An Analysis of Berkshire Hathaway

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T2 Partners LLC

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Berkshire Hathaway: A High-Quality, Growing 67-Cent Dollar

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History

- Berkshire Hathaway today does not resemble the company that Buffett bought into during the 1960s
- Berkshire was a leading New England-based textile company, with investment appeal as a classic Ben Graham-style “net-net”
- Buffett took control of Berkshire on May 10, 1965
- At that time, Berkshire had a market value of about $18 million and shareholder's equity of about $22 million

The Berkshire Hathaway Empire Today

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Stakes in Public Companies Worth $1.5+ Billion

Company	Shares	Price	Value ($B)
Coca-Cola	200.0	$69.00	$13.8
IBM	63.9	$197.76	$12.6
Wells Fargo	400.0	$30.18	$12.1
American Express	151.6	$53.33	$8.1
Procter & Gamble	72.4	$66.71	$4.8
Kraft	79.0	$37.88	$3.0
Munich RE	20.1	$146.55	$2.9
Wal-Mart	39.0	$58.79	$2.3
U.S. Bancorp	78.1	$28.73	$2.2
ConocoPhillips	29.1	$75.95	$2.2
Johnson & Johnson	31.4	$64.46	$2.0
Sanofi-Aventis	25.8	$71.59	$1.9
POSCO	3.9	$38,820	$1.5
Tesco	291.6	$5.01	$1.5

Note: Shares as of 12/31/11; Stock prices as of 2/24/12.

The Basics

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- Stock price (2/24/12): $120,000
  - $80.04 for B shares (equivalent to $120,060/A share)
- Shares outstanding: 1.65 million
- Market cap: $198 billion
- Total assets (Q4 ‘11): $393 billion
- Total equity (Q4 ‘11): $169 billion
- Book value per share (Q4 ‘11): $99,860
- P/B: 1.20x
- Float (Q4 ‘11): $70.6 billion

Earnings of Non-Insurance Businesses Have Soared Thanks to Burlington Northern and the Economic Rebound

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Earnings before taxes*	2004	2005	2006	2007	2008	2009	2010	2011
Insurance Group:								
GEICO	970	1,221	1,314	1,113	916	649	1,117	576
General Re	3	-334	523	555	342	477	452	144
Berkshire Reinsurance Group	417	-1,069	1,658	1,427	1,222	250	176	-714
Berkshire H. Primary Group	161	235	340	279	210	84	268	242
Investment Income	2,824	3,480	4,316	4,758	4,896	5,459	5,145	4,725
Total Insurance Oper. Inc.	**4,375**	**3,533**	**8,151**	**8,132**	**7,586**	**6,919**	**7,158**	**4,973**
Non-Insurance Businesses:								
Burlington Northern Santa Fe							3,611	4,741
Finance and Financial products	584	822	1,157	1,006	771	653	689	774
Marmon					733	686	813	992
McLane Company	228	217	229	232	276	344	369	370
MidAmerican/Utilities/Energy	237	523	1,476	1,774	2,963	1,528	1,539	1,659
Other Businesses	2,253	2,406	3,297	3,279	2,809	884	3,092	3,675
Total Non-Insur. Oper. Inc.	**3,302**	**3,968**	**6,159**	**6,291**	**7,552**	**4,095**	**10,113**	**12,211**
Total Operating Income	**7,677**	**7,501**	**14,310**	**14,423**	**15,138**	**11,014**	**17,271**	**17,184**

* In 2010, Berkshire changed this table from “Earnings before income taxes, noncontrolling interests and equity method earnings” to “Earnings before income taxes”. Thus, 2008-2011 reflect the new numbers, and all prior years reflect the old ones.

