

BERKSHIRE HATHAWAY

Although it's among the most famous publicly traded companies on the planet, Berkshire Hathaway's Chairman and CEO, Warren Buffett, is probably even more renowned than the business itself. As "The Oracle of Omaha," Buffett's opinions on all things from economics and finance to politics, sports and pop culture generate a buzz. We, however, appreciate him most as a businessman and investor. Given Berkshire's unique qualities and Buffett's record as an investor, we believe both are worthy of their fame and at the right price, worthy of investment.

Berkshire is, first and foremost, an insurance company. Core insurance operations include Geico, National Indemnity, General Re and Berkshire Hathaway Reinsurance. A well-run insurance company makes money in two ways: writing profitable policies and prudently investing the premiums collected from those policies. Berkshire excels in both areas. When competition heats up, it's tempting for an insurance company to lower rates in order to write more business, but Berkshire simply writes fewer policies rather than lowering prices and taking on excessive risk. This long-term, disciplined approach is very much a part of Berkshire's unique culture and the way premium income is invested. Buffett's wisdom, patience and disciplined focus are the keys to his success.

Berkshire owns outright or in part more than 70 companies, and its portfolio reveals obvious themes: clear, sustainable competitive advantages, strong brands, and easy-to-understand business models. For example, consider private companies such as Dairy Queen, Benjamin Moore, Fruit of the Loom, Geico, See's Candies, and The Pampered Chef; or public companies like American Express, Procter and Gamble, Kraft, Wal-Mart, and Coca-Cola. Clearly these are profitable, mega-brand, straightforward companies built for the long run. Something that's just as important to Berkshire's success, but less obvious, is that these companies typically generate tremendous cash flow—more cash, in fact, than the businesses themselves can reinvest. These excess funds then flow back to Berkshire, creating additional investment opportunities for Buffett. Berkshire doesn't pay a dividend, but when you've got Warren Buffett investing for you, it's hard to complain.

While the holding company structure described above isn't unique, we believe Berkshire's culture is. The disciplined, conservative, long-term approach to insurance underwriting and investing aren't accidental, they were built into every aspect of the enterprise. This stands in stark contrast to the short-term focus of most public companies. Another Berkshire strength is its approach to acquisitions. Preferring to own businesses rather than run them, Berkshire's well publicized "hands-off" philosophy allows business owners to retain the day-to-day operation of their firms, should they sell to Berkshire. Because of the opportunity Berkshire

gives to company founders, great business opportunities routinely land on Berkshire's doorstep, often on terms very favorable to Berkshire.

Financial health is critical to the long-term success of every insurance company, and as a result of its conservative approach, Berkshire is one of the most creditworthy firms in the world. Because of its financial strength and size, it often has access to deals that are simply unavailable to other firms. If you need a few billion dollars, there aren't many people you can call who can conclude a deal quickly. The recent preferred stock investments in Goldman Sachs and General Electric, which we consider to be attractive, are clear examples of this. Also, with its reputation, Berkshire is able to staff its management team with some of the most talented and dedicated leaders available.

We like a management team that acts like shareholders, and in the case of Berkshire, they *are* shareholders—owning more than 40% of the company. From a compensation standpoint, it gets rave reviews: Buffett allows himself a modest salary (about \$100k), and the company does not issue stock options. Instead, if managers wish to become owners, they must invest their own funds – and they have. Berkshire's annual reports are refreshingly clear, concise and honest—especially when it comes to bad news and admitting mistakes. In short, we believe Berkshire's management is about as good as it gets.

As it was for many firms, 2008 was a difficult year for Berkshire, despite its unique advantages. Most of its investments suffered, and it was not immune to the dramatic turmoil in the credit markets. Also, some derivative contracts written in 2007 have recently moved against Berkshire, bringing further pressure on the company, despite the long-term nature of these potential obligations. And it seems that the private investment arena, which has been very profitable for Berkshire, has gotten more competitive. In light of this, many pundits have asked whether Buffett has lost his touch, or given his age (79) whether he'll even be around much longer. We don't believe that Buffett has suddenly become stupid; instead, we feel that recent market turmoil spared no one. And while we acknowledge that Buffett's longevity is limited, we believe Berkshire's culture will endure after Buffett leaves. We also believe that Berkshire's derivative investments will make money, not lose it, when they begin to mature in 2019. Instead of becoming less attractive in this environment where current results suffer, we believe Berkshire is well positioned to take advantage of the sort of opportunities only these distressed times can offer.

Berkshire is a great example of the qualities we seek in an investment: forthright, shareholder-oriented management, stable operations, good growth opportunities, a strong financial base, and a clear and difficult-to-replicate competitive advantage. If an investor is able to collect enough of these opportunities at a reasonable price, great returns should follow.

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