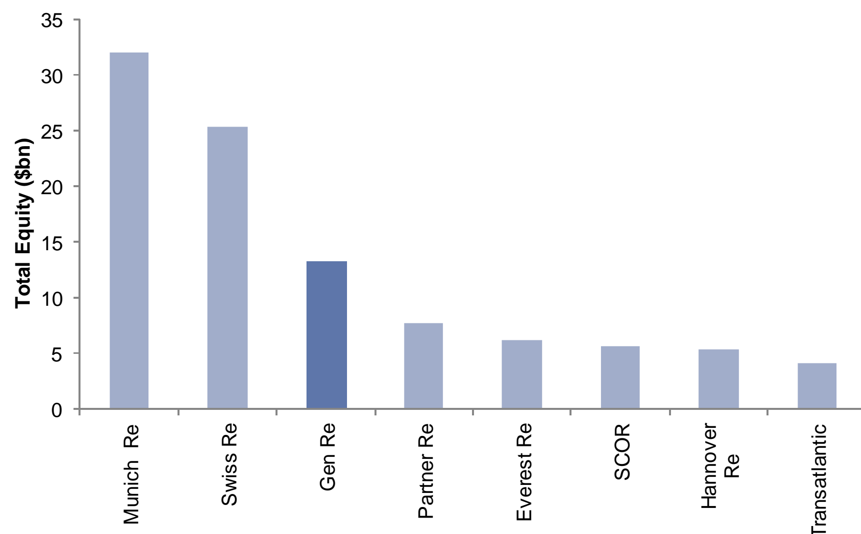
General Reinsurance is one of the largest reinsurers in the world. It operates under the brand name "Gen Re" providing tailored property/casualty and life/health reinsurance products to clients on a direct basis. The company writes business on both a treaty and facultative basis. Gen Re's principal operating subsidiaries include General Reinsurance Corporation and Cologne Re and the company maintains a global network of 45 offices in key reinsurance markets. The group has $13.2 billion in capital and wrote approximately $6 billion in premium in 2009 with a combined ratio of 91.8%.

Direct distribution and diversified lines of business

Gen Re is a direct reinsurer—it works directly with insurance company clients as opposed to most of the reinsurers under our coverage universe which operate in a "brokered" market. The company has leveraged the direct access model and its deep underwriting and technical expertise to provide customized risk transfer solutions to clients. These customized solutions combined with faster claims processing generates significant customer loyalty.

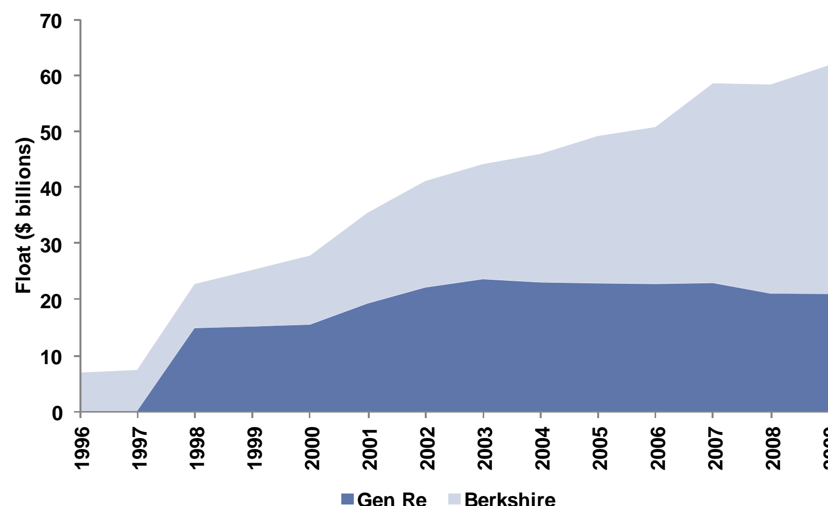
Gen Re business mix is diversified across non-life and life, property and casualty. In addition, the company's other segments include asset management, London market, primary specialty and surplus, alternative risk insurance, aviation underwriting, and reinsurance brokerage.

Exhibit 30: Gen Re is one of the largest reinsurers in the world
2009 Total Equity $bn



Source: Goldman Sachs Research, company data

Exhibit 31: Gen Re float added substantially to Berkshire
Float $bn



Source: Goldman Sachs Research, company data

Gen Re: Business mix

Reinsurance business: The company provides direct property/casualty reinsurance and direct life/health reinsurance business through its subsidiaries Gen Re and Cologne Re. The company has a strong market presence and leverages its underwriting expertise with clients via a direct model. The close interaction with clients helps the company provide relevant capacity and differentiated services.

Primary business: Gen Re operates its primary businesses under the brand names 'General Star' and 'Genesis'. General Star is a premier specialty and surplus lines provider, underwriting a broad array of property, casualty and professional liability business through a select group of wholesale brokers. Genesis is a premier alternative risk insurance provider, offering innovative solutions to meet the unique needs of its public entity, commercial and captive customers.

London Market: Gen Re participates in the London Market through its subsidiaries Faraday Re and Faraday Syndicate 435 at Lloyd's. Faraday Group has three teams underwriting business: aviation, casualty and property. It sources business from Lloyd's and company markets and a range of worldwide insurance and reinsurance classes.

Asset Management: Gen Re-New England Asset Management (GR-NEAM) is the asset management arm of General Re and provides enterprise risk and capital management, asset management, risk analytics and investment accounting services. GR-NEAM reported $67 billion in assets under management as of year end 2009. Substantially all of its AUM is for insurance company clients.

Aviation Underwriting: United States Aviation Underwriters, a General Re subsidiary, is a global leader in underwriting aviation insurance.

Reinsurance Brokerage: Gen Re Intermediaries is a reinsurance intermediary and risk advisor that specializes in delivering global reinsurance market solutions coupled with state of the art risk management analytics. Risk management solutions are offered in the following exposures: property catastrophe, aviation, workers' compensation catastrophe, and casualty clash exposures.

Exhibit 32: Snapshot of Gen Re's largest cedants: Over 100 clients with premiums over $1 million

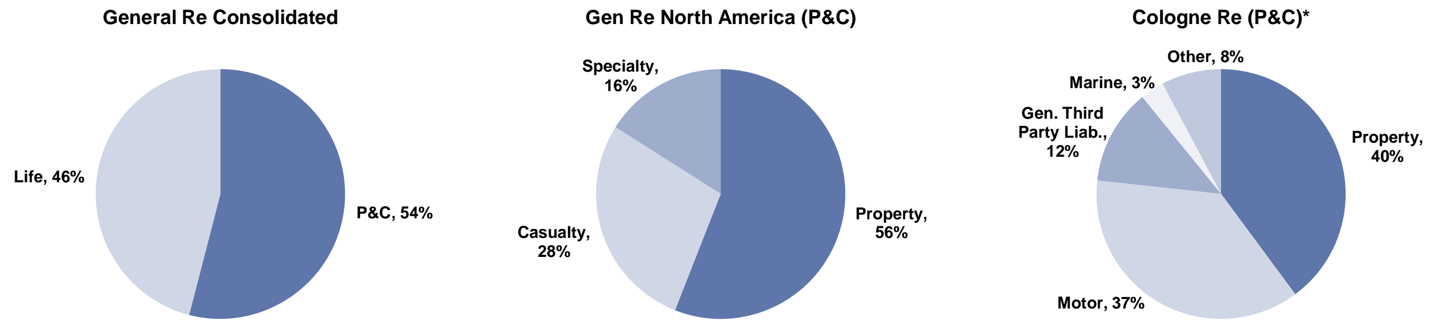
Ceding companies to General Reinsurance Corp (above $2mn in premium)

Cedent Group	$mn								
State Farm Mutual Automobile Ins Co	300	National Promoters & Services, Inc.	10	Allianz SE	6	Fairfax Financial Holdings Limited	4	AXIS Capital Holdings Limited	3
Factory Mutual Ins Co.	45	Cypress Insurance Group, Inc.	9	Old Republic International Corp	5	Navigators Group, Inc.	4	XL Capital Ltd	3
St. James Financial Holding Company, Inc.	45	American Financial Group, Inc.	9	N.C. Grange Mutual Ins Co.	5	Preferred Mutual Insurance Co.	4	Arch Capital Group Ltd.	3
Zurich Financial Services Ltd	36	Nationwide Mutual Group	9	Blue Cross and Blue Shield of SC	5	Utica Mutual Insurance Co.	4	PA National Mutual Cas Ins Co.	3
Chubb Corporation	36	NYCM Insurance Group	8	Farmers Alliance Mutl Ins Co.	5	Oregon Mutual Insurance Co.	4	International Fidelity Ins Co.	3
Church Mutual Insurance Co.	35	PA Lumbermens Mutual Ins Co.	8	Utica Mutual Insurance Company	5	Hanover Insurance Group, Inc.	4	Markel Corporation	3
Hartford Financial Services Group, Inc.	26	Arbella Mutual Insurance Company	8	Plymouth Rock Company Incorporated	5	M.J. Hall & Company, Inc.	3	Horace Mann Educators Corp	3
Liberty Mutual Holding Company Inc.	23	Florists' Mutual Insurance Co.	7	Mercer Insurance Group, Inc.	5	PMA Capital Corporation	3	Meadowbrook Insurance Group, Inc.	3
Travelers Companies, Inc.	21	W.R. Berkley Corporation	7	Bankers International Financial Corp	5	Pharmacists Mutual Ins Co.	3	AmTrust Financial Services, Inc.	3
American International Group, Inc.	18	Alaska National Corporation	7	Michigan Millers Mutual Ins Co	5	Arbella Mutual Insurance Co.	3	United Heritage Mutual Holding Co	3
State Auto Insurance Companies	17	Grange Mutual Casualty Company	7	White Mountains Insurance Group, Ltd.	4	Governmental Interinsurance	3	CAMICO Mutual Insurance Co.	2
Factory Mutual Insurance Company	16	Columbia Mutual Insurance Co.	7	Lumbermen's Undrwtg Alliance	4	American Family Insurance Group	3	Farmers Union Mutl Ins Co (AR)	2
Grange Mutual Casualty Co.	15	Star Casualty Insurance Co.	7	USAA Insurance Group	4	ARX Holding Corp.	3	Trident III, LP	2
Loews Corporation	15	Merchants Mutual Insurance Co.	6	FCCI Mutual Insurance Holding Co	4	West Bend Mutual Insurance Co.	3	Chase Family Ltd.	2
Argo Group International Holdings, Ltd.	13	Maine Mutual Group	6	Grinnell Mutual Reinsurance Co	4	NORCAL Mutual Insurance Co.	3	Jewelers Mutual Insurance Co.	2
UniGroup, Inc.	10	Beacon Mutual Insurance Co.	6	Hattbert Holdings, Inc.	4	Ohio Mutual Insurance Group	3	RLI Corp.	2
ACCC Holding Corporation	10	ACE Limited	6	New York Municipal Ins Recpl	4	First Mercury Financial Corporation	3	Other	111
								Grand Total	1095

Source: Goldman Sachs Research, SNL

Gen Re: Company highlights

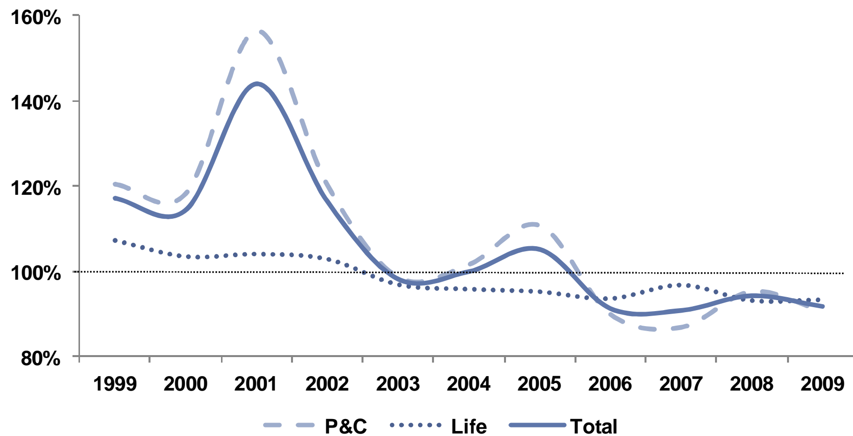
Exhibit 33: Gen Re business mix: Diversified across non-life and life, property and casualty
% 2009 Net written premiums



* Cologne Re business mix is based on 2008 gross premiums written

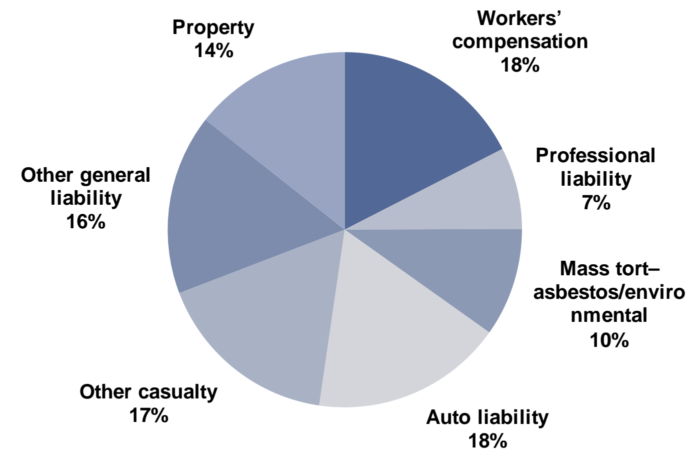
Source: Goldman Sachs Research, company data

Exhibit 34: Gen Re has maintained underwriting profitability in recent years
Combined ratio



Source: Goldman Sachs Research, company data

Exhibit 35: Reserves spread over various lines of business
2009 year end reserves



Source: Goldman Sachs Research, company data

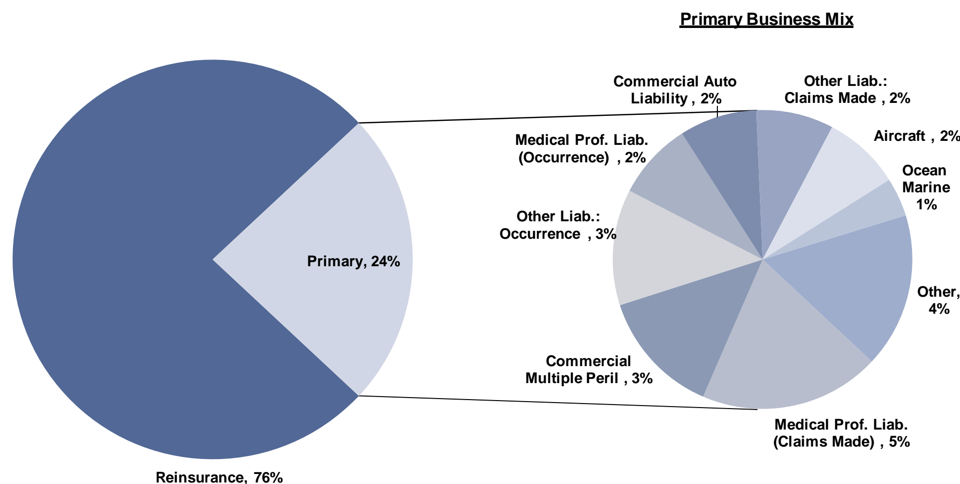
Berkshire Hathaway Primary Insurance Group: Small, but stable and profitable companies

Primary Ins Group: 1% of total GAAP earnings

The Primary Insurance Group is a collection of insurance companies that provide a diverse offering of insurance coverage across the US. The group includes the primary business of National Indemnity, US Investment Corporation (led by U.S. Liability Insurance Company), Medical Protective Corporation, Applied Underwriters, Boat America Corporation ("BoatU.S."), as well as the "Homestate Companies," and others.

National Indemnity was founded in 1940 as a writer of liability insurance for taxis and Berkshire Hathaway assumed control in 1967. The National Indemnity group of insurance companies offers the following primary coverages: Commercial auto insurance (business auto, passenger transport, commercial trucks and truckers, and specialty operations), general liability (for construction, installation, service & repair, manufacturing & distributing, stores & rental operations, and transportation), garage insurance, motor truck cargo insurance, prize indemnification, and special events insurance. The group utilizes a nationwide wholesale distribution method with a network of over 100 general agents.

Exhibit 36: National Indemnity Group 2009 NPW
National Indemnity Group SNL subgroup business mix



Source: Goldman Sachs Research, SNL

Non-Insurance: The high-growth, inflation-protected annuity

"The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the durability of that advantage." – *Warren Buffett, 1998*

Burlington Northern Santa Fe: Well-positioned railroad powerhouse

BNSF: 22% of total GAAP earnings

What is it? Burlington Northern Santa Fe, LLC (BNSF) operates one of the largest North American rail networks, mostly in the Western US, with about 32,000 route miles covering 28 states and two Canadian provinces. In 2009, the company had $4.8 billion in EBITDA and $1.8 billion in earnings.

BNSF's operations are organized into four segments: (1) **Consumer products revenue**—made up of intermodal (retail-like), automotive, and other—that combined to account for 32% of revenue in 2009; (2) **coal** (27% of revenues); (3) **industrial products** (21% of revenues); and (4) **agricultural products** (21% of revenues).