Quarterly Earnings of Key Business Units

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Earnings before taxes*	Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
Insurance Group:																				
GEICO	295	325	335	158	186	298	246	186	148	111	200	190	299	329	289	200	337	159	114	-34
General Re	30	230	157	138	42	102	54	144	-16	276	186	31	-39	222	201	68	-326	132	148	190
Berkshire Reinsurance Group	553	356	183	335	29	79	-166	1,280	177	-318	141	250	52	117	-237	244	-1,343	-354	1,375	-392
Berkshire H. Primary Group	49	63	77	90	25	81	-8	112	4	29	7	44	33	48	52	135	56	54	58	74
Investment Income	1,078	1,236	1,217	1,227	1,089	1,204	1,074	1,529	1,354	1,482	1,412	1,211	1,283	1,494	1,218	1,150	1,261	1,404	1,038	1,022
Total Insurance Oper. Inc.	**2,005**	**2,210**	**1,969**	**1,948**	**1,371**	**1,764**	**1,200**	**3,251**	**1,667**	**1,580**	**1,946**	**1,726**	**1,628**	**2,210**	**1,523**	**1,797**	**-15**	**1,395**	**2,733**	**860**
Non-Insurance Businesses:																				
Burlington Northern Santa Fe													476	974	1,127	1,034	965	1,070	1,236	1,470
Finance and Financial products	242	277	273	214	241	254	163	113	112	115	119	307	111	155	148	275	156	177	147	294
Marmon					28	261	247	197	162	170	194	160	190	219	212	192	222	273	257	240
McLane Company	58	72	50	52	73	68	68	67	143	66	64	71	80	109	89	91	82	105	124	59
MidAmerican/Utilities/Energy	513	372	481	408	516	329	526	1,592	303	402	441	382	395	338	416	390	451	320	489	399
Other Businesses	723	1,015	1,020	957	744	956	798	516	206	201	350	271	583	860	844	805	675	976	964	1,060
Total Non-Insur. Oper. Inc.	**1,536**	**1,736**	**1,824**	**1,631**	**1,602**	**1,868**	**1,802**	**2,485**	**926**	**954**	**1,168**	**1,191**	**1,835**	**2,655**	**2,836**	**2,787**	**2,551**	**2,921**	**3,217**	**3,522**
Total Operating Income	**3,541**	**3,946**	**3,793**	**3,579**	**2,973**	**3,632**	**3,002**	**5,736**	**2,593**	**2,534**	**3,114**	**2,917**	**3,463**	**4,865**	**4,359**	**4,584**	**2,536**	**4,316**	**5,950**	**4,382**

* In 2010, Berkshire changed this table from “Earnings before income taxes, noncontrolling interests and equity method earnings” to “Earnings before income taxes”, but a breakdown of Q1-Q3 numbers in 2008-2010 isn’t available, so we use the old numbers for Q1-Q3 of each year, but to get the Q4 numbers in 2008-2010, we subtract from the full-year numbers, which causes slight anomalies in Q4 08, Q4 09 and Q4 10.

Berkshire Is Becoming Less of an Investment Company and More of an Operating Business

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Yearend	*Per-Share Investments*	*Period*	*Compounded Annual Increase in Per-Share Investments*
1970	$ 66		
1980	754	1970-1980	27.5%
1990	7,798	1980-1990	26.3%
2000	50,229	1990-2000	20.5%
2010	94,730	2000-2010	6.6%

Year	*Per-Share Pre-Tax Earnings*	*Period*	*Compounded Annual Increase in Per-Share Pre-Tax Earnings*
1970	$ 2.87		
1980	19.01	1970-1980	20.8%
1990	102.58	1980-1990	18.4%
2000	918.66	1990-2000	24.5%
2010	5,926.04	2000-2010	20.5%

Source: 2010 annual letter.

