

Moats

The Competitive Advantages Of Buffett & Munger Businesses

By Bud Labitan
First Edition
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ISBN 978-1-105-41808-2

*This is part of a fact-check and analysis on
Clayton Homes, found in the report at this [link](#)
[here](#). Note the following about this book.*

*The text herein, save these italicized analysis comments, are as in the
original.*

*While the focus is on Clayton, some broader insights about Labitan's
book are shown below.*

[Dems Provide Revealing Clayton Info - Kevin Clayton, CEO Clayton
Homes Federal Testimony Yields Apparent Agreements with MHARR,
Concurs with Manufactured Housing Institute-Berkshire Hathaway,
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Moats

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When the document above was opened in Word and the Word search (navigation) function was utilized, there were no results found for the words shown above on 6.14.2021. That is significant. By the time this book was published Buffett had already made his infamous class warfare comments. He had already said that he wanted various man-eating aquatics in the waters of that moat. That may shed light on the author and researchers involved in this "Moat" book project. Keep in mind that Buffett has said that the rearview mirror is clearer than the windshield.



**A truly great business must have an enduring “moat” that protects
excellent returns on invested capital. ~ Warren
Buffett**

**How do you compete against a true fanatic? You can only try to
build the best possible moat and continuously attempt to widen it.
~ Charlie Munger**

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Introduction

GOALS

Moats is designed to be a valuable learning resource for investors, students, and managers of business. It can also be used as a starting point for discussions about real competitive advantages in business schools around the world. This book is about the competitive advantages of 70 selected businesses that Warren Buffett and Charlie Munger bought for Berkshire Hathaway. (NYSE: BRK.A, BRK.B). Most of these businesses are wholly owned subsidiaries. A handful of them are partially owned through large stock (equity) investments.

Imagine these competitive advantages as protective moats around each economic castle. Will these economic moats endure over time? Over time, each customer makes up a part of that answer. Charlie Munger stated it this way: “How do you compete against a true fanatic? You can only try to build the best possible moat and continuously attempt to widen it.”

DEFINITION OF MOATS

Moats are barriers. One of the oldest moats surrounded the ancient Egyptian settlement of Buhen, on the West bank of the Nile River. During the medieval period, the kings of Europe would build wide and deep trenches filled with water around their castles. These moats were built as single or double protective barriers against invading armies. In business, we think of economic barriers that can both defend and injure the invading competition.

When I started this project, I searched the internet for images of castles with moats. Interestingly, I learned of Berkhamsted Castle and its double moat. (<http://www.berkhamsted-castle.org.uk>) The Castle remains are

located about 20 miles northwest from the center of London, at Brownlow Road, Hertfordshire, Berkhamsted, United Kingdom.

Charlie Munger said, “Let’s go for the wonderful business.” So, after years of buying “bargain-purchase” follies, Warren Buffett and Charlie Munger realized that it is much better to buy a wonderful company at a fair price than a fair company at a wonderful price. Now, when buying companies or common stocks, they look for first-class businesses accompanied by first-class managements.

What makes a first-class business wonderful? It must have one or more economic moats. Charlie Munger observed that capitalism is a pretty brutal place. Yet, some good businesses can survive a little period of bad management. Warren Buffett said “A truly great business must have an enduring ‘moat’ that protects excellent returns on invested capital.”

WHY THESE 70 BUSINESSES?

This book is about the competitive advantages of 70 of the many businesses that Warren Buffett and Charlie Munger bought for Berkshire Hathaway. Why did I focus on these 70? I took the names of the businesses listed on Berkshire Hathaway’s website and its link to its subsidiaries. Then I added a few of their largest stock investments. They are arranged alphabetically. My intent was to study the economic moats, learn more about them, and see which ones are growing and which ones are shrinking.

SOURCES OF INFORMATION

The information comes from multiple online sources. The most important sources come from each business’ publications and the annual letters of Warren Buffett to the shareholders of Berkshire Hathaway.

Charlie Munger’s letters and talks were also a great source of material. Other pieces of information were found by the many volunteers and students listed in the Appendix.

THANKS TO RESEARCH CONTRIBUTORS AND EDITORS

The research volunteers and contributors to this book were asked two basic questions. First, what are the competitive advantages of the business you are looking at? Secondly, are these advantages sustainable for the next ten years?

When I posted this offer out on the web, I was pleased to welcome many enthusiastic and knowledgeable volunteers. While much of my research was already compiled, I needed to test my ideas against someone else. This testing of ideas yielded additional information that was new and valuable. It resulted in a bigger, but also better book. So, I thank each and every one of the contributors listed in the Appendix and at the Moats website here: <http://www.frips.com/book.htm>

I extend a special thanks to Professor Phani Tej Adidam, Ph.D. who is the Executive Education Professor of Business Administration, and Chair, Department of Marketing and Management, and Director, CBA International Initiatives at University of Nebraska at Omaha. Professor Adidam's MBA students of 2011 have contributed valuable ideas to many of these chapters.

Thank you Richard Konrad, CFA, of Value Architects Asset Management. Rick has been an insightful contributor to several chapters. Thank you Dr. Maulik Suthar of Gujarat, India. Maulik has been a thoughtful contributor to several chapters, and an enthusiastic supporter of this project. Thank you Scott Thompson, MBA for sharing your thoughts, analysis, and feedback.

SINGLE, DOUBLE, AND TRIPLE MOATS

Having a "Sustainable Competitive Advantage" means customers keep coming back to repurchase. The two major areas of competitive advantage are: 1. a cost advantage, and 2. a differentiation advantage. While the "marketing mix" teaches us to think about the product, price, place, and promotions, this all comes together in the mind of the potential customer. The customer may or may not perceive these two general areas of

advantage. This book refers to them as a “cost” and “special” advantages. I simplify by substituting the word “special” for differentiation.

Over the years, Warren Buffett and Charlie Munger found wonderful businesses by asking a lot of questions. What is the nature of each business? Can we predict it with a high degree of accuracy? Can we imagine a moat around each economic castle? Will this moat be enduring? Is there something special here for our customers, or is this advantage eroding?