The Back Story: Berkshire Hathaway first purchased a 6% stake in BNSF in 2006 and built up to a 22.5% stake by 2009. In 1Q10, Berkshire completed the acquisition of the remaining 77.5%. The total company was purchased for $34 billion in cash and stock while assuming an additional roughly $9 billion in net debt and $4 billion in operating leases.

The Controversy: Berkshire paid a sizeable 31.5% premium to where BNSF stock was trading before the announcement. We believe the relatively expensive valuation reflects: (1) a long investment time horizon, (2) the rails' long-term competitive barriers to entry, (3) the need for an acquisition of significant size to be material and use large growing cash reserves, and (4) the perspective gained from real-time data concerning product flows and raw commodity outlook.

We note overall our Neutral coverage view on Railroads is due partly to valuation given low free cash flow yields that indicate earnings beats are largely priced into the stocks, while any operational or macro missteps are not. We note that BNSF's purchase price is not at a premium to today's prices – since the announcement, railroad stocks are up 30% vs. the S&P as volumes continue to improve and incremental margins for the group have been above expectations. Longer-term we are positive on railroad fundamentals and expect Berkshire to earn a high single to low double digit return on the BNSF investment. At its core, we see the acquisition taking the investment view that: (1) railroad inflation-plus pricing power continues, (2) fuel prices rise and drive share shift to rail from truck, (3) Asia-US trade continues to increase, (4) potential regulatory changes are not significant enough to alter a relatively robust return outlook.

Exhibit 37: BNSF has the largest exposure to favorable coal and intermodal markets of the major railroads
2009 Railroad Exposures by Percent of Revenues

Railroads	Intermodal	Coal	Agriculture Products	Chemicals	Non Metallic Minerals & Products	Metallic Ores & Metals	Forest Products	Motor Vehicles & Equipment	Other RR
BNI	46.2%	28.5%	10.0%	6.2%	3.0%	2.0%	1.6%	1.2%	1.5%
CNI	31.0%	9.7%	10.5%	14.6%	4.7%	14.1%	9.3%	3.8%	2.1%
CP	40.7%	12.4%	20.3%	11.5%	3.6%	2.4%	2.7%	4.3%	2.1%
CSX	32.2%	25.8%	7.4%	10.2%	8.3%	3.7%	4.0%	4.1%	4.3%
KSU	31.6%	16.3%	12.1%	14.0%	5.8%	6.5%	6.3%	3.2%	4.3%
NSC	42.5%	23.0%	6.7%	6.8%	5.2%	3.9%	3.7%	4.9%	3.3%
UNP	38.8%	25.5%	9.6%	10.4%	5.6%	1.6%	2.2%	3.7%	2.6%
Average	**37.6%**	**20.2%**	**10.9%**	**10.5%**	**5.2%**	**4.9%**	**4.3%**	**3.6%**	**2.9%**

Source: Association of American Railroads.

BNSF: Company highlights

Why Berkshire Bought It

We believe railroads are poised to benefit from high barriers to entry that should help sustain strong base pricing. In addition, we expect railroads to continue to gain share from trucking (especially if fuel prices rise). Relative to its railroad peers, we take a positive view on Burlington's exposure to Asia, legacy contracts left to renew at higher rates, and west coast coal exposure (versus slower growth East coast coal). While the railroad business is highly capital intensive (capex accounts for roughly 15-17% of sales), we believe Berkshire views this capex as an attractive avenue to soak up an increasing supply of cash.

Competitive Advantages

- One of two railroads that operate in the Western US (the other being Union Pacific).
- Strong intermodal (retail-like) presence with long standing trucking partnerships (e.g., J.B. Hunt) and attractive port access.
- Exposure to Asian imports/exports, especially though largest U.S. port in Los Angeles/Long Beach.
- Access to Powder River Basin coal, with large deposits of low cost, low sulfur-content, US coal.

Things to Watch

- Weekly volume reports and performance metrics submitted to the Surface and Transportation Board (STB).
- Fuel prices, which are positively correlated to share gains from less fuel-efficient trucking carriers.
- Potential regulatory reform as introduced by the Senate Transportation Committee that could affect the pricing practices and rates railroads are able to charge.
- West coast port traffic.
- Powder River Basin coal production and demand.

BNSF: Will generate more cash than you think

Despite potential increasing capital investments, our model snapshot illustrates that BNSF should be a significant cash generator (see Exhibit 38). In fact, we estimate, even after segment-specific interest and taxes, BNSF will generate over $17 billion in cumulative free cash flow between 2010E-2016E, versus the roughly $16 billion in cash Berkshire paid for the acquisition (with the rest coming in equity). We note that our forecasts assume $400-$500 million in annual investments in terminal and line expansion (versus $221/$86 million in 2008/2009) –which we believe accounts for the company's preference to invest in the business now that it does not need to distribute dividends or buy back stock.

Exhibit 38: BNSF Company Model Snapshot
BNSF forecasted financials, 2004-2012E

millions	2004A	2005A	2006A	2007A	2008A	2009A	2010E	2011E	2012E
Revenue	**10,946**	**12,987**	**14,985**	**15,802**	**18,018**	**14,082**	**16,614**	**18,673**	**20,052**
YoY % change	*16.3%*	*18.6%*	*15.4%*	*5.5%*	*14.0%*	*-21.8%*	*18.0%*	*12.4%*	*7.4%*
Volumes (carloads)	*10.3%*	*5.1%*	*6.1%*	*-3.0%*	*-3.1%*	*-15.8%*	*6.0%*	*8.0%*	*3.8%*
Base price	*2.6%*	*5.4%*	*5.2%*	*8.3%*	*8.5%*	*2.9%*	*4.4%*	*4.0%*	*4.0%*
Fuel surcharge	*2.7%*	*6.9%*	*4.8%*	*1.1%*	*9.6%*	*-11.4%*	*5.8%*	*1.3%*	*-0.2%*
Business mix, other	*0.1%*	*-0.1%*	*-0.7%*	*-0.8%*	*-0.9%*	*2.4%*	*2.0%*	*-0.6%*	*-0.2%*
Expenses	**9,260**	**10,065**	**11,468**	**12,316**	**13,916**	**10,754**	**12,131**	**13,479**	**14,392**
EBIT	**1,686**	**2,922**	**3,517**	**3,486**	**4,102**	**3,328**	**4,484**	**5,194**	**5,660**
Margin	*15.4%*	*22.5%*	*23.5%*	*22.1%*	*22.8%*	*23.6%*	*27.0%*	*27.8%*	*28.2%*
Depreciation	1,012	1,075	1,130	1,293	1,397	1,537	1,721	1,876	2,037
CAPEX	1,527	1,750	2,014	2,248	2,175	1,991	2,490	2,932	2,996
FCF (excl interest, taxes)	**1,171**	**2,247**	**2,633**	**2,531**	**3,324**	**2,874**	**3,715**	**4,138**	**4,702**
Segment net int exp	409	437	485	511	533	561	610	643	640
Segment taxes	159	545	779	680	974	849	1,521	1,726	1,905
Segment FCF (excl WC)	**603**	**1,265**	**1,369**	**1,340**	**1,817**	**1,464**	**1,583**	**1,768**	**2,157**

We forecast revenues using detailed supply/demand models from our dedicated sector analysts and detailed end market mix models.

We forecast operating margins based on cost per gross ton mile basis taking into account inflationary pressures.

We assume a relatively large increase in capital expenditures as part of BNSF's reinvestment program.

Source: Company filings, Goldman Sachs Research estimates

BNSF: Positive view on railroads

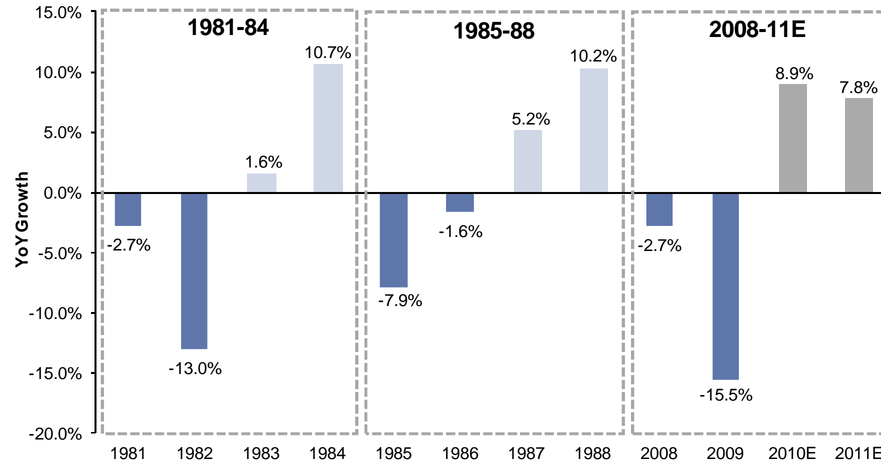
Our view on railroads

We have a positive view of railroads and expect Burlington Northern to offer attractive growth and significant cash generation for Berkshire over the long-term. Our positive view on railroads is largely based on high barriers to entry that should help sustain strong base pricing and potential share gains from trucking. Relative to its railroad peers, we take a positive view on Burlington's exposure to Asia, legacy contracts left to renew at higher rates, and west coast coal.

Cyclical: Cautiously optimistic – data points remain positive despite rising doubt

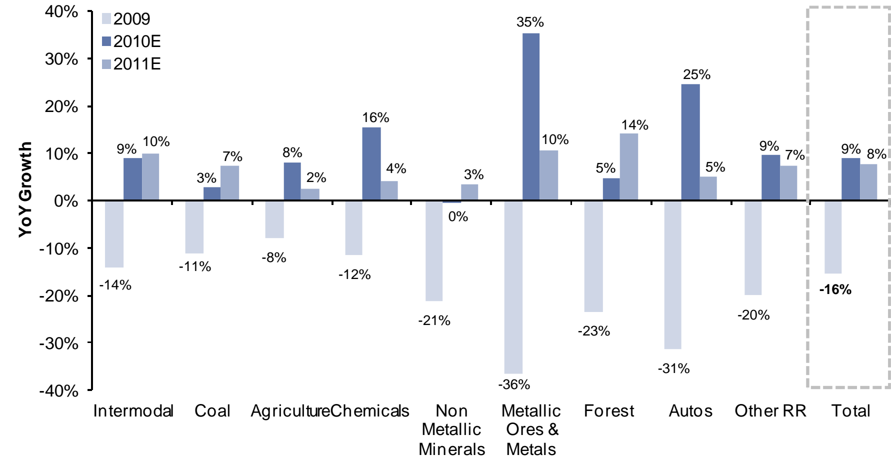
We estimate railroad volume growth of 9% in 2010 and 8% in 2011 (see Exhibit 39). We note that our analysis has led to 2010-2011 revenue forecasts for railroads that are generally above Street estimates. Our bottom-up approach is a detailed study of end markets based on supply-demand models of the various Goldman Sachs sector analysts. **Given this relatively positive backdrop, we estimate Burlington Northern volumes will increase 6% and 8% in 2010E and 2011E, respectively.**

Exhibit 39: 2010-2011 volume recovery estimates in line with prior recoveries
Originated Railroad Volume (YoY Growth)



Source: Goldman Sachs Research estimates and the Association of American Railroads.

Exhibit 40: Our analysis shows strong 2010 for metals, intermodal, chemicals
Railroad Carloads by End Market (YoY Growth)



Source: Goldman Sachs Research estimates and the Association of American Railroads.

Secular Positives: Pricing, share gains from trucks, Asian exposure

1. **Expect inflation-plus pricing over the longer-term:** We expect BNSF base pricing to increase 3-4% per year over the longer-term, down from high single digit increases but still high enough to drive margin improvement. We believe this pricing power stems from: (a) the roughly 25-45% of shippers that have no practical choice but to use a railroad to ship their products and there are rarely more than two railroads to choose from; and (b) the roughly 10% of BNSF volumes that are still under legacy contracts (were typically 10-20 years in length). Re-pricings on these contracts can be significant—in some cases over 100% increases from the final year of the contract.
2. **Intermodal (retail-like goods): Fuel price inflation could accelerate the shift from truck to rail:** We expect accelerated modal shift from truck to rail given railroad investments that have improved intermodal service and potential fuel price inflation. We estimate that rail is 2-5 times more fuel efficient than trucks (depending on the freight). Intermodal volume growth rates have averaged 4.6% since 1980 while all other carloads have averaged 0.9% growth. Intermodal now constitutes roughly 46% of BNSF volumes (and 40% of total railroad volumes). BNSF is the largest intermodal carrier in North America.
3. **Asian exposure should be a positive:** Despite some fears over slowing growth (tightening monetary policy, downside to real estate prices), we believe increased trade with Asia continues to present an attractive secular story. West Coast ports account for roughly 75% of Asian imports to North America. BNSF has attractive port access to LA / Long Beach, Oakland, Tacoma, Seattle, and Portland.

Exhibit 41: BNSF positioned to benefit from Asian imports entering Unites States through key Western ports
BNSF Network Map

Source: Company documents.

Secular risks: Regulatory, operational missteps

1. **Regulatory:** We expect potential rail regulation to come back to the forefront of investors' minds, and will likely pressure railroad stocks in general. Although the passage of a bill in 2010 is highly unlikely, we believe the progress towards changes could be a negative catalyst for the stocks. The Senate Transportation Committee released a draft of rail legislation in December 2009, and work on this draft is ongoing. Although mid-term elections and other factors will have a large impact on the outcome and timing, we do expect some legislative changes to eventually be passed, possibly in 2011. We believe the outcome from rail regulation will be somewhat more advantageous to the shippers than it is now, while we expect it to have less of an effect than the "doomsday" scenario that has worried many in the past.

   At its core, new regulations will be geared towards increasing rail competition where possible – in most cases attempting to increase the number of rails servicing a shipper from one to two. We believe all of high-level areas highlighted in Exhibit 42 below will be addressed in some way in upcoming regulation. Within these higher-level issues will be many details that will finally determine how much of an effect each has on Burlington Northern.

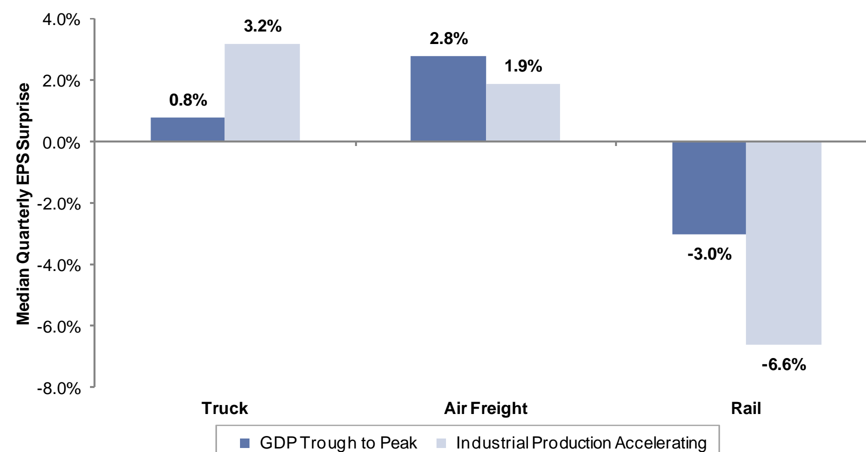
2. **Potential operational missteps:** If we use history as a guide, railroad earnings tend to underperform expectations during recoveries because incremental margins are hampered by difficulties in ramping up service for higher volumes. We analyzed reported EPS vs. consensus since 1991 for periods where GDP was coming out of a trough and industrial production growth was accelerating (see Exhibit 43). In previous cycles, railroads have had some difficulty bringing assets back online efficiently, and hiring employees back to deal with improving volumes. While this remains a concern, we believe the large investments in IT systems, as well as the availability of labor, mitigate some of the risks that pressured railroads in the past.

Exhibit 42: Legislative issues to be addressed in future rail regulation

Antitrust Exemption	Railroads currently enjoy Department of Justice antitrust exemptions; the revocation of these exemptions could open railroads to increased liabilities.
Paper Barriers	Contractual agreements that stipulate virtually all traffic that originates on shorter-haul railroads MUST be interchanged with the Class I railroad that originally sold/leased the tracks or pay a penalty.
Bottleneck pricing	Potential to require railroads to provide service for any two points on its system where traffic originates, terminates, or can be interchanged.
Mandatory reciprocal switching	Potential to require railroads that are close to one another to transport cars onto a competing railroad for a fee.
STB rate review process	The Surface Transportation Board (STB, unit of the US Department of Transportation) currently has the authority over some, but not all, of the rates that railroads charge. Estimates vary over what percentage of traffic meets the criteria for STB overview, but range from 10-30% of railroad ton-miles. The STB rate review process, while it has been improved, is still viewed as costing too much and taking too long.

Source: Goldman Sachs Research.

Exhibit 43: In recoveries, rails tend to miss expectations among transport cos
Median quarterly EPS surprise since 1991 under recovery conditions



Source: Goldman Sachs Research estimates, Factset..

MidAmerican Energy: Regulated electric and gas utilities with a global footprint

MidAmerican: 9% of total GAAP earnings

What is it? MidAmerican Energy Holdings Company's (MEHC) energy businesses generate, transmit, store, distribute, and supply energy. It is important to note that approximately 97% of the company's operating income in 2009 came from rate-regulated businesses.