After a Two-Year Hiatus, Berkshire Is Buying Stocks Again

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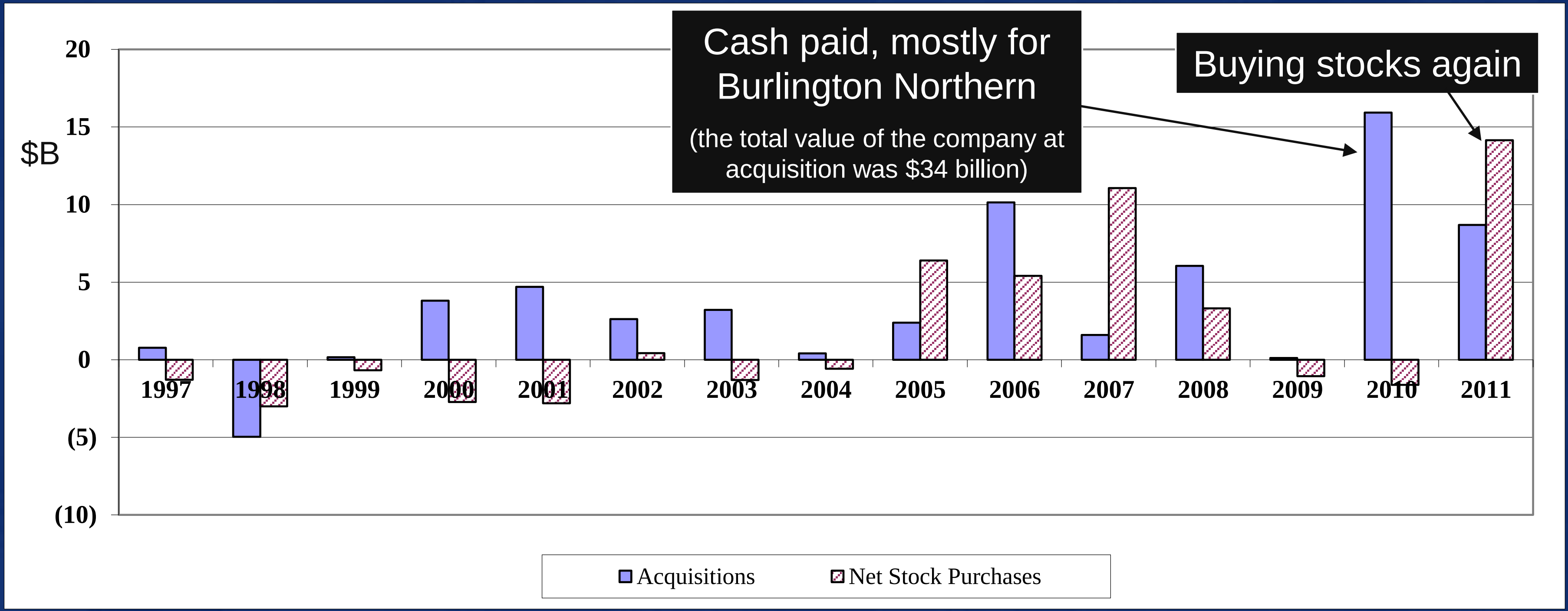

- Buffett is doing a good job investing – but the cash is coming in so fast!
  - A high-class problem
- Markets have a way of presenting big opportunities on short notice
  - Chaos in 2008, junk bonds in 2002
  - Buffett has reduced average maturity of bond portfolio so he can act quickly

Buffett Invested Large Amounts of Capital During the Downturn in 2008

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Investment/Commitment	Amount (Bn)	Comment
Mars/Wrigley	$6.5	
Auction rate securities	$6.5	Q2 event; sold much in Q3
Goldman Sachs	$5.0	Plus $5B to exercise warrants
Constellation Energy stock and preferred	$5.7	Sold for a $1.1B gain incl. breakup fee
Marmon	$4.5	The remaining 34.6% not owned by BRK will be purchased from 2011-14
General stock purchases	$3.3	Full year; net of sales
Dow/Rohm & Haas	$3.0	
General Electric	$3.0	Plus $3B to exercise warrants
Fed. Home Loan Disc. Notes	$2.4	Q2 event; sold much in Q3
Tungaloy	$1.0	Iscar acquisition
Swiss Re unit	$0.8	Plus sharing agreement
ING reinsurance unit	$0.4	
Other businesses purchased	$3.9	
TOTAL	**$46.0**	Plus $8B to exercise GS & GE warrants