Since the nature of capitalism is competition, a successful business needs to have “something special” in order to lead the pack and fend off present and potential competitors. It needs a barrier to entry. Sustainable Competitive Advantage is also called “favorable long-term prospects” or “enduring economic advantages.” It comes from things that make a business difficult to copy or enter.

A brand is such a barrier because it represents something unique and valued in the mind of a customer that promotes customer loyalty. A valuable patent or trademark can also give a business a period of protected advantage, acting as a barrier to entry.

Warren Buffett and Charlie Munger added to Ben Graham's foundation of bargain hunting by looking for a business with a big protective moat around it. Buffett and Munger look for something special in peoples' minds such as: Lower Cost of Production, Brands, Economies of Scale, Patented Technology, Location, Distribution System, Specialized Services, Network, Regional Monopolies and Intangible Assets that create higher switching costs and a barrier to entry.

So what makes one business thrive better than another business? There must be something special. In one example, Charlie Munger recommended the autobiography of Les Schwab “Les Schwab Pride in Performance: Keep It Going.” According to Munger, “Schwab ran tire shops in the Midwest and made a fortune by being shrewd in a tough business by having good systems.” That was Schwab's specialty.

At GEICO insurance, the cost advantage present is a barrier for competitors. Can they match GEICO in cost or service? Buffett stated that GEICO's direct marketing gave it an enormous cost advantage over competitors that sold through agents. What about size and capital rating? GEICO certainly has strong backing, and Berkshire Hathaway's other insurance and reinsurance operations also benefit from the size, rating, and "time tested" operational soundness of its business organization.

This ability to endure over time, in good times and in bad, and continue to earn a solid profit is an important competitive advantage that helps make a company a "wonderful business." Sometimes, that comes about because of decent economics plus superior managements who work to build a stronger moat in the product or service by creating a special "brand" impression.

Talking about less competitive and weaker businesses, Warren Buffett said, "In many industries, differentiation simply can't be made meaningful. A few producers in such industries may consistently do well if they have a cost advantage that is both wide and sustainable." However, these are a few exceptional businesses. In many industries, such enduring winners do not exist. So, for the great majority of businesses selling "commodity" products, Buffett believes that a depressing equation of poor business economics prevails. In his view, "a persistent over-capacity without administered prices (or costs) equals poor profitability."

Buffett and Munger like strong brands like those of Coke, Gillette, and Kraft. These companies have increased their worldwide shares of market in recent years. Their brand names, the attributes of their products, and the strength of their distribution systems gives them competitive advantage. So what does this sustainable competitive advantage look like in numbers? Take a look at their 5-10 year records of FCF (Free Cash Flow) and real owner earnings compared to those of competing businesses.

Consider why the Coca-Cola Company is such a good business from an investor's point of view. Both Coke and Pepsi make products we enjoy. As an investor, I prefer the Coca-Cola Company. One reason is the amount

of FCF generated for every sale. Since Coca-Cola has a combination of a special brand advantage, large scale cost of production advantage, and a global network distribution advantage, we could say that it has three moats around its economic castle.

Warren Buffett also commented on the competitive arena of selling insurance. He said, “Insurers will always need huge amounts of reinsurance protection for marine and aviation disasters as well as for natural catastrophes. In the 1980s much of this reinsurance was supplied by ‘innocents’ - that is, by insurers that did not understand the risks of the business - but they have now been financially burned beyond recognition.” In the world of marketing super-catastrophe insurance, Buffett said Berkshire Hathaway enjoys a significant competitive advantage because of its premier financial strength.

COMPETITION SIMPLIFIED AND DEMYSTIFIED

How does practical competitive advantage tie in with current academic thought? In his book, “Competition Demystified”, Bruce Greenwald of Columbia University presented a new and simplified approach to business strategy. The conventional approach to strategy taught in business schools is based on Michael Porter’s work. In Porter’s model, students can get lost in a sophisticated model of a business’ competitors, suppliers, buyers, substitutes, and other players.

Greenwald warns us to not lose sight of the big question, “Are there barriers to entry that allow us to do things that other firms cannot?” Then, after establishing the importance of barriers to entry, Greenwald and Kahn argue that there are really only three sustainable competitive advantages; 1. Supply. A company has this edge when it controls an important resource: A company may have a proprietary technology that is protected by a patent. 2. Demand. A company can control a market because customers are loyal to it, either out of habit - to a brand name, for example - or because the cost of switching to a different product is too high. 3. Economies of scale. If your operating costs remain fixed while output

increases, you can gain a significant edge because you can offer your product at lower cost without sacrificing profit margins.

Wal-Mart has shown its power in scale, and Charlie Munger put it this way: “Kellogg's and Campbell's moats have also shrunk due to the increased buying power of supermarkets and companies like Wal-Mart. The muscle power of Wal-Mart and Costco has increased dramatically.”

According to Professor Greenwald, the value of such a strong brand barrier can be quantitatively estimated. It is about equal to its “difficult for competitor to match” reproduction costs.

In order to insure success, the operation of these good businesses must continue to be in the hands of first-class, able, trustworthy, and experienced managers. Focus on whether these competitive advantages are due to power in demand, supply, or economies of scale. However, in this book, we simplify this even more into “cost” and/or “special” advantages. Then, we discuss our impressions of whether their moats can endure over time.

Warren Buffett and Charlie Munger look for companies that have a) a business they understand; b) favorable long-term economics; c) able and trustworthy management; and d) a sensible price tag. They like to buy the whole business or, if management is their partner, at least 80%. When control-type purchases of quality aren't available, they are also happy to simply buy small portions of great businesses. Buffett said that it is better to have a part interest in the Hope Diamond than to own all of a rhinestone.

The dynamics of capitalism guarantee that competitors will repeatedly assault any business 'castle, that is earning high returns. Buffett and Munger believe that a great business must have an enduring 'moat' that protects its excellent returns on invested capital. Strong barriers such as being the low cost producer (GEICO, Costco) or possessing powerful world-wide brands (Coca-Cola, Gillette, American Express, IBM, Kraft) are essential for sustained success.