MEHC's operations are organized and managed as eight distinct platforms: PacifiCorp, MidAmerican Funding, Northern Natural Gas Company, Kern River Gas Transmission Company, CE Electric UK Funding Company, CalEnergy Generation-Foreign, CalEnergy Generation-Domestic, and HomeServices of America, Inc.

Through these platforms, MEHC owns and operates an electric utility in the Western United States, an electric and natural gas utility in the Midwestern United States, two interstate natural gas pipelines in the United States, two electricity distribution companies in Great Britain, a diversified portfolio of independent power projects and the second-largest residential real estate brokerage firm in the United States.

The Back Story Berkshire Hathaway first purchased a majority equity interest in MidAmerican Energy in 2000. Due to constraints imposed by the Public Utility Holding Company Act of 1935 (PUHCA), the original transaction was structured so Berkshire gained a 76% equity interest in the company, but only 9.7% of the voting shares. After the repeal of the PUHCA in 2006, Berkshire converted its non-voting convertible preferred holdings into common stock, and today owns 89.5% of MEHC.

Exhibit 44: MEHC's operations are managed as 8 distinct platforms

PacifiCorp
- Regulated electric utility operating in Western U.S.
- Approximately 44% of MEHC operating income
- 1.7mn retail electric customers
- 10,483 net owned megawatts of generation
- Plans to build 2,000 miles of high-voltage transmission lines costing more than $6bn
- Direct-owned coal mines support 31% of company needs, helps moderate fuel expenditures

MidAmerican Energy
- Primarily regulated electric and natural gas utility businesses operating in the Midwestern US
- Approximately 20% of MEHC operating income
- Includes nonregulated retail electric sales and nonregulated gas sales targeted to businesses
- Largest wind-powered generation fleet in US with commitment to future investment
- 2,300 miles of transmission, 400 substations

Northern Natural Gas
- Regulated natural gas pipeline system primarily operating in the Midwestern U.S.
- Approximately 14% of MEHC operating income
- 15,000 miles of natural gas pipelines
- Largest pipeline system in US by area, 8th largest by throughput
- Major expansion project to add 650,000 Dth per day in capacity by end of 2010

Kern River
- Regulated natural gas pipeline system operating in the Inter-Mountain West
- Approximately 9% of MEHC operating income
- 1,700 miles of natural gas pipelines
- Only pipeline connecting Rocky Mountain supply to California end-market provides cost advantage
- Expansion projects to add 466,000 Dth per day in capacity by end of 2011

CE Electric UK
- Electric distribution company operating in the UK
- Approximately 16% of MEHC operating income
- Serve 3.8 million end-users in northeast England
- 18,000 miles of overhead lines, 40,000 miles of underground cables, and 700 major substations
- Also owns engineering contracting business and hydrocarbon exploration and development business

CalEnergy-Foreign
- Indirect majority ownership of 150MW Philippine irrigation and hydroelectric project
- Approximately 5% of MEHC operating income
- Single customer is Philippine government who guarantees all project obligations
- Project must be relinquished to government regulator in December 2021

CalEnergy-Domestic
- 15 independent, US-based power projects
- Less than 1% of MEHC operating income
- 927 MW of net owned generation
- Portfolio focus is natural gas fired plants, but also includes geothermal and hydroelectric assets

HomeServices of America
- Second largest real estate brokerage firm in the US
- Less than 1% of MEHC operating income
- Operates through 21 locally branded firms that have 16,000 agents across 300 offices in 20 states
- Provides mortgage origination services through joint venture agreements

Source: Goldman Sachs Research and company filings.

MidAmerican Energy Holdings: Company highlights

Why Berkshire Bought It

In the past, Berkshire Hathaway avoided capital intensive businesses like utilities in preference for more capital-efficient business models. As the company has grown and begun generating ever larger amounts of free cash flow, finding enough attractive capital-efficient businesses to soak up the supply of cash has become incrementally more difficult. Regulated utilities (like Berkshire's recent purchase of BNSF), require high levels of capital expenditures but provide a slow-and-steady regulated return on invested capital. For every dollar spent on capital projects, regulated utilities can earn in the range of a 10% return on equity over the long run. Viewed relatively against an investment grade corporate bond portfolio, for example, investing in MEHC allows for a steady and predictable return, zero reinvestment risk, and the potential to capture growth in the underlying business. Furthermore, consistent with other Buffet purchases, David Sokol and Gregory Abel are recognized as leading managers in their field.

Competitive Advantages

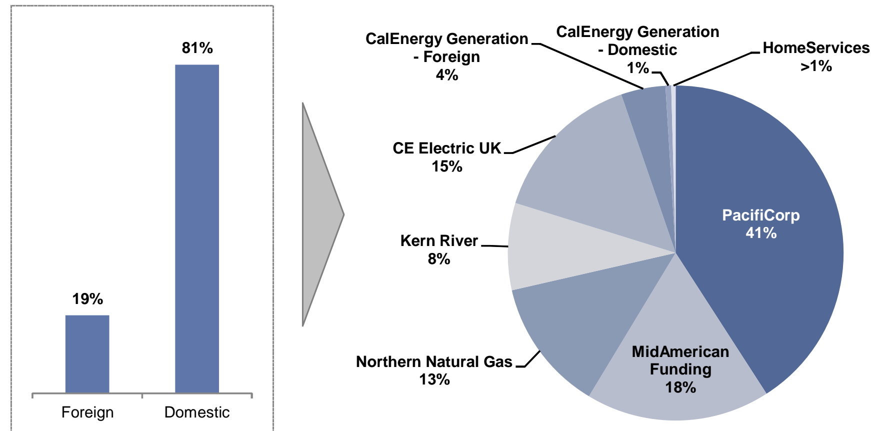
- Berkshire's buy-and-hold philosophy makes MEHC the buyer of choice when attractive power assets come to market.
- Berkshire has an agreement in place with MEHC upon which it is required to purchase up to $3.5 billion in common equity (recently Amended to step down to $2 billion in March 2011) which can be used to pay down debt or general corporate purposes, given Berkshires AA+ rating this allows MEHC to fund very cheaply.
- Berkshire balance sheet (separate from equity commitment), provides MEHC flexibility to acquire attractive targets throughout the economic cycle (example: BYD, CEG).
- Generation is weighted to base load assets that operate more of the time and at an average lower variable cost (see Exhibits 47 and 48 below).
- Diverse operating platform minimizes exposure to any one regulatory environment.

Things to Watch

- Rate cases are the primary driver of incremental revenue growth and are determined by state regulatory authorities.
- New environmental requirements can provide both a benefit or a drag on power companies depending on how they are structured.

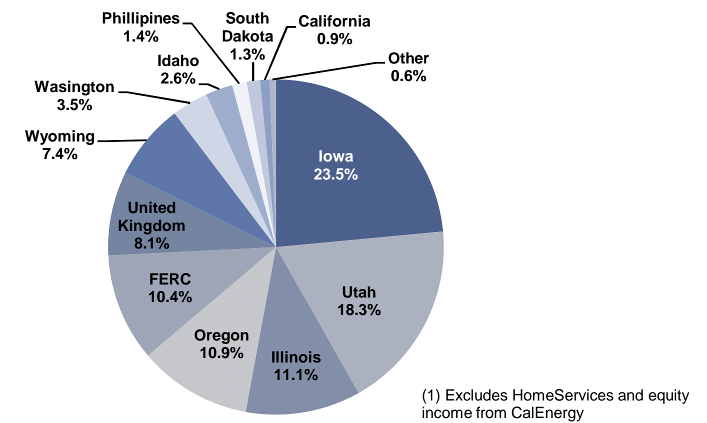
MidAmerican Energy Holdings Company in pictures

Exhibit 45: Diverse operating income is not dependent on any one business
MEHC Operating income Breakdown



Source: Goldman Sachs Research and company filings.

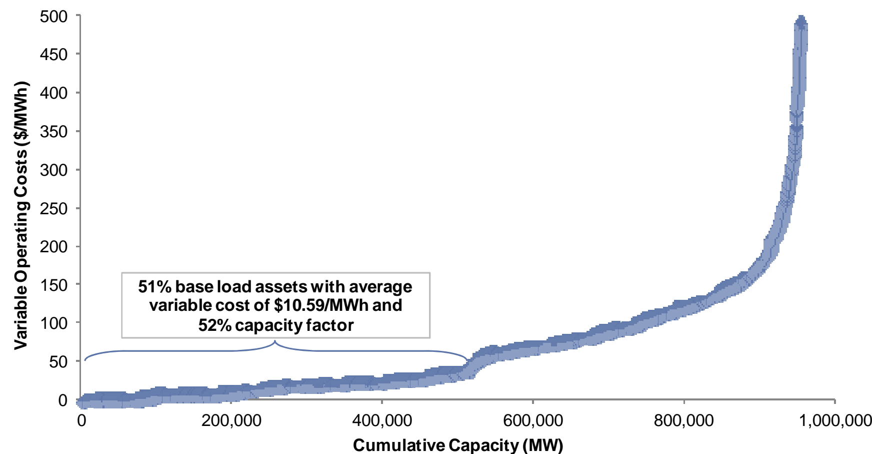
Exhibit 46: 2009 revenues of $10.2 billion spread across various regulators
2009 Energy Revenue[1]



(1) Excludes HomeServices and equity income from CalEnergy

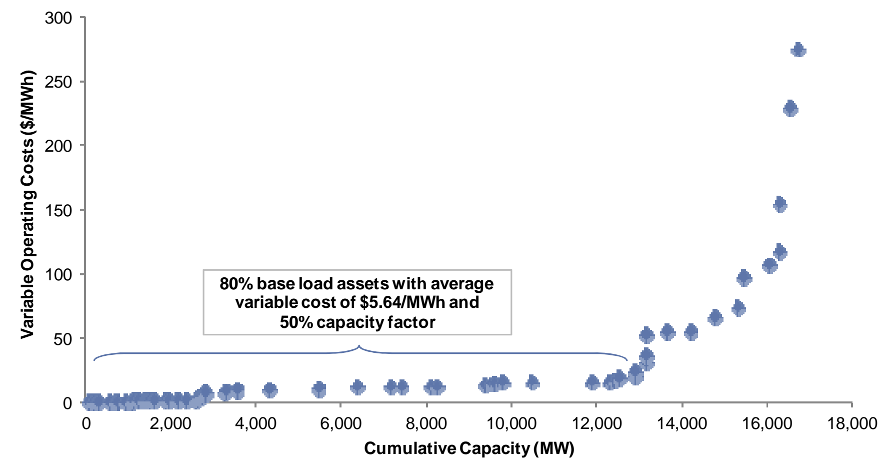
Source: Goldman Sachs Research and company disclosures.

Exhibit 47: Compared to the general industry's cost and asset profile…
US Industry Power Supply Curve



Source: Goldman Sachs Research and SNL DataSource.

Exhibit 48: MEHC has more base load assets at a lower average variable cost
MEHC Power Supply Curve

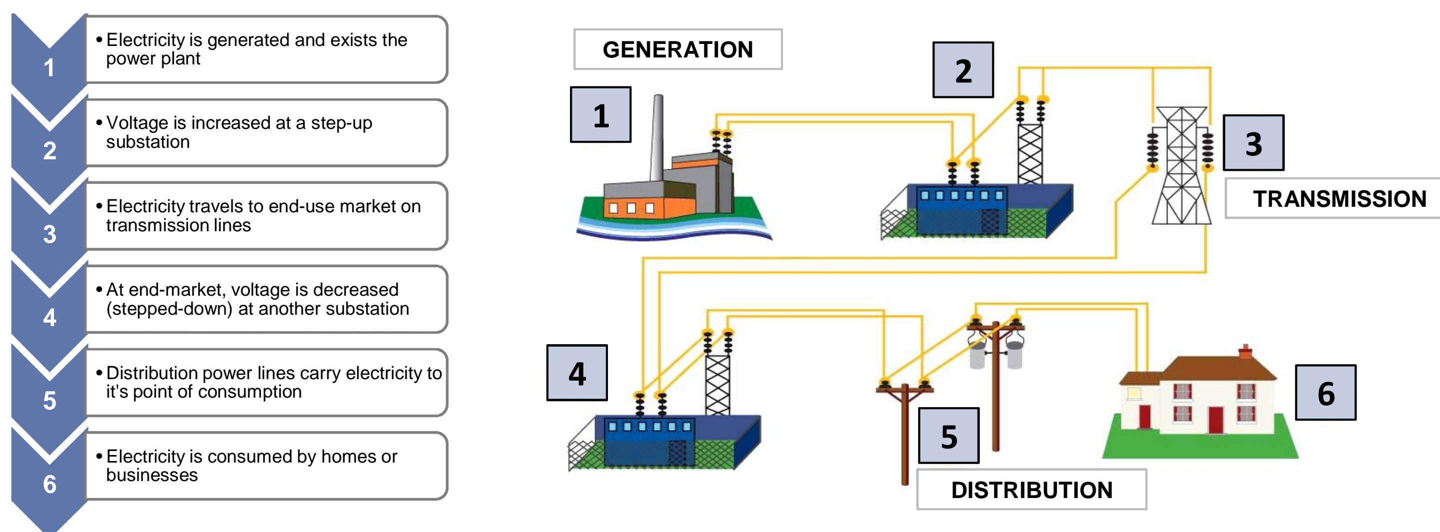


Source: Goldman Sachs Research and SNL DataSource

The Power Industry: How it works

The power industry can be viewed from a variety of perspectives, but on a basic level there are three different types of business functions: generation, transmission, and distribution (See Exhibit 49 for a brief explanation). In simple terms, generators produce power, transmission systems carry power over long distances, and distribution systems carry power "the last mile" to the home or business where it will be consumed. Often times, these functions are presented together in vertically integrated firms. Other firms focus on transmission and distribution only (T&D), and some firms only produce power (merchant generators). A fourth potential business model called a marketer or retailer simply aggregates end-users and sells the collective power demand back to producers or T&D companies. The vast majority of Berkshire's businesses are vertically integrated, and 97% are regulated.

Exhibit 49: The Power System in Brief



Source: Goldman Sachs Research and Edison Electric Institute.

It is important to understand the regulatory dimension of the power and utility space. Like operating insurance subsidiaries, utilities are primarily regulated at the state level. Given that most utilities are natural monopolies, regulators work to make sure that a crucial resource like power is available and affordable for all consumers. Regulators allow most fuel costs associated with power generation to be "passed through" to the end-user, buffering regulated utilities from volatile commodity prices (see Exhibit 51 on the following page). They also control electricity prices by setting a maximum authorized return on equity that a utility is allowed to earn over time. Furthermore, they mandate the firms capital structure (usually around 50% equity with a 10% authorized ROE). Exhibit 50 provides a simple authorized income calculation.

Exhibit 50: Regulators affect power prices by controlling each of the three variables presented below

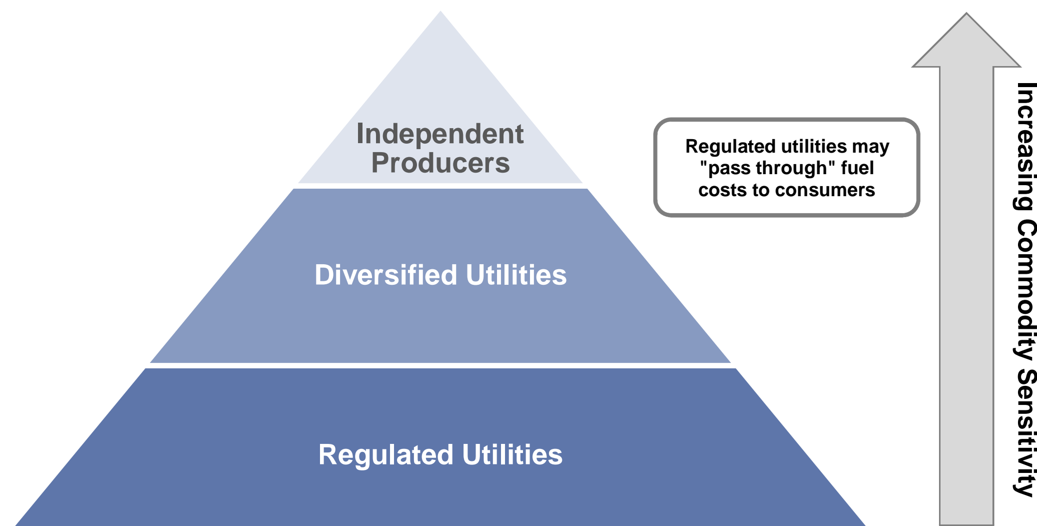
Regulatory Rate Base *(Adj. Net PP&E is GAAP proxy)* X Authorized Equity Component X Authorized ROE = Authorized Net Income

Source: Goldman Sachs Research.

Utilities are required to provide services to power customers in their operating territories, which requires ongoing investment. Given the structure presented above and the inherently capital intensive nature of the power business, capital expenditures (and associated depreciation and amortization) are an important driver of returns in the long run: at intervals, regulated utilities can request adjustments to the variables that constitute authorized net income in an effort to "earn back" capital invested in the business at a reasonable rate of return (called "rate cases"). This mechanism for a guaranteed return on capital over the long run is one of the primary reasons for Berkshire Hathaway's interest in regulated businesses such as utilities.