Note: Does not include capital committed to Berkshire's new bond insurance business, Berkshire Assurance

Valuing Berkshire

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"Over the years we've…attempt[ed] to increase our marketable investments in wonderful businesses, while simultaneously trying to buy similar businesses in their entirety." – 1995 Annual Letter

"In our last two annual reports, we furnished you a table that Charlie and I believe is central to estimating Berkshire's intrinsic value. In the updated version of that table, which follows, we trace our two key components of value. The first column lists our per-share ownership of investments (including cash and equivalents) and the second column shows our per-share earnings from Berkshire's operating businesses before taxes and purchase-accounting adjustments, but after all interest and corporate expenses. The second column excludes all dividends, interest and capital gains that we realized from the investments presented in the first column." – 1997 Annual Letter

Year	Investments Per Share	Pre-tax Earnings Per Share Excluding All Income from Investments
1967	$ 41	$ 1.09
1977	372	12.44
1987	3,910	108.14
1997	38,043	717.82

"In effect, the columns show what Berkshire would look like were it split into two parts, with one entity holding our investments and the other operating all of our businesses and bearing all corporate costs." – 1997 Annual Letter

Buffett's Comments on Berkshire's Valuation Lead to an Implied Multiplier of Approximately 12

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Year	Investments Per Share	Pre-tax EPS Excluding All Income From Investments	Year-End Stock Price	Intrinsic Value	Implied Multiplier
1996	$28,500	$421	$34,100	$34,100	13
1997	$38,043	$718	$46,000	$46,000	11
1998	$47,647	$474	$70,000	$54,000	13
1999	$47,339	-$458	$56,100	$60,000	

- 1996 Annual Letter: "Today's price/value relationship is both much different from what it was a year ago and, as Charlie and I see it, more appropriate."
- 1997 Annual Letter: "Berkshire's intrinsic value grew at nearly the same pace as book value" (book +34.1%)
- 1998 Annual Letter: "Though Berkshire's intrinsic value grew very substantially in 1998, the gain fell well short of the 48.3% recorded for book value." (Assume a 15-20% increase in intrinsic value.)
- 1999 Annual Letter: "A repurchase of, say, 2% of a company's shares at a 25% discount from per-share intrinsic value...We will not repurchase shares unless we believe Berkshire stock is selling well below intrinsic value, conservatively calculated...Recently, when the A shares fell below $45,000, we considered making repurchases."

Estimating Berkshire's Value: 2001 – 2011

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Year End	Investments Per Share	Pre-tax EPS Excluding All Income From Investments[1]	Intrinsic Value Per Share	Subsequent Year Stock Price Range
2001	$47,460	-$1,289	$64,000	$59,600-$78,500
2002	$52,507	$1,479	$70,000	$60,600-$84,700
2003	$62,273	$2,912	$97,000	$81,000-$95,700
2004	$66,967	$3,003	$103,000	$78,800-$92,000
2005	$74,129	$3,600	$117,300	$85,700-$114,200
2006	$80,636	$5,200-$5,400	$143,000-$144,400	$107,200-$151,650
2007	$90,343	$5,500-$5,700	$156,300-$158,700	$84,000-$147,000
2008	$75,912	$5,727	$121,728 (8 multiple)	$70,050-$108,100
2009	$91,091	$3,571	$126,801 (10 multiple)	$97,205-$128,730
2010	$94,730	$7,200	$166,730 (10 multiple)	$98,952-$131,463
2011	$98,366	$8,000[2]	$178,366 (10 multiple)	?

Given compressed multiples at the end of 2008, we used an 8 rather than a 12 multiple.
We've now increased this to a 10 multiple, still below the historical 12 multiple we believe Buffett uses.

1. Unlike Buffett, we include a conservative estimate of normalized earnings from Berkshire's insurance businesses: half of the $2 billion of annual profit over the past nine years.
2. Buffett reported $6,990/share in his 2011 annual letter, but we include half of normalized insurance earnings as well as run-rate earnings for Lubrizol.