Since business history is filled with companies with weak and temporary moats, the criteria of “enduring moat” caused Buffett and Munger to rule out companies in industries prone to rapid or continuous change. So, they avoid investing in technology companies. The chapter on IBM will explain why they recently invested in this technology related information solutions business.

Charlie Munger said, “How do you compete against a true fanatic? You can only try to build the best possible moat and continuously attempt to widen it.”

THE WONDERFUL BUSINESS IS SEE’S CANDIES

See's Candies taught Buffett and Munger much about the evaluation of franchises. Both men admit that they have made significant money because of the lessons they learned at See's. See's is the wonderful business.

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

Buffett and Munger respect able and trustworthy managers. As you read about these 70 great businesses, think about the product or service that: (1) is strongly desired; (2) has no close substitute and; (3) has pricing power. As Buffett said, “A moat that must be continuously rebuilt will eventually be no moat at all. Additionally, this criterion eliminates the business whose success depends on having a great manager.”

FOR FUTURE MANAGERS

While this book will help readers learn more about enduring competitive advantages, here is a little reminder about Buffett and Munger's contribution to behavioral finance. It was the subject of my first book, "The Four Filters Invention of Warren Buffett and Charlie Munger." Their four filters innovation helps us all find better investments: "Understandable first-class businesses, with enduring competitive advantages, accompanied by able and trustworthy managers, available at a bargain price."

If you have home run hitters, let them swing for the fences. Berkshire Hathaway is a collection of businesses that were picked for their unique economic advantages. Most of them are run by able and trustworthy managers. So, appreciate them and remember that the goal is not growth, but it is "growth in intrinsic value per share."

ACME BRICK COMPANY COMPETITIVE ADVANTAGES Bud

Labitan with Adam Ward, UNO-CBA

Having driven potential competitors from this market, Acme Brick enjoys a benefit from its “special high-quality brand,” some economies of scale, and a respected distribution network in the South.

Quality was important to Acme Brick's founder, George Bennett. He carefully looked for suitable clay and he invested in what was then state-of-the-art equipment. Bennett set the quality-focused culture. Acme Brick homes built a century ago are still standing, and a competitive advantage has been built from this quality brand.

In 2000, Warren Buffett wrote: “Acme produces more than one billion bricks per year at its 22 plants, about 11.7% of the industry’s national output. The brick business, however, is necessarily regional, and in its territory Acme enjoys unquestioned leadership. When Texans are asked to name a brand of brick, 75% respond Acme. This brand recognition is not only due to Acme’s product quality, but also reflects many decades of extraordinary community service by both the company and John Justin.”

Introduced in 1991, Acme's 100 Year Limited Guarantee document put Acme's commitment to quality in writing. Acme also proudly stamps its name into one end of select residential brick just before hard-firing. This logo forms a subtle indicator of its quality. All Acme Brick are manufactured to exceed the standards of building codes. The holes in each Acme Brick are an industry innovation credited to Acme's founder. George Bennett recognized that "coring" the brick would make the brick easier to handle and less expensive to ship. Core holes also allow every part of the brick to reach the desired firing temperature.

The mason’s time is one of the largest costs in brickwork. Acme introduced King Size brick in the 1960s. The larger face area means fewer bricks to handle, which saves money on construction. Acme Brick engineers

advance the uses of brick by designing innovative and economical applications.

Acme had revenue of about \$300 million in 2010. In 2011, Acme has been plodding through this slow economic recovery. But, having Berkshire behind it, Acme can look forward to its long term business success in the next building cycle. Said Charlie Munger, “Berkshire is in the business of making easy predictions. If a deal looks too hard, the partners simply shelve it.”

President and CEO Dennis Knautz is a 28-year veteran of the company. Here is an edited summary of his recent remarks to citybizlist.com: “Housing is the worst it has been since World War II. We have had to downsize dramatically. We have gone from more than 3,000 associates to about 1,800. We have closed one brick plant permanently, nine are temporarily idled and 14 are still operating. Only one is operating at full capacity. Acme has brick plants in Texas, Oklahoma, Arkansas, Kansas, Mississippi, Minnesota and Colorado. During this time, we have continued to operate all seven of our concrete block plants in Texas and our natural stone operation near Austin. We have also kept all 48 of our sales facilities across the Southwest open for business in addition to most of our American Tile stores in Texas. We have survived by managing our cash flow, trimming production rates, letting good hardworking associates go, and slashing capital spending.”

How does a strong company build up its moat during a recessionary period? Acme recently bought a struggling competitor, Jenkins Brick. For many years, Acme had sold some Jenkins brick and it had represented Acme in the Southeast. Like Acme, nearly every other brick company has had to address the same issues. This is an important deal for Acme because Jenkins' geographic sales coverage area fits nicely next to Acme's. Acme is now able to expand its reach from the Rocky Mountains to the Atlantic Ocean. This gives Acme the ability to meet

the needs of larger homebuilder customers who want the same brick supplier when they choose to start a subdivision.

Berkshire and Acme take a long-term view. “Acme didn't buy Jenkins for the 2011 returns; it was for what this deal will do for us over the next 10, 20 years.” Warren Buffett says the company's time horizon is forever. And, all managers are encouraged to look for bolt-ons to existing businesses.

One of the competitive advantages for Acme Brick Co. is that they offer a 100 year warranty on their products when their competitive standard was 3-5 years. This warranty has set them apart from other brick makers by telling the customer the product will outlast them. Acme Brick can sustain this advantage by producing quality products that last a lifetime and building its brand image.

Acme needs to be cautious of what is going on around them because the invention of cement bricks vs. clay bricks is a discussion that is being raised. With cement bricks being cheaper and quoted to be just as strong as clay bricks, Acme may have to broaden their business and start developing more types of cement bricks along with their traditional clay bricks.