Transmission and distribution are always regulated. Generation is regulated when part of a vertically integrated utility. Merchant generators and retailers are unregulated. Businesses that cross state lines such as T&D and natural gas pipelines are regulated by the Federal Energy Regulatory Council (FERC), as opposed to the states.

Exhibit 51: Regulation impacts commodity sensitivity and thus relative business economics
Basic Categories of Power Business

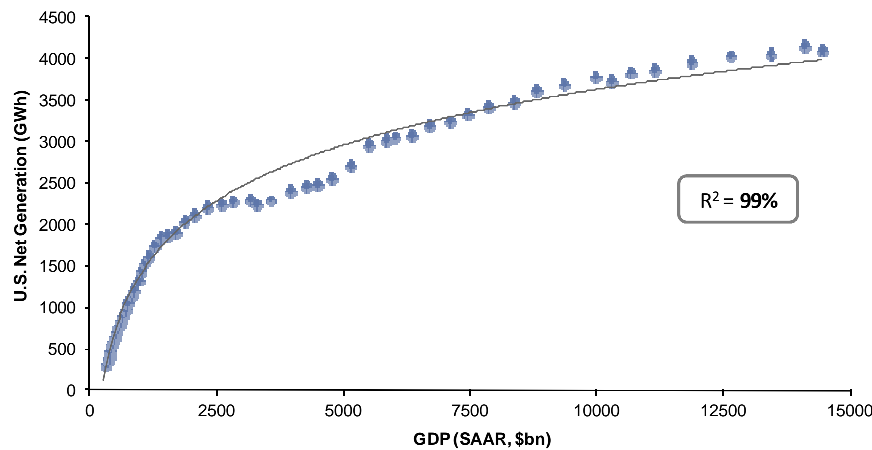


Source: Goldman Sachs Research.

What Drives Utilities?

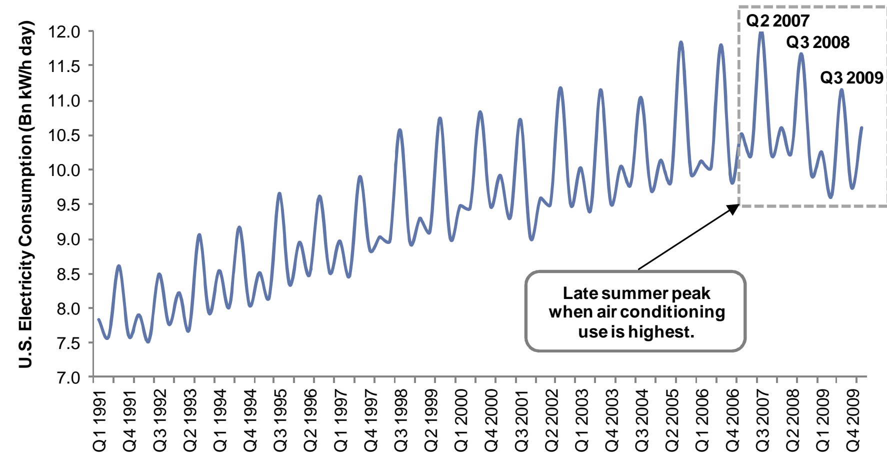
- In the short-term, weather is the major driver of electricity demand. Demand peaks in the summer when air-conditioning use in both the residential and commercial markets is highest. There is also a winter peak in many service areas where heating requirements consume more energy in the coldest months of the year.
- However, in the long-term—especially in such a carefully regulated sector—electricity demand closely tracks economic growth.

.Exhibit 52: Over the long run, power demand tracks economic growth
Electricity Generation (GWh) vs. Gross Domestic Product (SAAR, $bn)



Source: Goldman Sachs Research, BEA, and the Energy Information Administration.

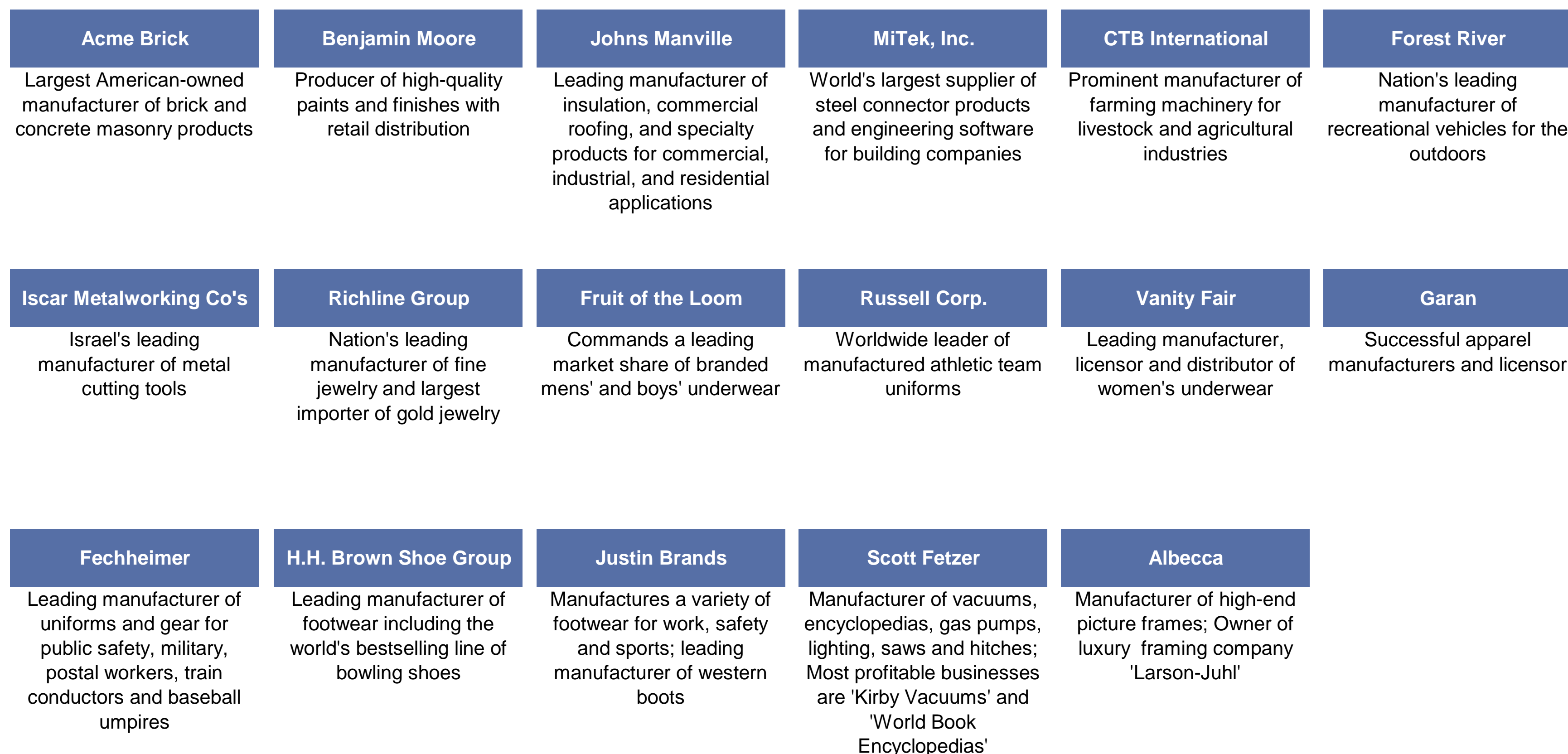
Exhibit 53: Electricity demand is highly seasonal, peaking in the summer
Seasonality of Electricity Demand



Source: Goldman Sachs Research and the Energy Information Administration.

Other Manufacturing: A manufacturing and services conglomerate (9% of GAAP earnings)

Exhibit 54: A diverse portfolio of industry-dominant companies
Other Manufacturing flow chart



Other Manufacturing Segment Snapshot

millions	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010E	FY 2011E	FY 2012E
Revenue	8,152	9,260	11,988	14,459	14,127	11,926	*13,357*	*14,426*	*15,580*
Expenses	6,992	7,925	10,232	12,422	12,452	11,112	*11,955*	*12,875*	*13,788*
Earnings p/t	1,160	1,335	1,756	2,037	1,675	814	*1,402*	*1,551*	*1,792*
Margin	*14.2%*	*14.4%*	*14.6%*	*14.1%*	*11.9%*	*6.8%*	*10.5%*	*10.8%*	*11.5%*

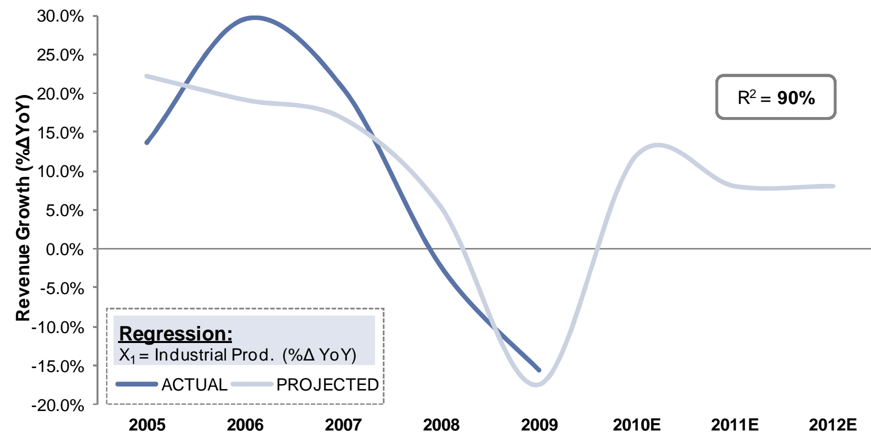
We drive revenue growth by our GS economists' views of industrial production growth.

Expenses are driven by the average aggregate margin on the underlying businesses.

Source: Goldman Sachs Research, company data.

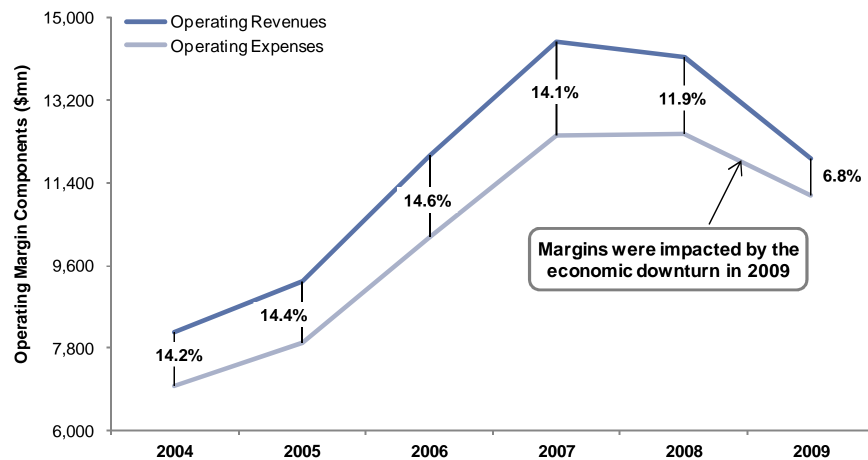
Other Manufacturing in pictures

Exhibit 55: After a major dip in industrial production during the crisis, we expect revenue to bounce back followed by moderation
Other Manufacturing Revenue Regression Model



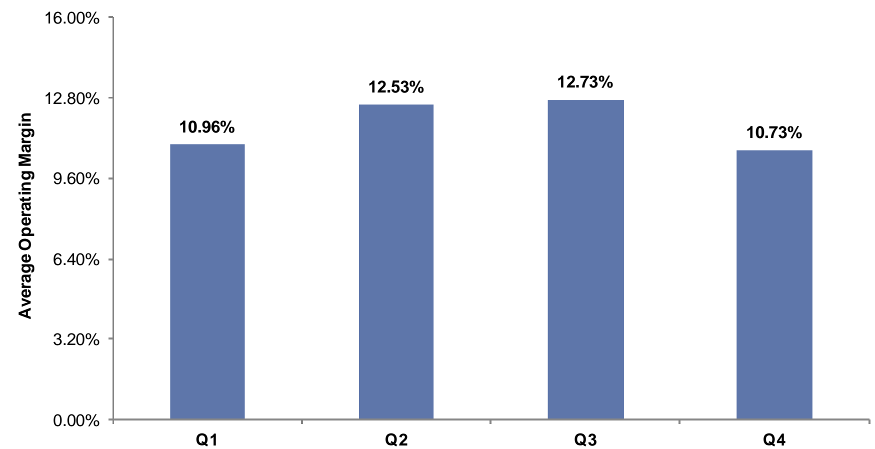
Source: Goldman Sachs Research.

Exhibit 56: Normalized margins for this segment appear to be around 13%
Operating Margin Components



Source: Goldman Sachs Research and company filings.

Exhibit 57: Operating earnings show some seasonality
Operating Margin Seasonality



Source: Goldman Sachs Research and company filings.

Marmon: A manufacturing and services conglomerate (5% of GAAP earnings)

What is it? The Marmon Group is an international association of approximately 130 manufacturing and service companies operating independently within 11 different business sectors, but shares a common consulting and administrative infrastructure.

The Back Story Berkshire Hathaway acquired a 60% interest of The Marmon Group for $4.5 billion dollars in March 2008. The remaining interest is currently held by the Pritzker family of Chicago through various trusts. Berkshire has since invested an additional $329 million to increase its ownership stake to 64.4% and plans to gradually acquire the remainder of The Marmon Group over a five to six year period.

Exhibit 58: Marmon is a diversified manufacturing and services conglomerate

Sample Listing of Marmon Group Holdings

Transportation Services & Engineered Products	Industrial Products	Engineered Wire & Cable	Water Treatment	Highway Technologies
Enersul Inc.	Atlas Bolt & Screw	Aetna Insulated Wire LLC	Amarillo Gear Company LLC	Fleetline Products
Enersul Operations	Cerro E.M.S. Limited	Cable USA LLC	Amarillo Wind Machine LLC	Fontaine International, Inc.
Enersul Technologies	Cerro Fabricated Products LLC	Comtran Cable LLC	Ecodyne Heat Exchanger LLC	Fontaine Modification Company
EXSIF Worldwide, Inc.	Deerwood Fasteners International	Dekoron Unitherm LLC	Ecodyne Limited	Fontaine Spray Suppression Company
Intermodal Transfer LLC	IMPulse NC LLC	Dekoron Wire and Cable LLC	Ecodyne Water Treatment LLC	Fontaine Trailer Company
McKenzie Valve & Machining LLC	Koehler-Bright Star LLC	Harbour Industries LLC	Ecodyne Canada Ltd.	Marmon-Herrington Company
Penn Machine Company LLC	Nylok LLC (Delaware)	Marmon Utility LLC (Hendrix)	EcoWater Systems Europe NV	NU-LINE Products Inc.
Procor Limited	Pan American Screw LLC	Marmon Utility LLC (Kerite)	EcoWater Systems LLC	Perfection
Railserve, Inc.	Robertson Inc.	Owl Wire and Cable LLC	Graver Technologies LLC	Triangle Suspension Systems, Inc.
Trackmobile LLC	Specialty Bolt & Stud Inc.	RSCC Aerospace & Defense	Graver Water Systems LLC	TSE Brakes, Inc.
Uni-Form Components Co.	Wells Lamont Europe Industry	RSCC Wire & Cable LLC	KX Technologies LLC (KXT)	Webb Wheel Products, Inc.
Union Tank Car Company	Wells Lamont Industry Group LLC	TE Wire & Cable LLC		
WCTU Railway LLC				

Retail Store Fixtures & Flow Products	Distribution Services	Food Service Equipment	Construction Services	Building Wire
Eden	Bushwick Metals LLC	Catequip S.A. and Cat'Serv S.a.r.l.	Sterling Crane	Cerro Wire LLC
L.A. Darling Company LLC	Future Metals LLC	Prince Castle LLC		
Leader Metal Industry Co., Ltd.	M/K Express Company LLC	Silver King		
Sloane	Marmon/Keystone Canada Inc.	Unarco Industries LLC		
Store Opening Solutions LLC	Marmon/Keystone LLC			
Thorco Industries LLC				
Wells Lamont Retail Group				
Anderson Cooper and Brass Co. LLC				
Cerro Flow Products LLC				
Penn Aluminum International LLC				

Source: Goldman Sachs Research and company disclosures.

Marmon: Company highlights

Why Berkshire Bought It

The Marmon Group fits the common Berkshire acquisition themes of family-run businesses with solid management teams, operating in stable industries. The company focuses on niche product markets with profitable growth potential, seeking to create synergies across its various businesses. The group was formed in 1953 by Jay and Robert Pritzker.

Competitive Advantages

- Marmon's diverse portfolio of businesses provides some buffer against specific negative trends in any one operating sector.
- Many of Marmon's businesses are North American industry leaders. Examples include Union Tank Car (the largest manufacturer and lessor of railroad tank cars), Sterling Crane (the largest provider of crane services), and Marmon Building Wire (a leading manufacturer of copper electrical building wire).

Things to Watch

- Given the Marmon Group is highly leveraged to the overall US economy with a large portfolio of manufacturing and services businesses, as GDP grows, Marmon should as well.