Berkshire Is 33% Below Intrinsic Value, Close to a Multi-Decade Low

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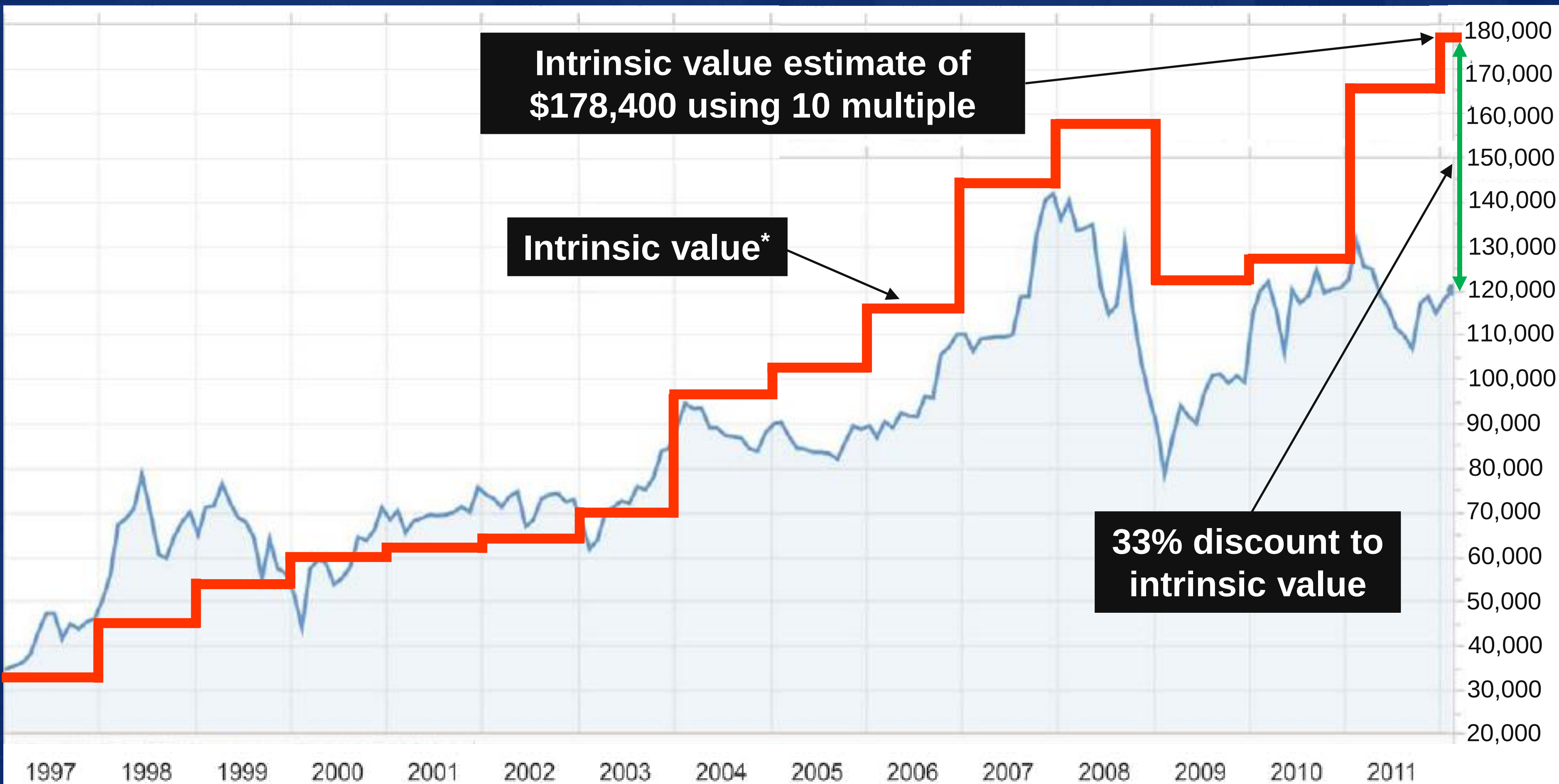

* Investments per share plus 12x pre-tax earnings per share (excluding all income from investments) for the prior year, except for YE 2008 (8 multiple) and YE 2009 onward (10 multiple).