Charlie Munger once said, “Our ideas are so simple that people keep asking us for mysteries when all we have are the most elementary ideas.”

Acme Brick's scale, cost, and brand competitive advantages are sustainable if managers continue to emphasize high quality production and high quality customer service. Having driven potential competitors from this market, Acme Brick enjoys a benefit from its “special highquality brand,” some economies of scale, and a respected distribution network in the South.

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AMERICAN EXPRESS CO. (AXP) COMPETITIVE ADVANTAGES Bud
Labitan with Dr. Maulik Suthar, Gujarat, India

Extraordinary business franchises are rare, and some are developed. American Express can handle future risks better than other competitors

because of its more financially capable customer base and its strong financial strength.

American Express was founded in 1850 as a joint stock association. It was incorporated in 1965 as a New York corporation. AXP's principal products and services are charge and credit card payment products and travel-related services offered to consumers and businesses around the world.

American Express Company and its principal operating subsidiary, American Express Travel Related Services Company, Inc. ("TRS"), are bank holding companies under the Bank Holding Company Act of 1956 (the "BHC Act").

Warren Buffett's history with American Express goes back to the mid 1960s. AXP stock was battered by the company's infamous salad-oil scandal, and Buffett put about 40% of Buffett Partnership Ltd.'s capital into the stock. This was the largest investment the partnership ever made. This commitment gave the Buffett Partnership more than 5% ownership in Amex at a cost of \$13 million.

Buffett's history with Amex's IDS unit goes back even further. He first purchased stock in IDS in 1953 when it was growing rapidly and selling at a price-earnings ratio of only 3. IDS was later renamed American Express Financial Advisors. This was later spun off as Ameriprise Financial. While the operations are different from what they were then, Buffett wrote that he found "a long-term familiarity with a company and its products is often helpful in evaluating it."

American Express was an extraordinary business franchise with a localized excisable cancer. Buffett wrote that this should be distinguished from a true “turnaround” situation.

In 1991, Buffett purchased fixed-income securities of American Express. His American Express preferred was a convertible that carried a fixed dividend of 8.85% on a \$300 million cost. The preferred had to be converted three years after issuance, into a maximum of 12,244,898 shares. Though there was a ceiling on the value of the common stock that they received upon conversion, there was no floor. Overall, Berkshire realized large capital gains from these holdings, including about \$152 million in 1991. The after-tax yields exceeded those earned by most fixed-income portfolios.

Buffett tells students they'd be better off if they never used credit cards. He says “I can't make money if I'm out borrowing at whatever the rate may be, 12%, 14%, 16%... if I borrow at credit card rates, I'm in trouble.”

So why has he invested in American Express? Buffett said that American Express came in and priced their card higher than the Diner's card. American Express targeted the business owner and established their card as something special. Buffett also noted that his failed attempt to launch a credit card at Geico cost him about \$60 million.

As of 2010, American Express Company is a global service company that provides customers with access to products, insights and experiences that enrich lives and build business success. The American Express Brand and its attributes—trust, security, integrity, quality and customer service—are key competitive assets of the Company. AXP continues to focus on brand building by educating employees about these attributes and by incorporating them into programs, products and services.

The Company's results for 2010 reflected strong spending growth and improved credit performance. Compared with 2009, AXP in 2010 delivered increased total revenues net of interest expense of \$27.8 billion, up 13% from \$24.5 billion. The 2010 return on average equity was up to 27.5%, compared with 14.6%.

The AXP brand has consistently been rated one of the most valuable brands in the world and they believe that this brand provides AXP with a significant competitive advantage.

In the USA, American Express Company enjoys approximately 24 percent market share in credit card transactions that is highest among all players. Although Visa and MasterCard still controlled 75 percent of the overall card market, innovations in traditional credit cards put American Express in a position to remain very competitive in the 21st century.

American Express Company derives half of its revenue from merchants; charging them a discount rate for each transaction processed and majority of revenues come from cardholders themselves, who pay annual fees and interest charges on balances. Compared to Visa or MasterCard, American Express earns much more per swipe because of higher discount rates and big-spending cardholders. In addition, average spending on American Express cards is over four times greater than that of VISA or MasterCard.

The key to understanding American Express and its competitive advantages is how it differentiates "membership" from other credit and charge card companies. The exclusivity of American Express is part of its brand and its strategies.

Differentiation is about rewarding the customer with something unique at a premium price. The new Blue card is one such example. Another competitive advantage American Express has are a network effect and formidable economies of scale. This is because the company has the widest global payment network. It is extremely tough for a new entrant to establish a parallel network. Neither consumers nor the merchants accept a card that has limited accessibility points. Therefore, American Express has been able to produce more than 25% normalized return on equity in the payments business and able to grow earnings at 12-15%.

Recently, AXP's 5Yr Gross Margin (5-Year Avg.) is approximately 100% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 11.4%, while the industry Net Profit Margin (5-Year Avg.) is a negative 34.9%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

American Express attracts higher-spending individuals and corporations for its “spend-centric” model. It rewards access to unique experiences and outstanding customer service including the worldwide travel office network. This approach encourages consumers to use cards to get earn rewards.

Can these competitive advantages be maintained? American Express believes that its brand and its attributes are critical to ongoing success. They invest heavily in managing, marketing and promoting this brand. In addition, since AXP places significant importance on trademarks, service marks and patents, it diligently protects its intellectual property rights around the world. American Express also successfully sued Visa and MasterCard on anti-trust grounds to allow U.S. banks to issue American Express cards.

Charlie Munger said, “We came to this notion of finding a mispriced bet and loading up when we were very confident that we were right.” In the mid-1960s, just after the stock was battered by the company's infamous salad-oil scandal, Buffett put about 40% of Buffett Partnership Ltd.'s capital into the stock. It was the largest investment the partnership had ever made. This commitment later gave them over 5% ownership in Amex at a cost of \$13 million.