Exhibit 59: The Marmon Group Company Snapshot

millions	FY 2008	FY 2009	FY 2010E	FY 2011E	FY 2012E
Revenue	5,529	5,067	***5,241***	***5,399***	***5,561***
Expenses	4,796	4,381	***4,559***	***4,682***	***4,824***
Earnings p/t	733	686	***681***	***716***	***738***
Margin	*13.3%*	*13.5%*	***13.0%***	***13.3%***	***13.3%***
Depreciation	361	521	***521***	***521***	***522***
Capex	553	436	***527***	***538***	***587***
FCF a/t	224	456	380	392	355
Assets	9,757	9,768	9,774	9,791	9,856
FCF on Assets	*2.3%*	*4.7%*	*3.9%*	*4.0%*	*3.6%*

As a large portfolio of various manufacturing and services business that span 11 separate sectors, we find GDP growth is an appropriate driver for the Marmon Group segment.

Source: Goldman Sachs Research and company highlights.

Service: Collection of transportation & service related businesses (5% of GAAP earnings)

Exhibit 60: A diverse mix of service-related businesses
Service Flow Chart

Other Service Segment Snapshot

millions	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010E	FY 2011E	FY 2012E
Revenue	4,507	4,728	5,811	7,792	8,435	6,585	*6,914*	*7,734*	*8,372*
Expenses	4,095	4,399	5,153	6,824	7,464	6,676	*6,214*	*6,951*	*7,524*
Earnings p/t	412	329	658	968	971	(91)	*700*	*783*	*848*
Margin	*9.1%*	*7.0%*	*11.3%*	*12.4%*	*11.5%*	*-1.4%*	*10.1%*	*10.1%*	*10.1%*

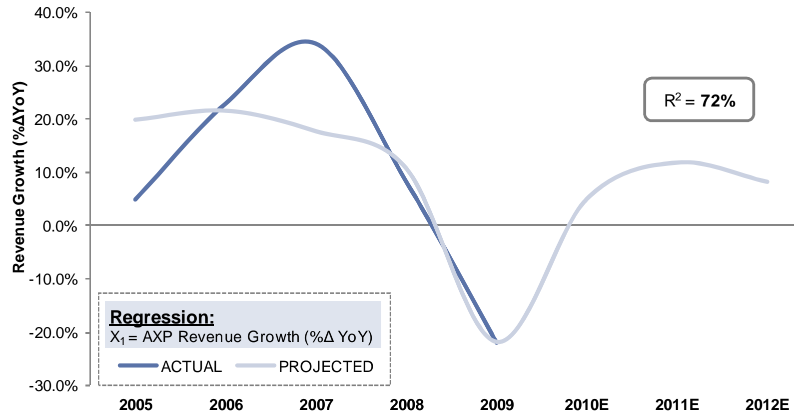
We drive revenue using American Express revenue growth as a proxy for health of the high-end consumer--a key constituency in a segment that includes NetJets.

Expenses are driven by the average aggregate margin on the underlying businesses (excluding the large NetJets loss in FY 2009).

Source: Goldman Sachs Research, company data.

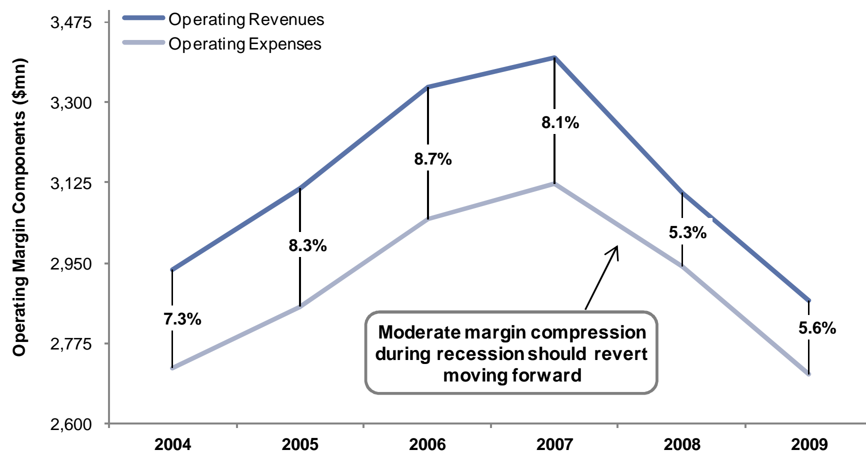
Service in pictures

Exhibit 61: As the high-end consumer (NetJets driver) returns relatively quickly, Service segment revenues will follow
Service Revenue Regression Model



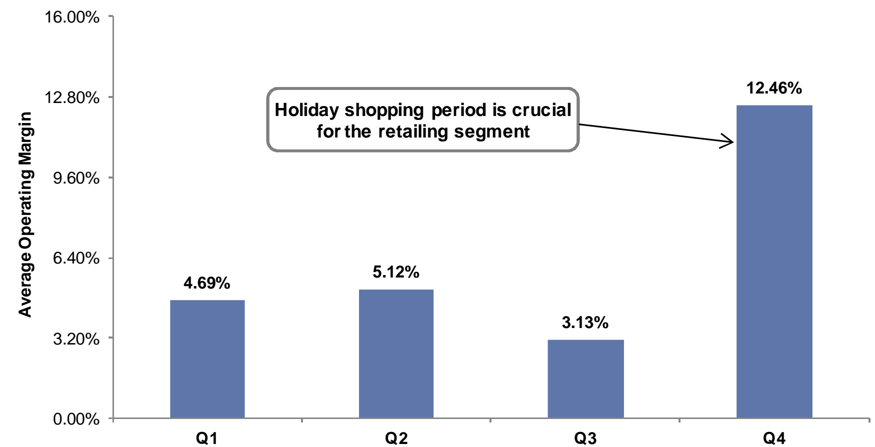
Source: Goldman Sachs Research.

Exhibit 62: Margins should return to a steady-state level around 8%
Operating Margin Components



Source: Goldman Sachs Research and company filings.

Exhibit 63: Unsurprisingly, weighted to holiday shopping and to traveling
Operating Margin Seasonality



Source: Goldman Sachs Research and company filings.

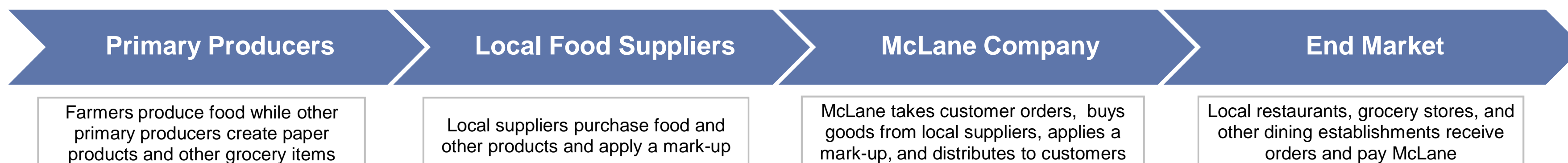
McLane: Supply chain and distribution for the food industry (2% of GAAP earnings)

What is it? McLane is a leading supply chain services company operating primarily in the grocery and foodservices industry. The company serves as an intermediary between food and grocery product producers, distributing goods to end customers like grocery stores, convenience stores, and chain restaurants. The company employs a high-volume, low margin business model with 2009 revenues of $31.2 billion and an operating margin of approximately 1.1%.

The Back Story For nearly 100 years, the McLane Company remained family-run until 1990 when the business was sold to Wal-Mart Stores. As a Wal-Mart company, McLane developed state-of-the-art logistics capabilities and in 2000 leveraged this expertise to enter the foodservices business, adding distribution operations to restaurants throughout the US.

Berkshire Hathaway acquired McLane Company in May 2003 for $1.45 billion dollars in cash. Interestingly, Berkshire strategically timed the acquisition at a moment when the foodservices industry was in transition: a major competitor was under investigation for an accounting scandal and another key player filed for Chapter 11 protection one month prior to Berkshire's acquisition. Furthermore, separating McLane from Wal-Mart removed many of the prior restrictions on doing business with Wal-Mart's direct competitors (such as Target), thus providing McLane with an opportunity to grow share at a time competitors were particularly weak.

Exhibit 64: A leading supply chain service company in the food service industry
McLane Company Flow Chart



Source: Goldman Sachs Research and company filings.

McLane: Company highlights

Why Berkshire Bought It

Like many industries that attract Berkshire, food distribution is very stable: the basic business model is unlikely to be disrupted by any new technologies, and demand for the product—food—has a natural support. McLane is a high-volume, low-margin business with sales of almost 10 billion pounds of merchandise delivered per year.

McLane's service-oriented culture and use of appropriate technologies has allowed it to develop a reputation for providing reliable, accurate, and timely delivery of merchandise. This in turn supports long-term distribution relationships with customers. Notably, McLane maintains an exclusive distribution agreement with Wal-Mart, the world's largest retailer, which has accounted for approximately one third of its annual top line.

Competitive Advantages

- Nationwide footprint through 38 automated distribution centers and one of the industry's largest fleets.
- One of the largest food service distributors in the country, competeing with heavyweights like Sysco Corporation (SYY), US Foodservice, Inc. and Performance Food Group.
- Over 15,000 employees and a carefully constructed service-oriented culture.
- Primary distributor to Wal-Mart (WMT), Yum! Brands (YUM), and Darden Restaurants (DRI)..

Things to Watch

- Given customer end demand drives top line growth, look for new major distribution contracts signed or lost
- The food services business is closely tied to consumer sentiment and spending trends—the more money people are willing to spend dining out, the more supplies restaurants need McLane to deliver.
- McLane has one of the largest truck fleets in the nation and it is a major consumer of gasoline—monitor fule costs as not all costs can be passed onto customers in a timely manner.

McLane: Business drivers and an earnings framework

Exhibit 65: McLane Company Model Snapshot

millions	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010E	FY 2011E	FY 2012E
Revenue	23,373	24,074	25,693	28,079	29,852	31,207	***32,253***	***34,912***	***38,704***
Expenses	23,145	23,857	25,464	27,847	29,576	30,863	***31,931***	***34,562***	***38,317***
Earnings p/t	228	217	229	232	276	344	***323***	***349***	***387***
Margin	*1.0%*	*0.9%*	*0.9%*	*0.8%*	*0.9%*	*1.1%*	***1.0%***	***1.0%***	***1.0%***
Depreciation	107	96	94	100	109	120	***120***	***122***	***124***
Capex	136	125	193	175	180	172	***175***	***178***	***181***
FCF a/t	113	107	39	63	86	134	***128***	***143***	***164***
Indentifiable Assets	2,349	2,555	2,986	3,329	3,477	3,505	***3,560***	***3,616***	***3,673***
FCF on Assets	*4.8%*	*4.4%*	*1.4%*	*2.0%*	*2.5%*	*3.8%*	***3.6%***	***4.0%***	***4.5%***

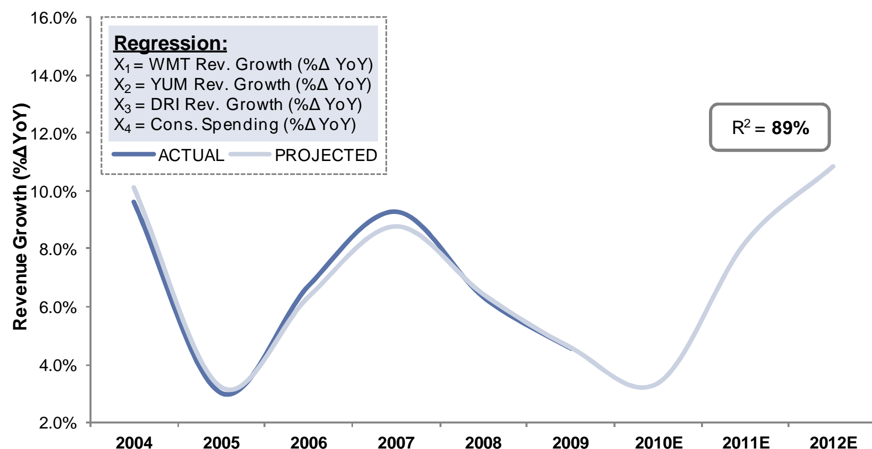
We forecast revenues from a "pull" perspective using a regression model based on top line growth at McLane's top three customers and consumer spending growth.

We forecast the operating margin based on food prices (base inputs) and gasoline (cost of distribution) as measured by the relevant S&P GSCI Commodity Indices.

Source: Goldman Sachs Research and company filings

Exhibit 66: Regression model sees 3.4% top line growth for McLane in 2010

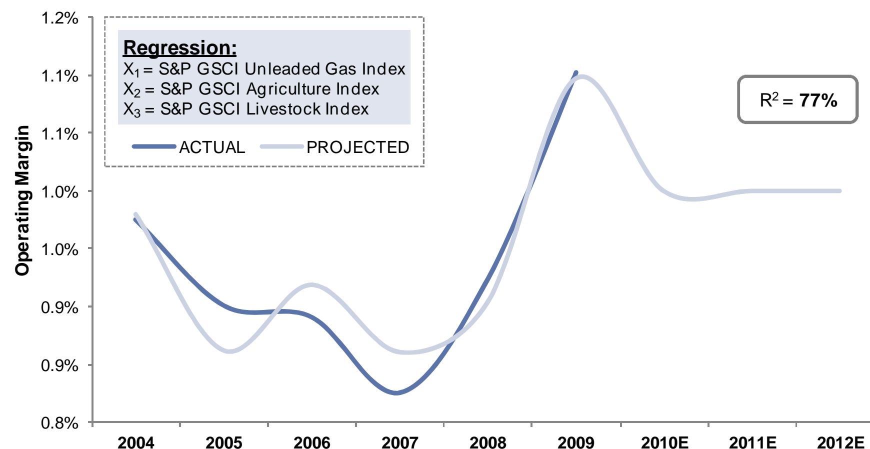
McLane Revenue Regression Model



Source: Goldman Sachs Research estimates and Thompson FirstCall.

Exhibit 67: Regression model sees margin compression in 2010, up in 2011

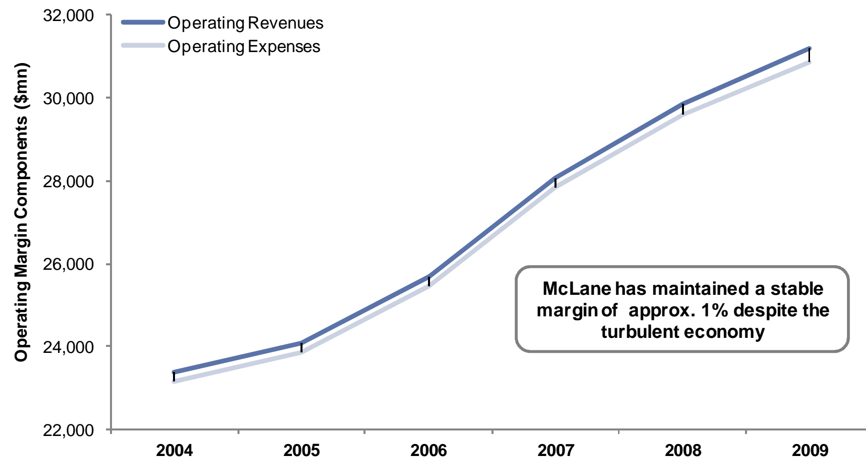
McLane Margin Regression Model



Source: Goldman Sachs Research and Haver Analytics.

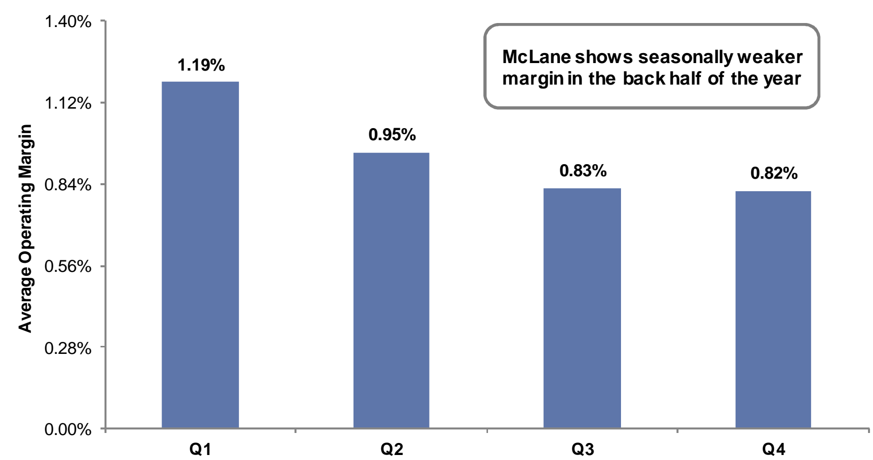
McLane in pictures

Exhibit 68: McLane maintains a stable operating margin of about 1%
Operating Margin Components



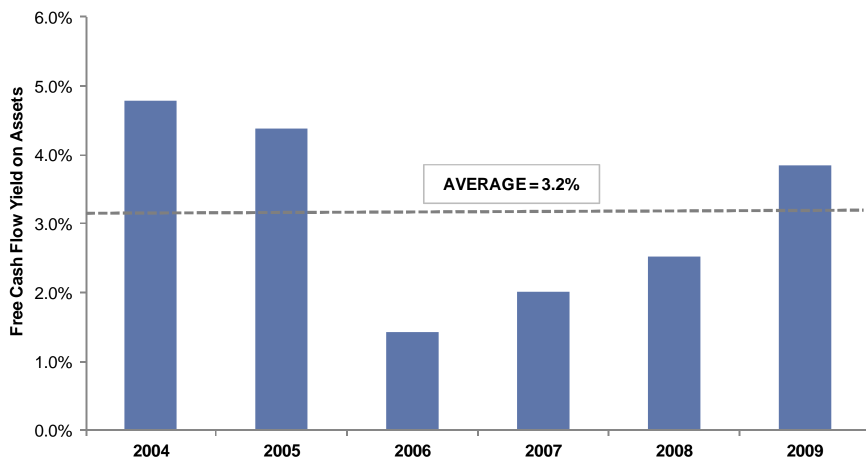
Source: Goldman Sachs Research and company filings.