12-Month Investment Return

- Current intrinsic value: $178,400/share
- Plus 8% growth of intrinsic value of the business
- Plus cash build over next 12 months: $7,000/share
- Equals intrinsic value in one year of $200,000
- 67% above today's price

Catalysts

- Continued earnings growth of operating businesses, especially as $1+ billion of pre-tax earnings from Lubrizol are incorporated
- New equity investments
- Additional cash build
- Meaningful share repurchases
- Eventually, Berkshire could win back a AAA rating (not likely in the near term)
- Potential for more meaningful acquisitions and investments
  - If there's a double-dip recession, this becomes more likely

Berkshire's New Share Repurchase Program

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- On September 26th 2011, Berkshire announced the first formal share repurchase program in Berkshire's history, and only the second time Buffett has ever offered to buy back stock
- It's unusual in three ways:
  1. There's no time limit
  2. There's no dollar cap
  3. Buffett set a price: "…no higher than a 10% premium over the then-current book value of the shares. In the opinion of our Board and management, the underlying businesses of Berkshire are worth considerably more than this amount…"
- Book value at the end of Q4 '11 was $99,860 ($66.57/B share)
- Thus, a 10% premium means that Buffett is willing to buy back stock up to $109,846 ($73.23/B share), 8.5% below today's price

The Share Repurchase Program Has Significantly Improved the Risk-Reward Equation, So We Bought More Stock

- It confirms that Buffett shares our belief that Berkshire stock is deeply undervalued
  - He wouldn't be buying it back at a 10% premium to book value if he thought its intrinsic value was, say, 20% or even 30% above book
  - Our estimate is nearly $180,000/share, 50% above today's levels
- Buffett put a floor on the stock: he was clear in numerous interviews after the program was announced that he is eager to buy back *a lot* of stock – and he has plenty of dry powder to do so:
  - Berkshire has $33.5 billion of cash (excluding railroads, utilities, energy, finance and financial products), plus another $31.2 billion in bonds (nearly all of which are short-term, cash equivalents), which totals $64.7 billion
  - On top of this, the company generated more than $12.3 billion in free cash flow in 2011 – in other words, more than $1 billion/month is pouring into Omaha
  - The press release notes that "repurchases will not be made if they would reduce Berkshire's consolidated cash equivalent holdings below $20 billion," so that leaves $45 billion to deploy (and growing by more than $1 billion/month), equal to 23% of the company's current market cap
    - It's unlikely, however, that Buffett would repurchase anything close to this amount, as some of the cash and bonds are held at various insurance subsidiaries, plus Buffett likely wants to keep plenty of dry powder to make acquisitions and investments like the recent $5 billion one into Bank of America
  - In summary, Buffett could easily buy back $10-20 billion of stock *and* still have plenty of dry powder for other investments

Berkshire Stock Outperformed the S&P 500 by 83 Percentage Points in the Year After the Only Other Time Buffett Offered to Buy Back Stock