American Express has approximately 91 million cards in circulation worldwide for fiscal year ending December, 2010. This is extremely difficult to compete with. The powerful brand and position in the marketplace has allowed American Express to form premium lending partnerships with leading merchants such as Costco, as well as Delta, British Airways, Air France, Alitalia, Qantas, etc.

American Express generates revenue from five major sources: 1. Discount Revenue, 2. Travel, Commission and other Fees, 3. Net Card Fees, 4. Net Securitization Income and 5. Net Interest Income. AXP receives a portion of every transaction charged to its credit/ charge cards and this fee is assessed to merchants' respective businesses.

Throughout its history, American Express has built a respected premium brand around credit card service innovations, profitability, and integrity. The company redesigned its technology to balance efficiency with flexibility, in order to build excellent relationships. American Express can handle future risks better than other competitors because of its more financially capable customer base and its strong financial strength.

APPLIED UNDERWRITERS COMPETITIVE ADVANTAGES

BUD LABITAN WITH ADAM WARD, UNO-CBA

Special products and services are different, and they gain recognition. Applied offers “True Product Differentiation” Its products are unique, providing alternatives within a market where everything looks alike.

Applied Underwriters was founded in 1994 by Sid Ferenc and Steve Menzies as a profit-driven worker's compensation insurance company. Originally based in the San Francisco Bay Area, it has developed and expanded across the country, diversifying its products to suit the needs of clients in every state.

In 2001, Applied Underwriters brought its claims handling in house and established an operations center in Omaha, Nebraska. In 2005, Applied Underwriters founded its own insurance carrier, called California Insurance Company. A.M. Best gave the new company an 'A-' rating. It has since upgraded its rating to an 'A' for its North American Casualty Group.

Berkshire Hathaway agreed to buy 81% of Applied Underwriters in 2006. Applied Underwriters became a subsidiary of Berkshire Hathaway in part due to its longtime association with another Berkshire subsidiary, General Re. Applied Underwriters then started its own PPO health provider, Promesa Health, to ensure low-cost and effective drugs, treatments, and coaching for its clients. Applied Underwriters offers a combination of payroll services and workers' compensation insurance to small businesses. A majority of Applied's customers are located in California.

Applied is an industry provider in integrated workers' compensation solutions. Applied continues to be managed by its founders, Chairman and Chief Executive Officer Sidney Ferenc, and President and Chief Operating Officer Steven Menzies. It remains headquartered in San Francisco, but it maintains its national operations center in Omaha, Nebraska.

Previously, in 1998, Applied acquired an Omaha-based operation that offered a somewhat-similar service. Sid Ferenc and Steve Menzies concluded that Omaha had many advantages as an operational base. So, today, most of the company's employees are located there.

Later, Applied entered into a large reinsurance contract with Ajit Jain, the extraordinarily successful manager of National Indemnity's reinsurance division. Ajit was impressed by Sid and Steve, and they liked Berkshire Hathaway's method of operation. Sid Ferenc and Steve Menzies retain 19% ownership of Applied.

Warren Buffett invests in proven companies that are industry leaders, and that offer significant growth potential. Applied's management team has the disciplined mindset necessary to lead a profitable underwriting operation," Buffett said. Applied Underwriters provides business insurance solutions for a wide range of companies, with specific expertise in crafting workers' compensation and business services solutions for small and medium-sized enterprises. Applied's products include SolutionOne and EquityComp.

Applied Underwriter offers a variety of products through its own insurance carrier, North American Casualty Group, of which California Insurance Company and Continental Indemnity Company are members. It does business in all 44 non-monopolistic fund states except Texas. Texas is the only state that does not require its employers to carry worker's compensation insurance.

Applied Underwriters is different from other workers' compensation insurance providers in many ways. One of the biggest points of difference is the range of products and services offered. They include:

SolutionOne is designed for companies with a payroll between \$100,000 and \$5 million. SolutionOne combines 'A' -rated workers' compensation insurance coverage plus employment practices liability insurance, payroll processing, risk reduction programs, and employer extended coverages. These extended coverages is a comprehensive package of services meant to handle administrative hassles such as worker safety training, background checks, and drug testing. All of these services are managed in house, so there are no pass-through costs involved.

PremierExclusive combines 'A' -rated workers' compensation insurance coverage along with profit-sharing options which allow clients to share in the underwriting profit by controlling their losses. PremierExclusive is a competitive alternative to upfront discounts and back-end dividends and the reduced pay-in provides cash flow benefits to companies. PremierExclusive is a premium product that is currently offered exclusively only through select agents.

A competitive advantage for Applied has been the combination of workers compensation coverage with financial and business services. This unique combination has allowed the company to double its customer base. Also, Applied Underwriters has some of the highest customer retention rates in excess of 90%. Applied has a claims closure rate 2.5 times faster than the industry average.

Applied's EquityComp program is designed for companies with premiums in excess of \$200,000 who seek flexible risk financing, EquityComp delivers like no other solution out there. Good experience is rewarded with reduced rates.

Applied's Claims Management is a competitive advantage. For the past 5 accident years, its claims closure rate has been 2.5 times faster than the industry average. This is because Applied assigns adjusters low caseload numbers, allowing them to manage claims accurately and close them quickly.

Promesa Health has many benefits not usually offered under regular workers' compensation insurance including pharmacy services and return-to-work programs. Promesa provides quick, thorough and evidence-based utilization review to ensure injured workers get the appropriate care. Promesa Health® is accredited by the Utilization Review Accreditation Commission (URAC).

Applied's Loss Control system is a competitive advantage. The Loss Control Department is designed to help businesses identify - and eliminate - potentially harmful conditions that could otherwise result in significant losses. Applied understands the importance of minimizing employee accidents, injuries and illnesses. Its highly skilled staff has experience and training specific to different lines of business and will work hard to help a

company operate more safely. From on-call support and personalized risk management programs to drug tests and safety training materials, Applied has its customers covered.

Charlie Munger says, “This is a good life lesson: getting the right people into your system is the most important thing you can do.” Buffett and Munger like Applied’s founders, Sidney Ferenc and Steven Menzies.