Exhibit 69: The food distribution business shows some seasonality
Operating Margin Seasonality



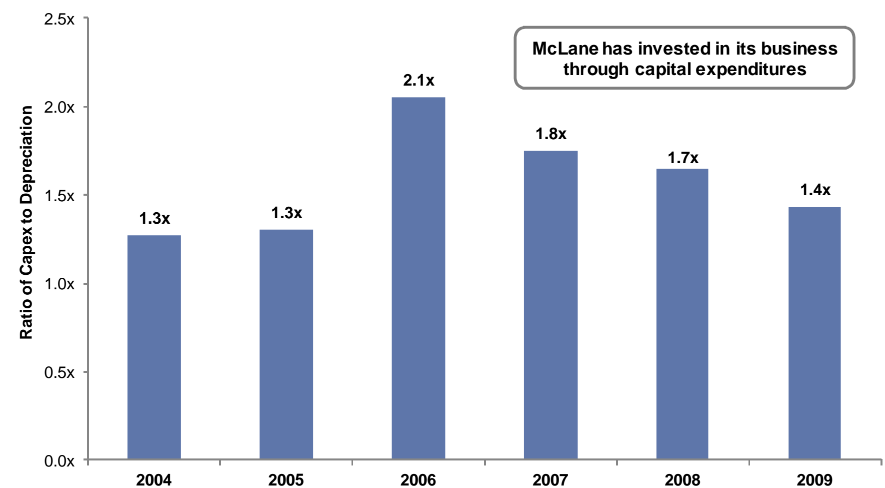
Source: Goldman Sachs Research and company filings.

Exhibit 70: McLane provides steady free cash flow
Free Cash Flow Yield on Assets



Source: Goldman Sachs Research and company filings.

Exhibit 71: Historically, McLane has prioritized re-investment in its business
Ratio of Capex to Depreciation



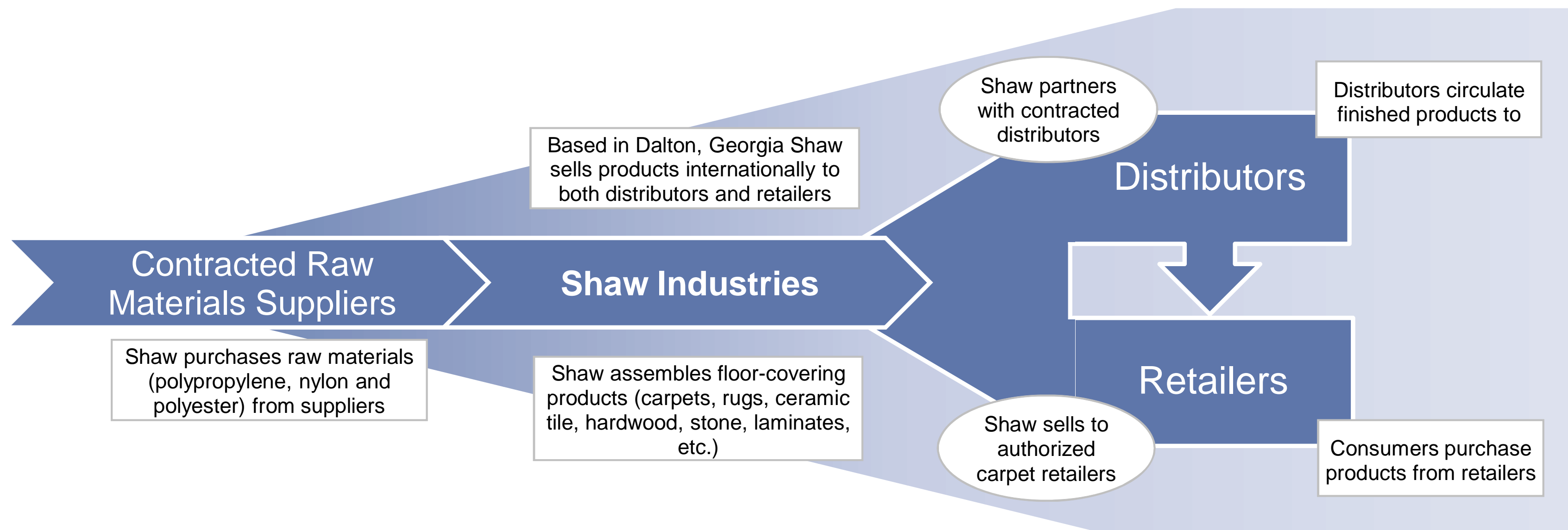
Source: Goldman Sachs Research and company filings

Shaw: Floor covering manufacturing and distribution (1% of GAAP earnings)

What is it? Shaw is the world's largest manufacturer of carpets and rugs and second largest total flooring manufacturer. Shaw sells its floor-covering products through both distributors and directly to retailers. Shaw had 2009 revenues of $4.01 billion and an operating margin of approximately 3.6%, versus a historical margin closer to 9%.

The Back Story In January 2001, Berkshire Hathaway acquired approximately 87.3% of Shaw's common stock for $2.1 billion from management. The remaining 12.7% interest was acquired in January 2002 for $324 million dollars in stock.

Exhibit 72: The world's leading manufacturer of carpets and rugs and second largest provider of floor coverings overall
Shaw Industries Flow Chart



Source: Goldman Sachs Research and company filings.

Shaw: Company highlights

Why Berkshire Bought It

As a leading company in its industry, Berkshire Hathaway's 2001 acquisition of Shaw Industries fits into the broader themes of Berkshire portfolio companies. With normalized margins in the high single digits and a free cash flow yield on assets approaching 8%, Shaw produces a dependable return with its diverse product mix, spanning from high-end, installed wood floors to "do-it-yourself" options. This wide product breadth has allowed Shaw to capture 21% of the total flooring market worldwide—the second largest in the industry.

Competitive Advantages

- Shaw and its nearest competitor (Mohawk) control nearly 50% of the floor covering market (with the next closest competitor at around 6% share)—in a vertically integrated company this allows a degree of pricing power
- In the floor covering market, carpet makes up about 60% of all sales by volume and value—Shaw is the market leader with 31% market share (larger than industry leader Mohawk).

Things to Watch

- Discretionary cash flow at both the consumer and corporate level is a major driver of top line growth, with around two-thirds of sales driven by flooring replacement purchases.
- Flooring firms are serial acquirers with the aim of continued vertical integration.
- Synthetic fibers like nylon and other polypropylene-based products are important base inputs for the carpet and rug-making industry and are affected by supply/demand dynamics in the chemicals market.

Shaw: Business drivers and an earnings framework

Exhibit 73: Shaw Company Model Snapshot

millions	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010E	FY 2011E	FY 2012E
Revenue	4,012	4,334	4,660	5,174	5,723	5,834	5,373	5,052	4,011	***3,868***	***4,288***	***4,582***
Expenses	3,720	3,910	4,224	4,708	5,238	5,240	4,937	4,847	3,867	***3,823***	***4,134***	***4,396***
Earnings p/t	292	424	436	466	485	594	436	205	144	***46***	***154***	***187***
Margin	*7.3%*	*9.8%*	*9.4%*	*9.0%*	*8.5%*	*10.2%*	*8.1%*	*4.1%*	*3.6%*	***1.2%***	***3.6%***	***4.1%***
Depreciation	88	91	91	99	113	134	144	150	149	***153***	***155***	***157***
Capex	71	196	120	125	209	189	144	173	186	***186***	***188***	***190***
FCF a/t	188	140	245	263	208	304	260	93	41	***(7)***	***55***	***73***
Assets	1,619	1,932	1,999	2,153	2,711	2,776	2,922	2,924	3,068	***3,101***	***3,134***	***3,167***
FCF on Assets	*11.6%*	*7.3%*	*12.3%*	*12.2%*	*7.7%*	*11.0%*	*8.9%*	*3.2%*	*1.3%*	***-0.2%***	***1.7%***	***2.3%***

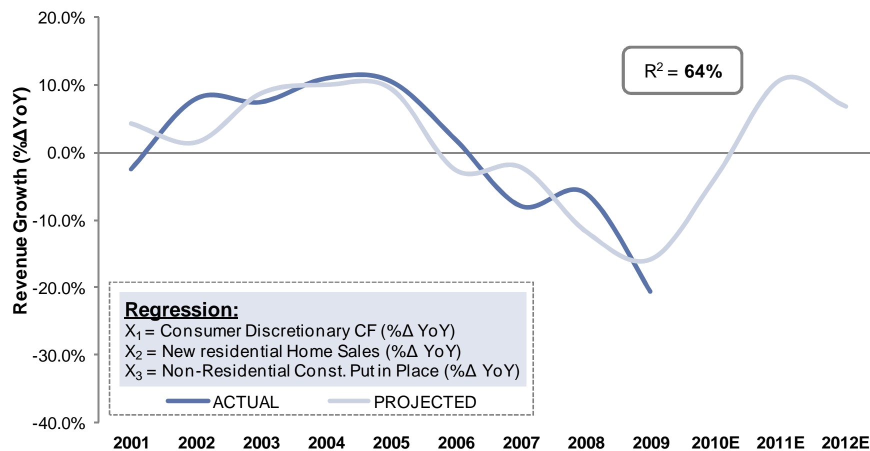
We forecast revenues based on our regression model using residential home sales, the growth in the value of nonresidential construction put in place, and our proprietary GS Discretionary Cash Flow Model.

We forecast the operating margin based on the price of polypropolyene (a fiber input) and a subset of the Federal Reserve Industrial Production Index that includes carpeting.

Source: Goldman Sachs Research and company filings.

Exhibit 74: Model sees continued contraction in 2010, then sharp rebound

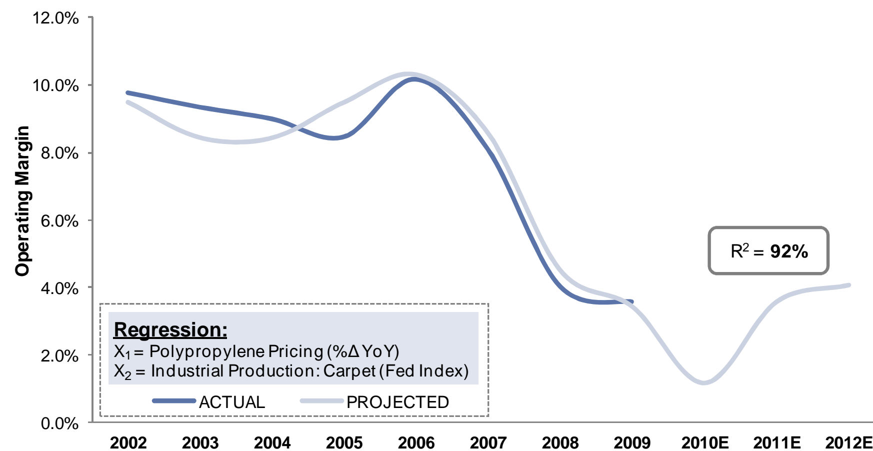
Shaw Revenue Regression Model



Source: Goldman Sachs Research estimates and the US Census Bureau.

Exhibit 75: Regression model sees margin compression in 2010, up in 2011

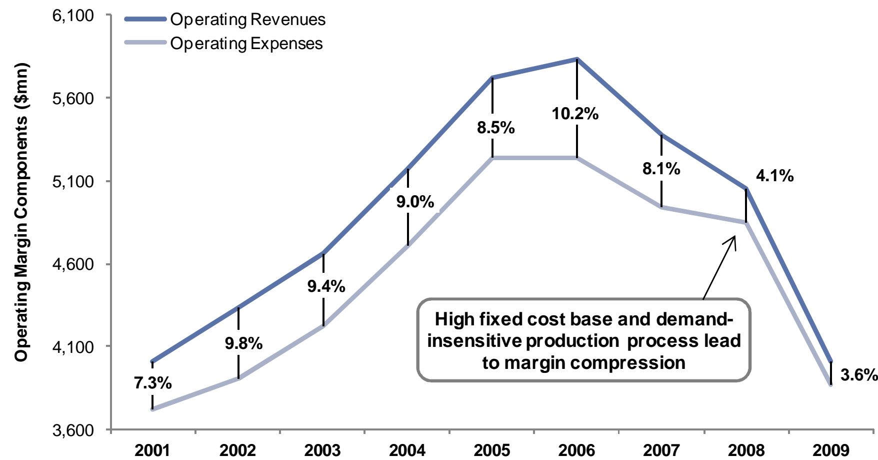
Shaw Margin Regression Model



Source: Goldman Sachs Research estimates, Chemical Data, and the Federal Reserve Board.

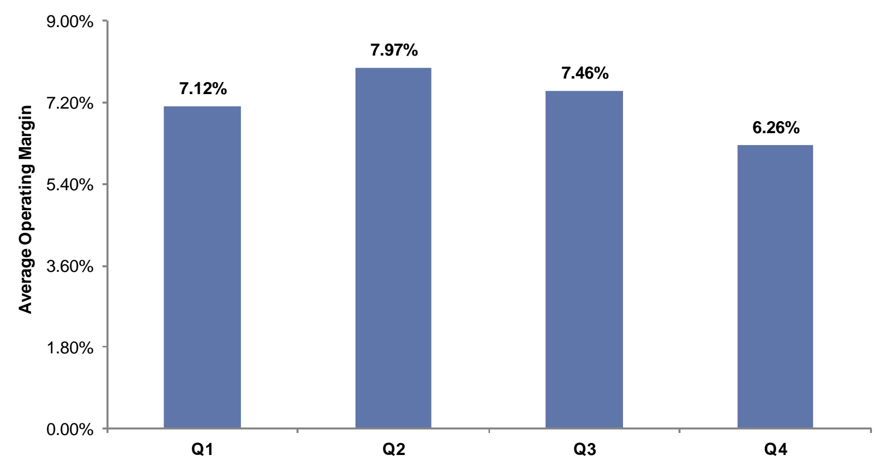
Shaw in pictures

Exhibit 76: In a normal environment, Shaw should post 9% margins
Operating Margin Components



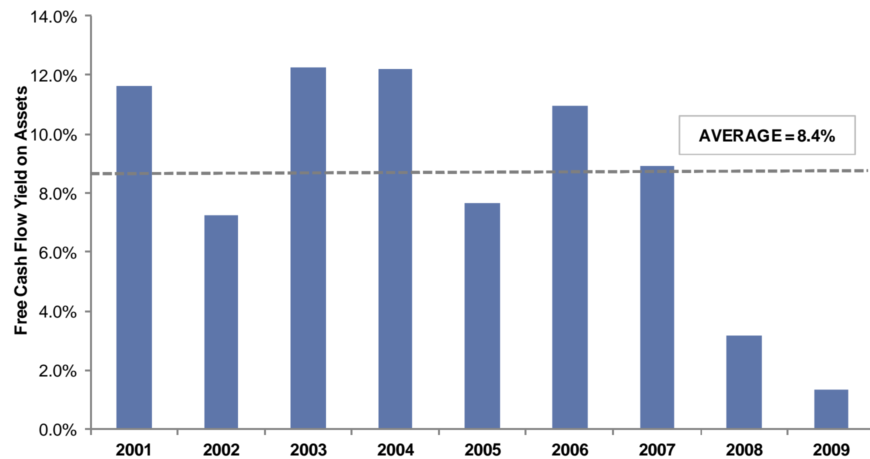
Source: Goldman Sachs Research and company filings.

Exhibit 77: Shaw's operating margin varies slightly over the year
Operating Margin Seasonality



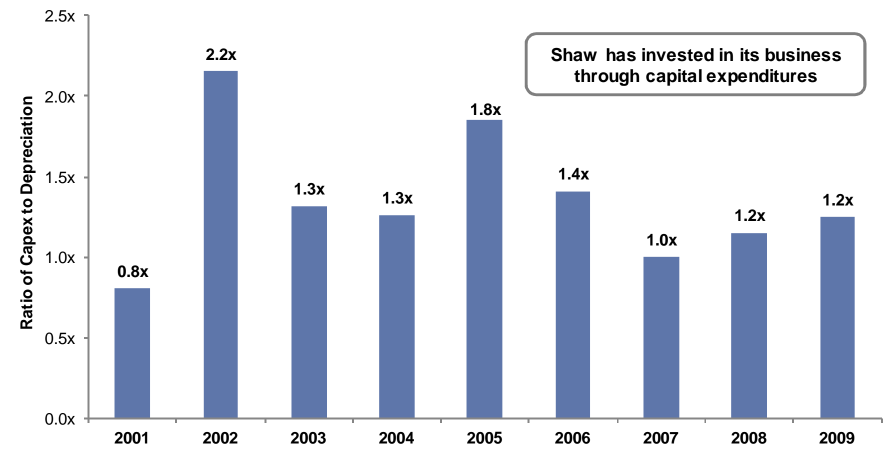
Source: Goldman Sachs Research and company filings.