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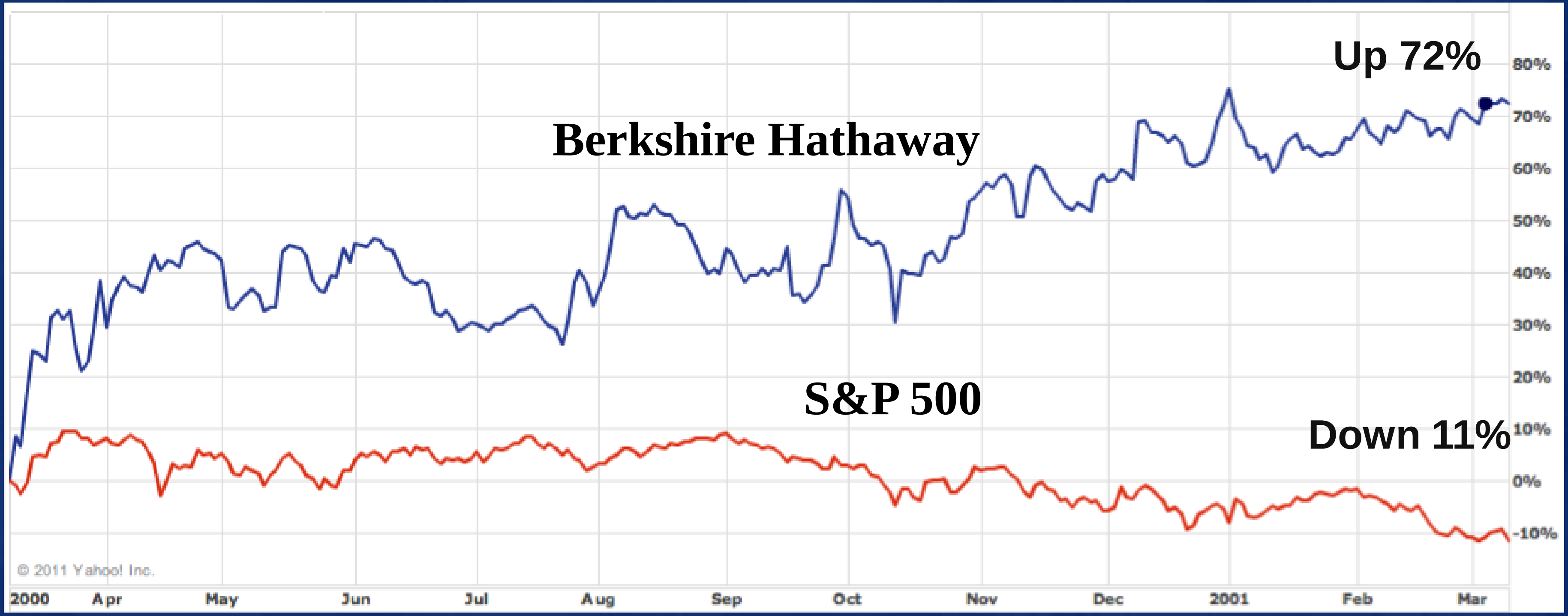
March 11, 2000 – March 11, 2001



Risk: Who Will Replace Buffett?

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- When Buffett is no longer running Berkshire, his job will be split into two parts: one CEO, who has not been named, and a small number of CIOs (Chief Investment Officers)
  - Two have been named already, Todd Combs and Ted Weschler, who both appear to be excellent investors
- Nevertheless, Buffett is irreplaceable and it will be a significant loss when he no longer runs Berkshire for a number of reasons:
  - There is no investor with Buffett's experience, wisdom and track record, so his successors' decisions regarding the purchases of both stocks and entire business might not be as good
  - Most of the 75+ managers of Berkshire's operating subsidiaries are wealthy and don't need to work, but nevertheless work extremely hard and almost never leave thanks to Buffett's "halo" and superb managerial skills. Will this remain the case under his successors?
  - Buffett's reputation is unrivaled so he is offered deals (such as the recent $5 billion investment in BofA) on terms that are not offered to any other investor – and might not be offered to his successors
  - Being offered investment opportunities on terms/prices not available to anyone else also applies to buying companies outright. There's a high degree of prestige in selling one's business to Buffett (above and beyond the advantages of selling to Berkshire). For example, the owners of Iscar could surely have gotten a higher price had they taken the business public or sold it to an LBO firm
  - Buffett's Rolodex is unrivaled, so he gets calls (and can make calls that get returned) that his successors might not

Aren't We Concerned About the Uncertainty of Berkshire After Buffett?