Applied offers “True Product Differentiation” Its products are unique, providing alternatives within a market where everything looks alike.

Additionally, in the future, Berkshire Hathaway can provide the financial backing needed to grow Applied from mid-level company underwriting to large company underwriting. Going forward, Applied Underwriting needs to stay customer focused, be able to estimate catastrophic losses, and price risks accordingly.

BEN BRIDGE JEWELER COMPETITIVE ADVANTAGES

BUD LABITAN WITH BERYL CHAVEZ LI, UNIVERSITY OF MANCHESTER

Special memories are created by personal jewelers. The Ben Bridge Jeweler business was started over 96 years ago in Seattle. Warren Buffett said that both the business and the family enjoy extraordinary reputations, and, same-store sales have progressively increased.

In 2000, Ben Bridge Jeweler was a purchase made by phone between Buffett and the Ben Bridge management. Upon learning that the Bridge family considered selling its company, Barnett Helzberg gave a strong and positive recommendation about Berkshire and the Ben Bridge company. Ed Bridge called Warren Buffett. He explained his business and sent some figures. The deal was made; half for cash and half for stock.

It was vital to the Bridge family that the company operates in the future as it did in the past. No one wanted another jewelry chain to come in and change the organization with ideas about synergy and cost saving. In making the deal, Buffett told Ed and Jon Bridge that they would continue

to be in charge. The Bridges gave a bonus to hundreds of coworkers who had helped the company achieve its success.

Ben Bridge Jeweler believes that fine jewelry helps create special memories. Ben Bridge is a special jeweler dedicated to personal service. Their store signs proclaims their motto: “Your Personal Jeweler Since 1912”.

This special memory is created with the brilliance of diamonds, the radiance of incredible colored gemstones and the beautiful reflections of precious platinum and gold. They are proud of over 96 years of serving communities with the best in jewelry values and special attention to personal, caring service.

Charlie Munger says, “You don’t have to have perfect wisdom to get very rich - just a bit better than average over a long period of time.” Since 1912, Ben Bridge Jeweler has served its customers well. Ben Bridge Jeweler has more Registered Jewelers and Certified Gemologists of the American Gem Society than any other jeweler in North America. This shows their commitment to longer term professionalism.

What is Ben Bridge Jeweler’s Competitive Advantage? The company has a long time reputation offering assistance on fine, high quality jewelry since 1912. The family business sells fine diamonds, gold, platinum, and has a wide range of the world’s recognizable watch brands. Its professionalism, expertise, and brand recognition has grown over several generations.

Ben Bridge Jeweler’s selection of jewelry is competitively priced. Each diamond is guaranteed to be graded to the standards of the Gemological Institute of America with Certification available. Its brands including Pandora, Mikimoto, Ikuma, and Jessica Fong are well recognized. They are sold with flexible return and trade in policies.

What about Sustainability? One of the profitable brands at Ben Bridge Jeweler is Pandora from Copenhagen.

Brands like Ritani help drive more traffic to retailers' stores. Ritani has teamed up with De Beers brand Forevermark to create a new collection of engagement rings, earrings and pendants. The Ritani Collection features

more than 30 designs in precious metals including platinum and palladium. One of their "hero" rings is available in palladium, gold or platinum and retails for between \$2,490 and \$3,820, not including the centre diamond. Ben Bridge Jeweler is one of ten authorized retailers, also competitors, currently carrying the collection: Underwood's Fine Jewelers, Fink's Jewelers, King Jewelers, Perry's Emporium, Browning & Sons, Zimmer Brothers, and Jewels of Lake Forest.

Ben Bridge Jeweler also sells fine pearls from the Mikimoto brand of south sea pearls. Fine diamonds are mined and also sold in Canada under the Ikuma name. In America, Ben Bridge Jeweler sells these fine diamonds under Ben Bridge signature diamonds, Artcarved, and Love Speak. Fashionable jewelry is also sold from the Jessica Fong brand and the Toscano brand of Italian gold.

Ben Bridge Jewelers recently introduced its own designer brand of perfume called FLAWLESS. The bottle looks like an upside-down diamond. It has a Ben Bridge Signature Diamond shaped cap. It has a clean look and it is a nice aromatic reminder of happy times for customers. Smart in design, the box opens like a ring box, showing off the bottle, and the diamond shape sitting within. Ben Bridge is building its brand impression and building its economic moat.

The customer base of Ben Bridge Jeweler is wide. It sells to customers from all over Asia, Canada, America and Europe. It sells a wide selection of high quality jewelry.

For the past ten years, Ben Bridge has been a member of the Berkshire Hathaway group of profitable well run companies. With personalized customer service, high quality products, customer loyalty, a good reputation, professionalism, and competitive pricing within different market segments, Ben Bridge Jewelers can continue to compete, grow, and profit by being "Your Personal Jeweler."

BENJAMIN MOORE & CO. COMPETITIVE ADVANTAGES

BUD LABITAN WITH MR. JACK WANG CPA, LEXICO ADVISORY

First class high quality beats lesser quality most of the time. Founder Benjamin Moore started the company in 1883. He produced the highest quality paints and finishes and delivered them directly to customers. This is now done through a nationwide network of knowledgeable, customer-friendly retail store operators.

In July of 2000, Bob Mundheim, a director of Benjamin Moore Paint, called Warren Buffett to ask if Berkshire might be interested in acquiring it. Buffett knew Mundheim from Salomon, where he was general counsel during some difficult times. Warren Buffett and Charlie Munger met with Richard Roob and Yvan Dupuy, past and present CEOs of Benjamin Moore. They liked them and the business, so, they made a \$1 billion cash offer on the spot.

Benjamin Moore has been making paint for over 128 years and has thousands of independent dealers that are a vital asset to its business. Years before government requirements, the Benjamin Moore Company eliminated lead, formaldehyde, and mercury from its paints. In eight research and development laboratories at the 80,000-square-foot facility in Flanders, New Jersey, more than 100 chemists, chemical engineers, technicians, and support staff ensure that Benjamin Moore formulations are best in class, whether commercial or premium coating.