Exhibit 78: In a normal environment, Shaw produces lots of free cash flow
Free Cash Flow Yield on Assets



Source: Goldman Sachs Research and company filings,

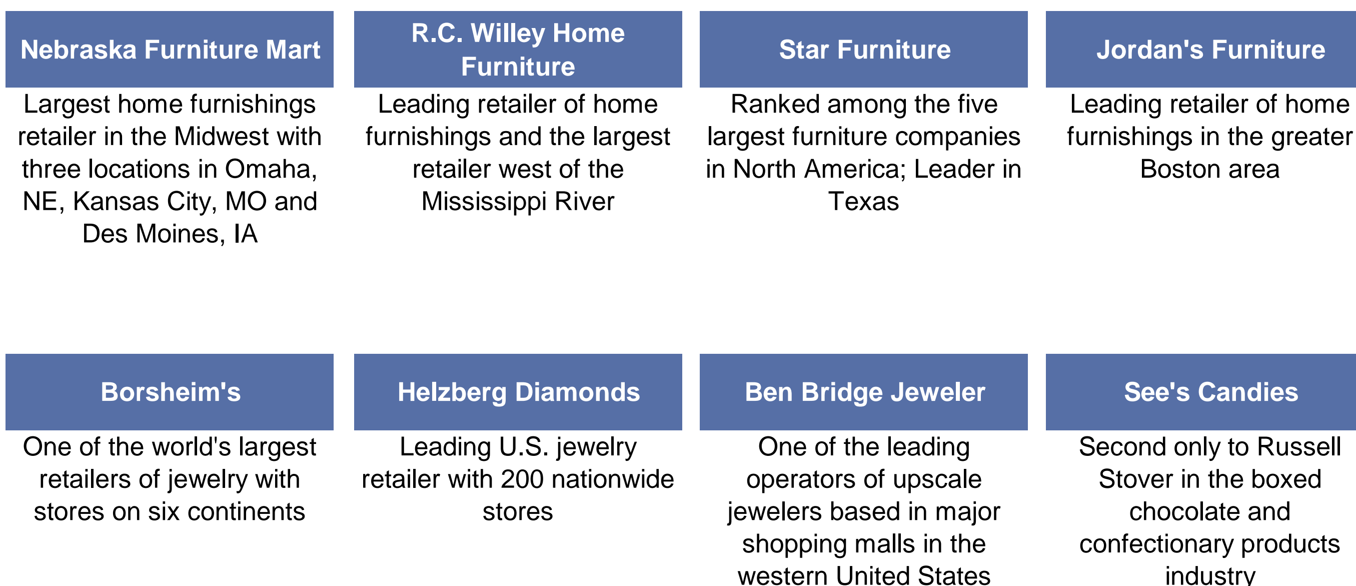
Exhibit 79: Historically, Shaw has invested in its operating base assets
Ratio of Capex to depreciation



Source: Goldman Sachs Research and company filings.

Retailing: Leading jewelry, furniture, and confectionary stores (1% of GAAP earnings)

Exhibit 80: A select group of high quality retail companies
Retailing flow chart



Other Retailing Segment Snapshot

millions	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010E	FY 2011E	FY 2012E
Revenue	2,936	3,111	3,334	3,397	3,104	2,869	*2,935*	*3,002*	*3,071*
Expenses	2,721	2,854	3,045	3,123	2,941	2,708	*2,723*	*2,786*	*2,850*
Earnings p/t	215	257	289	274	163	161	*211*	*216*	*221*
Margin	*7.3%*	*8.3%*	*8.7%*	*8.1%*	*5.3%*	*5.6%*	*7.2%*	*7.2%*	*7.2%*

We drive revenue growth by our GS economists' views of consumer spending growth.

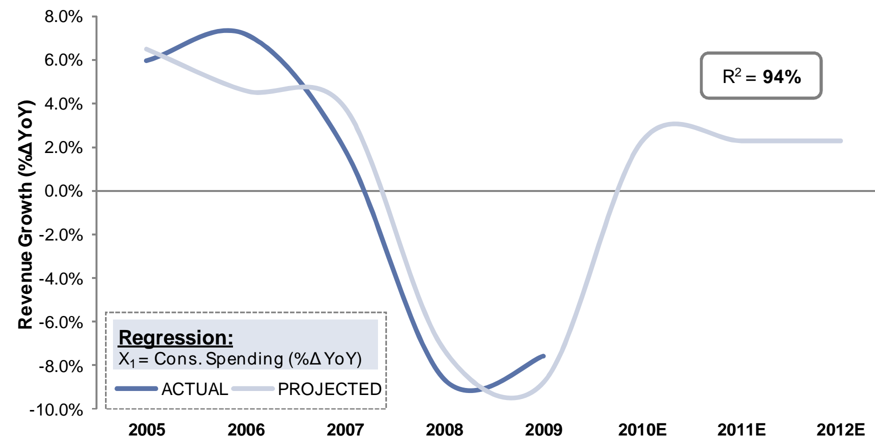
Expenses are driven by the average aggregate margin on the underlying businesses.

Source: Goldman Sachs Research, company data.

Retailing in pictures

Exhibit 81: If consumer spending improves in line with our economists' expectations, Retailing topline should improve

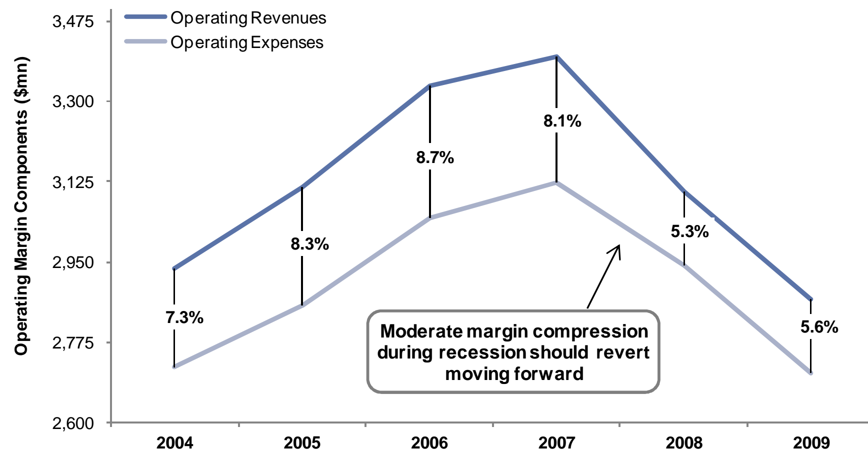
Retailing Revenue Regression Model



Source: Goldman Sachs Research.

Exhibit 82: Normalized margins appear to be around 8%

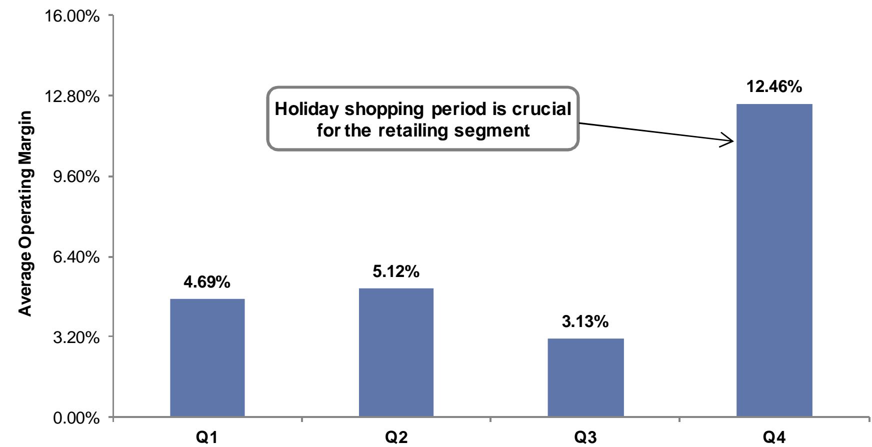
Operating Margin Components



Source: Goldman Sachs Research and company filings.

Exhibit 83: Unsurprisingly, Retailing is weighted to holiday shopping

Operating Margin Seasonality



Source: Goldman Sachs Research and company filings.

Clayton Homes: Leading manufactured and modular home builder

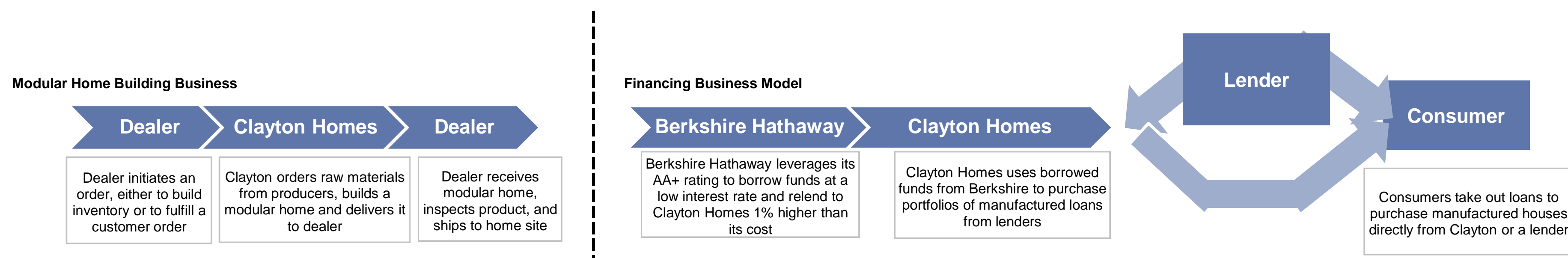
Finance & Financial Products: 3% of total GAAP earnings

What is it? Clayton Homes (part of the Finance & Financial Products reporting segment) is a leading producer of manufactured and modular homes in the United States. In addition to its manufacturing operations, the company operates financing, loan-servicing and insurance businesses and sells its homes to approximately 1,800 dealers throughout the country.

Why Berkshire Bought it: Industry leading market share for sector that appears defensive given a floor level of demand for affordable housing. Further, with the ability to leverage Berkshire's credit ratings to reduce borrowing costs (Berkshire charges Clayton a one percentage-point markup), the company can profit from purchasing manufactured housing loans that major banks have found unprofitable and difficult to service. Thus, it increased its installment loans from $2 billion in 2003 to $12.3 billion in 2009.

The Back Story: Clayton is a family-run company founded in 1966 as a retail mobile-homes business. The company began building manufactured homes in 1970 and benefitted from an increasing consumer acceptance of modular homes which allowed it to expand beyond the southeastern United States. Berkshire acquired Clayton in 2003 for $1.7 billion dollars in cash.

Exhibit 84: The leader in manufactured and modular home building and financing
Business flow charts



Source: Goldman Sachs Research and company filings

Competitive Advantages

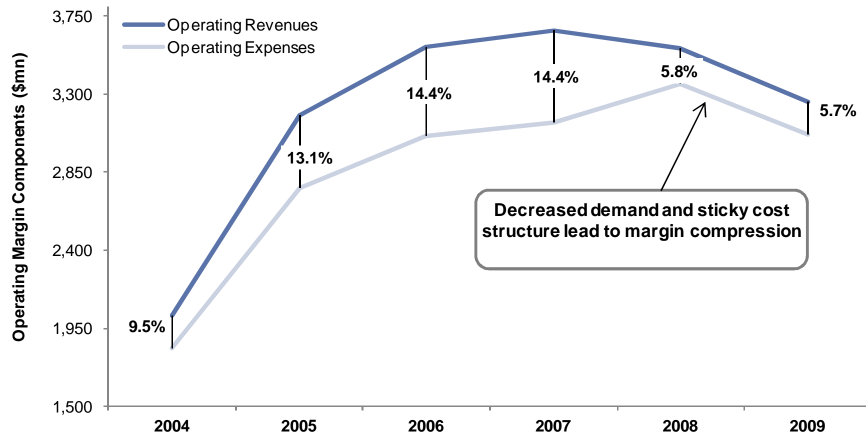
- Nationwide footprint with 35 plants and a dealer network of approximately 1,800 (mostly independent).
- Product mix includes a full breadth of homes ranging from 700 to 3,000 square feet priced between $20,000 and $130,000.

Things to Watch

- Look for increased sales to dealers with any incremental recovery in U.S. consumer housing demand.
- New eco-friendly modular homes, such as Clayton's i-house, could improve sentiment in favor of manufactured housing.
- Clayton is levered to raw materials costs in construction —unexpected price increases could adversely affect profitability.

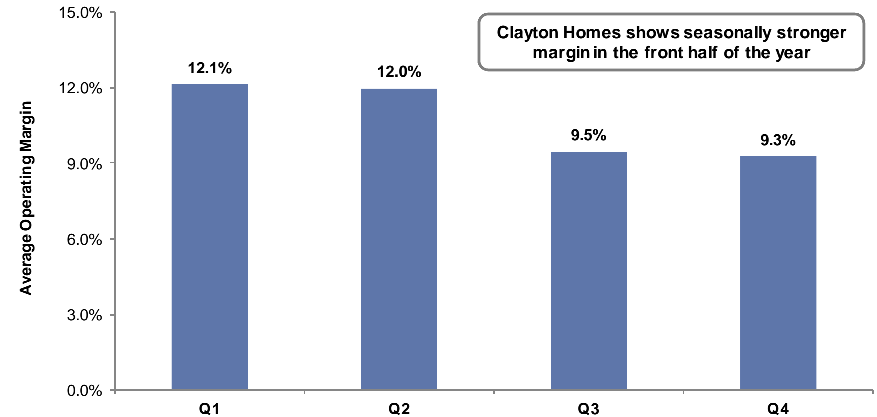
Clayton Homes in pictures

Exhibit 85: Operating margins have been suppressed during the recession
Operating Margin Components



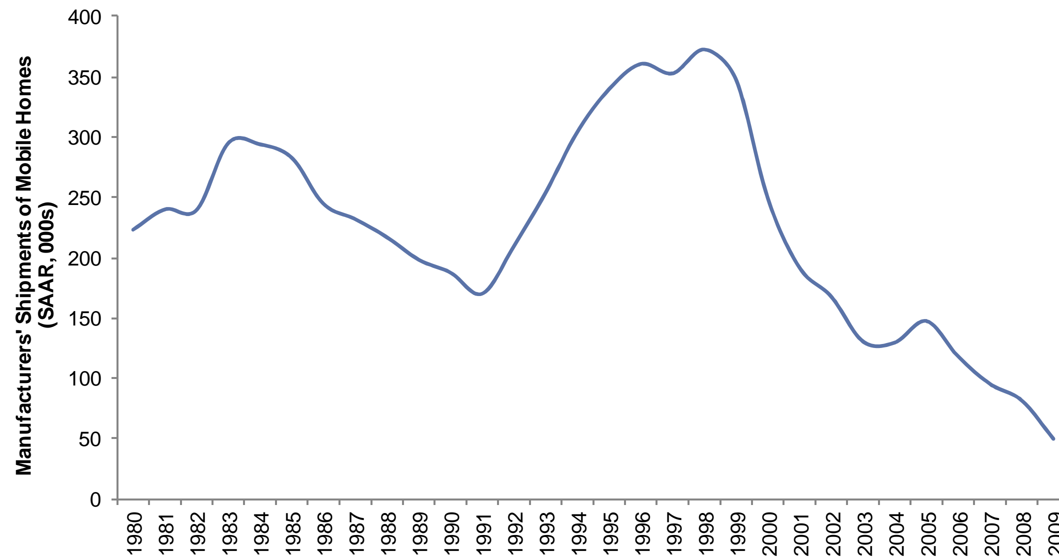
Source: Goldman Sachs Research and company filings.

Exhibit 86: The manufactured housing business shows some seasonality
Operating Margin Seasonality Over 5 Years



Source: Goldman Sachs Research and company filings.

Exhibit 87: Manufactured housing demand has decreased over last 11 years
Manufacturers' Shipments of Mobile Homes (SAAR, 000s)



Source: Goldman Sachs Research, U.S. Census Bureau, and Haver Analytics.

Derivative contract exposures: An overview

Berkshire Hathaway writes four main types of derivative contracts: equity index put options, high-yield index credit default swaps, individual corporate credit default swaps, state/municipality credit default swaps, as well as certain other derivative contracts. In aggregate, the notional value of these derivatives is $63.1 billion with float totaling $6.3 billion (which is separate from insurance float). In general, the company prefers derivatives contracts that do not require posting collateral. At year end $35 million of collateral was posted as required by certain contracts. The peak collateral requirement was $1.7 billion at the 2009 trough in the stock and credit markets. A ratings downgrade to A- by S&P or A3 by Moody's would require an additional $1.1 billion in collateral to be posted. Current financial regulatory reform raises the potential for OTC derivatives to require collateral posting. While it is still unclear how the regulation will impact Berkshire's legacy portfolio, we would note the significant level of Berkshire's cash and liquid securities would allow the company to easily meet any requirements.