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Answer: Not really, for two primary reasons:

1. Buffett isn't going anywhere anytime soon. We think it's at least 80% likely that Buffett will be running Berkshire for five more years, and 50% likely he'll be doing so for 10 more years
   - Buffett turned 81 on Aug. 30th, is in excellent health, and loves his job
   - There are no signs that he is slowing down mentally – in fact, he appears to be getting better with age
   - A life expectancy calculator (http://calculator.livingto100.com) shows that Buffett is likely to live to age 93 (12 more years) – and we'd bet on the over
2. The stock is very cheap based on our estimate of intrinsic value (nearly $178,400/A share), which does not include *any* Buffett premium
   - We simply take investments/share and add the value of the operating businesses, based on a conservative multiple of their normalized earnings
   - The value of the cash and bonds won't change, and Coke, American Express, Burlington Northern, GEICO, etc. will continue to generate robust earnings even after Buffett's no longer running Berkshire

Why Doesn't Buffett Identify His Successor Now?

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We think it's wise that Buffett hasn't named his successor for two reasons:

1. It would place enormous pressure and expectations on this person, which is unnecessary and counterproductive;
2. It might be demotivating for the candidates who were not chosen; and
3. Who knows what will happen between now and the time that a successor takes over (which could be more than a decade)?
   - Maybe the current designee falls ill, leaves Berkshire, performs poorly, or makes a terrible mistake (like Sokol did)?
   - Or what if another candidate (perhaps one of the two backup successors today) performs incredibly well, or Berkshire acquires a business with a fantastic CEO, and Buffett and the board decide that another candidate is better?
   - In either case, Buffett and the board will be able to switch their choice without the second-guessing and media circus that would occur if the successor had been named

The Real Buffett Risk

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- Buffett is often asked (as are we): “What would happen to the company (and stock) if you got hit by a bus (i.e., die suddenly)?
  - If it happened tomorrow, our best guess is that the stock would fall 10-15% (which would give Berkshire the opportunity to buy back a lot of stock if it was trading below 110% of book value)
  - But this isn’t likely. Not to be morbid, but most people don’t die suddenly from something like an accident or heart attack, but rather die slowly: their bodies (and sometimes minds) break down gradually
  - A far greater risk to Berkshire shareholders is that Buffett begins to lose it mentally and starts making bad investment decisions, but doesn’t recognize it (or refuses to acknowledge it because he loves his work so much) and the board won’t “take away the keys”, perhaps rationalizing that a diminished Buffett is still better than anyone else
  - Buffett is aware of this risk and has instructed Berkshire’s board members, both publicly and privately, that their most important job is to “take away the keys” if they see him losing it
  - We trust that both Buffett and the board will act rationally, but also view it as our job to independently observe and evaluate Buffett to make sure we’re comfortable that he’s still at the top of his game. Today, we think he’s never been better.

An Analogy with Apple & Steve Jobs

- The most comparable example of a business that, like Berkshire, is closely associated with its legendary founder and CEO is Apple
  - As Steve Jobs's health began to fail, he assumed fewer day-to-day responsibilities, passing them to top lieutenants
  - Jobs resigned as CEO on Aug. 24, 2011 and died exactly six weeks later
  - Apple's stock on the first trading days after his retirement and death were announced declined less than 1%, as this chart shows:

First day of trading after Steve Jobs announces retirement

First day of trading after Steve Jobs dies

Other Risks

- A double-dip recession impacts Berkshire's earnings materially
- No catalyst occurs, so the stock sits there and doesn't go up
  - Intrinsic value will likely continue to grow nicely
- Berkshire's stock portfolio declines
- Losses in the shorter-duration derivatives such as credit-default swaps are larger than expected and/or mark-to-market losses mount among the equity index puts
- A major super-cat event occurs that costs Berkshire many billions
- Berkshire is downgraded

Conclusion

- Cheap stock: 67-cent dollar, giving no value to recent investments and immense optionality
- Extremely safe: huge cash and other assets provide intrinsic value downside protection, while the new share repurchase program provides downside protection on the stock
- Strong earnings should eventually act as a catalyst