Each Benjamin Moore lab focuses on a different area of expertise, from evaluating color standards to enhancing high-performance coatings designed for industrial facilities. They continually test and improve existing products before they go to market. And, they continually research and develop new products to meet customers' needs.

This commitment to research and innovation led Benjamin Moore to a number of industry firsts: the introduction of the first eggshell interior finish in 1972; the first Computer Color Matching System in 1982, now an

industry standard; the first pearl interior finish in 1988; and EcoSpec®, low-VOC/low-odor latex paint, which earned both the GREENGUARD Environmental Institute and Green Seal® certificates. Low-VOC means low volatile organic compounds.

In testing, Benjamin Moore's outdoor "test farm", they subject coatings to every kind of weather condition for months or even years. Data gathered from more than 22,000 panels provide their chemists with invaluable insights and information.

Benjamin Moore's competitive advantages lie in its product quality and reputation in the industry and its ability to deliver them directly to customers through a nationwide network of knowledgeable, customerfriendly retail store operators.

Are the advantages sustainable for the next 10 years? Benjamin Moore should be able to sustain its product differentiation competitive advantages for the next 10 years. It has devoted tremendous resources into its product research and development at its labs in New Jersey, with more than 100 chemists, chemical engineers, and technicians.

Benjamin Moore enjoys great loyalty among architects and designers, who depend on its products to inject colors that are unbeatable for accuracy, beauty, and transformational properties.

Since 1883, Benjamin Moore has developed independent retailers with 4,000 strong, comprising 1,200 Signature Stores (and growing) plus more than 3,000 paint and decorating stores, hardware stores, and lumberyards. Nevertheless, the company has to take extreme caution against the foreign imports especially the quality Japanese paint manufacturers such as Nippon Paint. It might also face strong domestic competition from Kelly-Moore Paint Company and the Sherwin-Williams Company. Thus, it must continue to build both its special brand identity of high quality premier paints and finishes.

The better the resins and colorants, the better the paint. Benjamin Moore creates and manufactures its own special resins. This is a key component of its competitive advantage. Resins are the binders that make the film and finish of a paint. Colorants are the pigments that give the paint its unique color and hiding characteristics. Then they take these proprietary

ingredients and custom-formulate them to optimize their performance in each product. The secret behind the superior performance of Benjamin Moore coatings: extraordinary application properties, durability, scrubbability, and longevity.

A few key events in its economic moat building history include:

1883 - Moore Brothers start in Brooklyn, New York, with one product, "Moore's Prepared Calsom Finish," and a commitment to sell its paints through independent retailers.

1907 - Benjamin Moore & Co. hires its first chemist and establishes its research department.

1957 - Regal® Wall Satin® Latex Interior Paint is introduced. The DIY, "Do It Yourself" decorating market grows.

1972 - Regal® Aqua Velvet®, a low gloss latex based paint that gives an eggshell with excellent scrubbability. An industry first.

1976 - In collaboration with the National Park Service (NPS) Benjamin Moore creates its Historic Colors Collection with colors from the archives of the NPS and its historic house sites.

1982 - Moore's® Computer Color Matching System is introduced, another industry first. No longer is color choice limited to chips.

2000 - Benjamin Moore & Co joins the Berkshire Hathaway family of companies.

2002 - Benjamin Moore & Co starts the Signature Store Program, designed to create a world class shopping experience.

2003 - Regal® Matte merges great colors and a flat sheen with a level of durability and a proprietary stain release resin.

Color Lock® technology in the new Aura® paint and water-borne colorant system sets the new gold standard for VOC compliance; color matching; fast, easy application; durability; and performance.

Charlie Munger said, "We've really made the money out of high quality businesses. In some cases, we bought the whole business. And in some cases, we just bought a big block of stock. But when you analyze what

happened, the big money has been made in the high quality businesses. And most of the other people who've made a lot of money have done so in high quality businesses."

What else makes Benjamin Moore such an enduring franchise? Its brand is known as a first-class high quality paint. Substitutes are thought of as being inferior, and Benjamin Moore has brand pricing power. Warren Buffett said, "Benjamin Moore's prime objective: first-class paint at all times. Better tomorrow than yesterday."

BERKSHIRE HATHAWAY GROUP COMPETITIVE ADVANTAGES BUD

LABITAN WITH BRIAN GREISING, MAINSTREET ADVISORS AND

AND RICK MAYHEW

Simple, direct, reliable, and strong are desirable qualities. The Berkshire Hathaway Group (BHG) maintains its economic moat by controlling costs and selling an SPIA, Single Premium Immediate Annuity and an SPDA, Single Premium Deferred Annuity directly to the public via its website (brkdirect.com).

The business behind life insurance can be complex. Consumers can find themselves questioning the actual practices of these instruments.

Consider a single-premium deferred annuity, SPDA. Many of BHG's competitors often lure in consumers by offering a policy that seems to outperform. Unfortunately, policyholders are often guaranteed what is termed, "teaser rates" in order to entice consumers to invest in higher risk policies. Such policies often guarantee a higher rate of return for the first few years. Then their rates thereafter become susceptible solely to a company's needs at that company's discretion. Ultimately, the issuing company is going to strive towards recovering the money spent from attaining that policy. Herein lays the agency issue, where a clear conflict of interest exists between the two parties. In an attempt to offset this, consumers can try to find an agent whom they trust to examine all such

intricacies in their policy. However, this will come at a cost. Typically, these commissions are very high, totaling 5-7% for annuities, and the entire first year premium cost in life insurance.

Why invest in a BRK Direct SPIA, Single Premium Immediate Annuity? The financial security of your insurer should be a key consideration in your purchase decision. As a member of the Berkshire Hathaway group of insurance companies, BRKDirect offers exceptional financial strength. Often times, the companies that credit high "interest rates" do not have high financial ratings.