Equity index put options: Notional value of $37.9 billion at YE 2009

- The four underlying indexes include the S&P 500, FTSE 100, Euro Stoxx 50, and NIKKEI 225.
- The European style contracts will only require payment if the indexes are below the strike prices at expiration, which range between September 2019 and January 2028 (the weighted average remaining life of contracts was 11.5 years at year end 2009).
- The intrinsic value, or undiscounted liability, assuming year end index values at expiration was $4.6 billion at year end. The fair value liability estimate was $7.3 billion using Black-Scholes at year end.
- Berkshire amended 6 equity put contracts with certain counterparties in 2009. The respective contract expiration dates were reduced between 3.5 and 9.5 years, related strike prices were reduced between 29% and 39%, and the notional value increased by $161 million.
- A 30% increase in the value of underlying indexes would reduce the fair value liability estimate of $7.3 billion by $2 billion (a +1% change in shareholders' equity).
- A 30% decrease in the value of underlying indexes would increase the fair value liability estimate of $7.3 billion by $3 billion (a -1.5% change in shareholders' equity).

High-yield index credit default swaps: Notional value of $5.6 billion at YE 2009

- Underlying the credit default swaps are various indices comprised of about 100 North American below investment grade corporate debt issuers.
- The estimated fair value liability for these contracts was $781 million at year end 2009
- Contracts are typically 5 years in length and the weighted average contract life was 2 years at year end 2009.

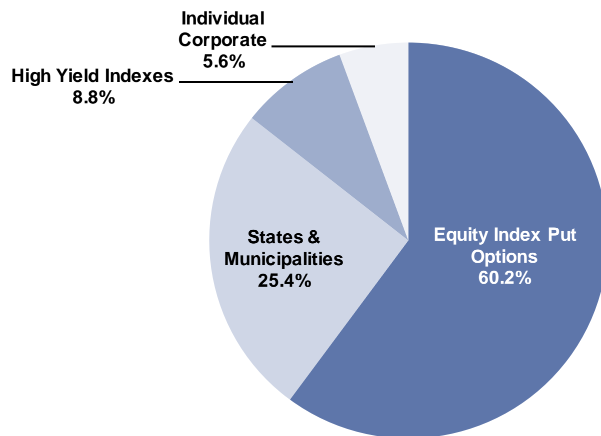
Individual corporate credit default swaps: Notional value of $3.6 billion at YE 2009

- These contracts insure debt obligations of individual investment grade North American corporate issuers.
- Contracts were written in 2008 and expire in 2013 and the estimated fair value liabilities were $81 million at year end 2009.

States/municipalities credit default swaps: Notional value of $16 billion at YE 2009

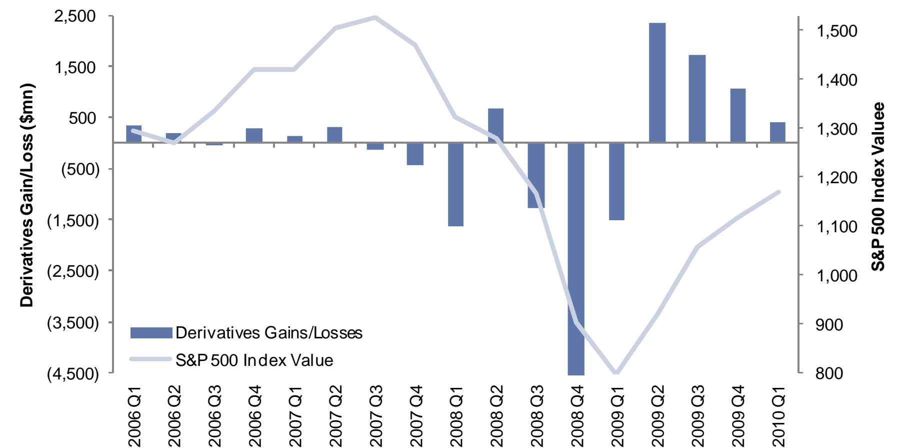
- Contracts insure over 500 state and municipality issuers and had a weighted average contract life of 11 years at year end 2009. Potential obligations related to about half of the notional value cannot be settled before expiration.
- Fair value liabilities are estimated at $853 million
- These tax-exempt bond insurance contracts represent the same type of risks that Berkshire Hathaway Assurance Corp (BHAC) would assume, but are written as derivative contracts as certain clients prefer protection in this form.

Exhibit 88: Majority of derivatives exposure is in equity put options
Percent of 2009 Derivative Aggregate Notional Value of $63.1 billion



Source: Goldman Sachs Research, company filings,

Exhibit 89: Derivative volatility tracks equity market movements
Derivative marks vs S&P 500 index values



Source: Goldman Sachs Research, company filings, FactSet

CORT and XTRA: Furniture and commercial truck leasing leaders

CORT and XTRA are furniture and truck leasing businesses, respectively, and make up a part of Berkshire's Finance and Financial Products segment. Pre-tax operating margins range between 7% and 10% for CORT and 20% to 30% for XTRA in normal economic conditions. As a point of reference, CORT and XTRA had combined pre-tax operating profits of $14 million in 2009, but have avareged over $100 million in prior years.

CORT: What Is It?

CORT is the world's largest provider of rental furniture spanning the residential, commercial, and event furnishings markets in the "rent-to-rent" (versus "rent-to-own") segment of the furniture industry. In addition to furniture, the company offers a full line of houseware rentals (linens, kitchenware, etc.). Alongside its core rental business, CORT runs a variety of services to help people and businesses relocate successfully. Its furniture inventory is sold at the conclusion of its leasing life, typically three years. Through its history, the company has served over 80% of Fortune 500 companies. CORT's nationwide presence provides a competitive advantage in a market predominantly characterized by smaller regional and local furniture rivals. CORT's profitability was pressured in 2009 as margin compressed.

CORT's roots can be traced back to the carpet industry in 1972 when Mohasco, the nation's largest carpet manufacturer at the time, purchased five regional furniture rental companies and consolidated them to create CORT. Berkshire Hathaway purchased the furniture rental company for Wesco Financial, an 80% subsidiary of Berkshire, for $386 million in cash in February 2000.

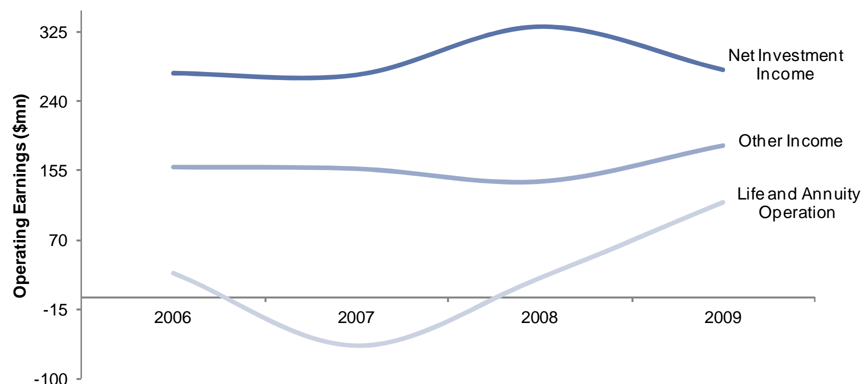
XTRA: What Is It?

XTRA is one of the largest truck trailer leasing companies in North America. The company's diverse fleet of more than 100,000 trailers provides supplemental and emergency equipment to a variety of transportation suppliers including railroads, shipping lines, trucking companies and other firms that do not own a truck fleet or have short-term needs. XTRA's profitability was pressured in 2009 as margin compressed.

Other Finance: Investment and interest, life and annuity, derivatives

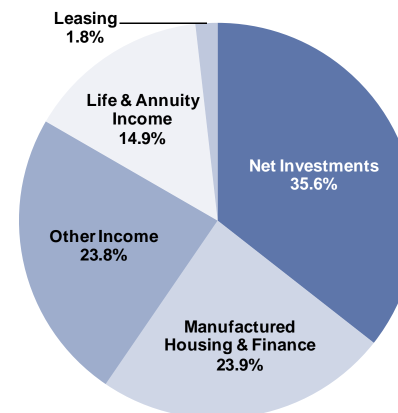
What is it? Berkshire Hathaway's other businesses within the Finance and Financial Products segment are comprised of three sub-segments, net investment income, life and annuity operations (moved to insurance investment income in 2010), and other income. Net investment income is primarily composed of trading and interest income earned on fixed maturity investments and a small portfolio of commercial real estate loans. The fixed maturity assets include $1.3 billion of investment grade auction rate bonds and variable rate demand notes issued by municipalities in 2009. The annuity insurance business earnings consist of net interest income. The majority of the other income business includes interest related to Clayton Homes' borrowings.

Exhibit 90: Operating earnings remained largely unaffected by recession
Growth of Pre-tax Operating Earnings



Source: Goldman Sachs Research and company filings

Exhibit 91: Other Finance income sources are mixed
Percent of 2009 Other Pre-Tax Operating Earnings of $781mn



Source: Goldman Sachs Research and company filings

Summary Financials: BRK.A and BRK.B

Exhibit 92: Berkshire Hathaway summary model

Summary Model ($ millions, except per share)	2006	2007	2008	2009	2010E	2011E	2012E	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	2Q 2010E	3Q 2010E	4Q 2010E
Insurance - Net premiums earned	23,964	31,783	25,525	27,884	30,064	30,834	31,839	8,183	6,485	6,595	6,621	7,426	7,436	7,610	7,591
Insurance - Underwriting gain	3,838	3,374	2,792	1,559	1,790	1,805	1,657	339	125	560	535	345	533	469	443
Insurance - a/t Earnings	2,485	2,184	1,805	1,013	1,165	1,173	1,077	219	83	363	348	226	346	305	288
Investment income - Revenue	4,347	4,791	4,759	5,223	5,223	5,484	5,649	1,310	1,437	1,362	1,114	1,302	1,308	1,308	1,306
Investment income - Pre-tax earnings	4,316	4,758	4,722	5,173	5,225	5,486	5,651	1,298	1,422	1,348	1,105	1,283	1,294	1,294	1,354
Investment income - a/t Earnings	3,120	3,510	3,497	4,085	3,825	3,964	4,083	1,033	1,159	976	917	988	932	932	973
Burlington Northern - Revenue	-	-	-	-	14,823	18,673	20,052	-	-	-	-	2,073	4,087	4,301	4,363
Burlington Northern - Pre-tax earnings	-	-	-	-	3,489	4,543	5,013	-	-	-	-	476	891	1,059	1,064
Burlington Northern - a/t Earnings	-	-	-	-	2,150	2,817	3,108	-	-	-	-	282	552	657	659
MidAmerican - Revenue	11,856	12,629	13,972	11,443	11,781	12,183	12,487	2,949	2,656	2,811	3,027	2,977	2,726	2,896	3,182
MidAmerican - Pre-tax earnings	1,482	1,783	2,964	1,528	1,635	1,631	1,682	303	403	440	382	395	329	453	459
MidAmerican - a/t Earnings	885	1,114	1,704	1,071	964	1,021	1,033	203	253	346	269	223	171	282	287
Marmon - Revenue	-	-	5,529	5,067	5,241	5,399	5,561	1,254	1,286	1,306	1,221	1,397	1,286	1,306	1,252
Marmon - Pre-tax earnings	-	-	733	686	681	716	738	162	170	194	160	190	172	175	144
McLane - Revenue	25,693	28,079	29,852	31,207	32,253	34,912	38,704	6,993	7,864	8,170	8,180	7,430	8,100	8,415	8,308
McLane - Pre-tax earnings	229	232	276	344	323	349	387	143	66	64	71	80	81	84	77
Other Manufacturing, Service, and Retailing - Revenue	26,967	31,021	30,718	25,391	27,075	29,362	31,604	5,798	6,233	6,479	6,881	6,526	6,439	6,768	7,341
Other Manufacturing, Service, and Retailing - Pre-tax earnings	3,297	3,715	3,014	1,028	2,360	2,704	3,047	206	201	350	271	583	648	683	445
Total Manufacturing, Service, and Retailing - Revenue	52,660	59,100	66,099	61,665	64,569	69,672	75,869	14,045	15,383	15,955	16,282	15,353	15,825	16,490	16,901
Total Manufacturing, Service, and Retailing - Pre-tax earnings	3,526	3,947	4,023	2,058	3,364	3,769	4,172	511	437	608	502	853	901	942	667
Total Manufacturing, Service, and Retailing - a/t Earnings	2,131	2,353	2,283	1,113	1,907	2,148	2,378	258	239	336	280	477	514	537	379
Finance and Financial Products - Revenue	5,124	5,119	4,947	4,587	4,352	4,472	4,580	1,009	1,099	1,143	1,336	977	1,102	1,150	1,124
Finance and Financial Products - Pre-tax earnings	1,157	1,006	787	781	444	478	515	127	135	142	377	111	109	111	113
Finance and Financial Products - a/t Earnings	732	632	479	494	278	299	322	78	82	92	242	69	68	70	71
Total Operating Revenue	**97,116**	**112,737**	**115,248**	**111,706**	**131,012**	**141,319**	**150,475**	**27,767**	**27,278**	**28,086**	**28,575**	**30,308**	**32,484**	**33,754**	**34,467**
% growth		*16.1%*	*2.2%*	*-3.1%*	*17.3%*	*7.9%*	*6.5%*	*4.0%*	*-6.4%*	*-4.7%*	*-4.5%*	*9.2%*	*19.1%*	*20.2%*	*20.6%*
Total Earnings - before tax and minority interest	**14,319**	**14,868**	**15,288**	**11,099**	**15,947**	**17,713**	**18,689**	**2,578**	**2,522**	**3,098**	**2,901**	**3,463**	**4,057**	**4,329**	**4,098**
% growth		*3.8%*	*2.8%*	*-27.4%*	*43.7%*	*11.1%*	*5.5%*	*-13.3%*	*-30.6%*	*3.2%*	*-48.9%*	*34.3%*	*60.9%*	*39.7%*	*41.3%*
Total Earnings - after tax and minority interest	**9,353**	**9,793**	**9,768**	**7,776**	**10,289**	**11,422**	**12,000**	**1,791**	**1,816**	**2,113**	**2,056**	**2,265**	**2,583**	**2,782**	**2,658**
% growth		*4.7%*	*-0.3%*	*-20.4%*	*32.3%*	*11.0%*	*5.1%*	*-7.3%*	*-22.1%*	*7.3%*	*-41.8%*	*26.5%*	*42.2%*	*31.7%*	*29.3%*
Other	(47)	(159)	(129)	(207)	(215)	(235)	(250)	(86)	(36)	(58)	(27)	(43)	(55)	(59)	(58)
Operating Income	**9,306**	**9,634**	**9,639**	**7,569**	**10,074**	**11,187**	**11,750**	**1,705**	**1,780**	**2,055**	**2,029**	**2,222**	**2,528**	**2,723**	**2,600**
Operating earnings per Class A share	**6,036**	**6,233**	**6,223**	**4,880**	**6,161**	**6,792**	**7,134**	**1,100**	**1,147**	**1,324**	**1,310**	**1,389**	**1,535**	**1,653**	**1,578**
Average common shares outstanding (Class A Equivalent)	1.542	1.546	1.549	1.551	1.635	1.647	1.647	1.549	1.552	1.552	1.549	1.599	1.647	1.647	1.647
Operating earnings per Class B share	**4.02**	**4.16**	**4.15**	**3.25**	**4.11**	**4.53**	**4.76**	**0.73**	**0.76**	**0.88**	**0.87**	**0.93**	**1.02**	**1.10**	**1.05**
Average common shares outstanding (Class B Equivalent)	2,313	2,319	2,323	2,327	2,453	2,471	2,471	2,324	2,328	2,328	2,324	2,399	2,471	2,471	2,471
Realized investment and derivatives gains/losses (a/t)	1,709	3,579	(4,645)	486	1,411	-	-	(3,239)	1,515	1,183	1,027	1,411	-	-	-
Net Income	**11,015**	**13,213**	**4,994**	**8,055**	**11,485**	**11,187**	**11,750**	**(1,534)**	**3,295**	**3,238**	**3,056**	**3,633**	**2,528**	**2,723**	**2,600**
Net earnings per Class A share	**7,144**	**8,548**	**3,224**	**5,193**	**7,024**	**6,792**	**7,134**	**(990)**	**2,123**	**2,087**	**1,973**	**2,272**	**1,535**	**1,653**	**1,578**
Net earnings per Class B share	**4.76**	**5.70**	**2.15**	**3.46**	**4.68**	**4.53**	**4.76**	**-0.66**	**1.42**	**1.39**	**1.32**	**1.51**	**1.02**	**1.10**	**1.05**
Book value per Class A share	**70,265**	**77,993**	**70,540**	**84,473**	**94,141**	**100,933**	**108,067**	**66,248**	**73,806**	**81,247**	**84,473**	**89,374**	**90,909**	**92,562**	**94,141**
Book value per Class B share	**46.84**	**52.00**	**47.03**	**56.32**	**62.76**	**67.29**	**72.04**	**44.17**	**49.20**	**54.16**	**56.32**	**59.58**	**60.61**	**61.71**	**62.76**

Source: Goldman Sachs Research estimates

Reg AC

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