Berkshire Hathaway Life Insurance Company of Nebraska, your annuity provider, is rated AA+ (Very Strong) by Standard & Poor's and A++ (Superior) by A.M. Best. Annuities in the State of New York are issued by First Berkshire Hathaway Life Insurance Company, which is not yet rated, but it will be guaranteed by Berkshire Hathaway Life Insurance Company of Nebraska.

Because BRK Direct sells its product directly, it can offer a more competitive interest rate to the buyer. They do not pay an agent or broker any of the premium invested. Therefore the buyer's entire premium is put to work for the buyer.

BRK Direct will credit the annuity contract with an interest rate that is equal to the yield of a comparable U.S. Treasury strip. This interest rate is fixed for the life of the contract and cannot change. The rate is fully guaranteed and BRK Direct does not adjust the manner in which this rate is set for any reason.

Why invest in a SPDA, Single Premium Deferred Annuity? The basic answer is "Tax Advantages." Traditional savings are taxed each year whether the buyer spends the earnings or not. The SPDA, being a "deferred" annuity postpones that tax, enabling the buyer to earn extra interest on their money. By postponing income taxes, the buyer's money compounds faster, making it possible to increase the buyer's income during the buyer's retirement years. This is often referred to as "the power of tax-deferred earnings". In this way, an SPDA works like a 401(k), IRA, or Keogh plan. Given this tax feature of an SPDA, BRK Direct does not recommend that the buyer purchase this product with before-tax dollars

(e.g. 401(k), IRA and Keogh plans) as the tax advantages would be eliminated.

Another tax-favorable aspect of an SPDA is that the buyer may be in a lower tax bracket at the Maturity Date, than the buyer was when the buyer purchases the SPDA, enhancing the buyer's taxable equivalent return.

Note that there is no limit on the amount that the buyer can invest. Unlike 401(k), IRA, or Keogh plans, there is no limit on the amount the buyer can invest in an SPDA. The buyer determines their level of comfort in their retirement planning process and the buyer makes an investment decision based upon the buyer's needs, not IRS limitations.

There is an option to annuitize the contract value. The buyer has the option to convert an SPDA into a Single Premium Immediate Annuity (SPIA) for pay-out purposes on the Maturity Date. This process, known as "annuitizing the contract value", allows for further tax-deferral. The taxes payable on an SPDA at maturity can be paid over time with the periodic payments from an SPIA instead of all at once at the Maturity Date of the SPDA.

The Berkshire Hathaway Group understands these issues and implements a unique business practice. When looking to protect the ones closest to us, security and clarity are crucial. The Berkshire Hathaway Group has ventured to simplify and deliver a quality life insurance product. All policies issued by BHG are rated at levels of "A++" by A.M. Best or "AA+" by Standard & Poor's.

With the tightening of regulations during this anemic economy, the leading rating agencies will be heavily utilized to ensure the legitimacy of the quality of business practices. With BHG's policies having such high ratings by these agencies, consumers are assured that their longterm position will be rewarded. Additionally, these policies offer fixed terms, so the consumer knows what the value of their policy will be at all times, without variation. Preset calculations of the policies' value can be performed directly on the website. This website, brkdirect.com, avoids using agents. Therefore, this eliminates commissions, further benefitting policy holders with cost savings.

Ultimately, BHG minimizes the risk involved by eliminating the common detractors to the insurance business. The company aligns its interests with their consumer's interests. BHG delivers an easily understood, guaranteed, quality product, which is sold directly to the consumer. In terms of selling a quality product tailored to providing maximum value with very low risk, BHG is arguably the best in the industry.

Are these competitive advantages sustainable for the next 10 years? Yes, BHG is a financially strong competitor. Given the current market conditions and the heightened level of economic uncertainty, volatility is stressful on the system. Market values are fluctuating with the ongoing concerns of the recent downgrade of the U.S. government by the S&P, and the looming debt crisis in Europe.

Keeping in mind that insurance companies make significant portions of their money through investing the premiums collected into the market, insurance policies may be considered more risky during the market's current volatility. Therefore, it is crucial that buyers seeking insurance policies allocate their money towards insurance companies that have highly rated financial positions and able trustworthy managers.

Charlie Munger has said, "I m glad we have insurance, though It's not a no-brainer, I'm warning you. We have to be smart to make this work." Knowing that BHG is rated very highly by two accredited rating agencies provides additional credibility to the group. The most attractive aspect of BHG is that the company aligns its interests with that of the consumer. BHG looks to save the consumer money in removing the need for insurance agents by implementing its user friendly web site. They also only offer policies with fixed terms, so the consumer knows exactly what their policy is worth at all times. This type of policy structure avoids the confusion derived from the variable rated, frequently misconstrued, policies that are sold by many competitors.

BHG offers safe, clearly defined policies, while also avoiding unnecessary charges to the consumer. As a subsidiary of Berkshire Hathaway, it has strong financial backing and strong investment management capabilities. Therefore, a customer would not be inclined to switch or find a substitute provider. So, we believe the BHG, (brkdirect.com), run as designed, will continue to prosper and be highly competitive in the years to come.

BERKSHIRE HATHAWAY HOMESTATE COMPANIES COMPETITIVE ADVANTAGES

BUD LABITAN WITH BERYL CHAVEZ LI, UNIVERSITY OF MANCHESTER

Guarantors must be strong and reliable. The Berkshire Hathaway Homestate Companies (BHHC) is a group of six regional insurance carriers that are part of the Berkshire Hathaway Insurance Group. Each has earned an A++ Rating from A.M. Best.

Headquartered in Omaha, Nebraska, BHHC has evolved from a midwestern regional carrier to a multi-state insurance group writing a diverse book of policies from coast to coast. The “Homestate Companies” are comprised of these six insurance companies: Brookwood Insurance Company, Continental Divide Insurance Company, Cornhusker Casualty Company, Cypress Insurance Company, Oak River Insurance Company, Redwood Fire and Casualty Insurance Company.

This combination of unparalleled financial strength and superior claims paying ability sets BHHC apart from its competitors. In fact, BHHC’s policyholders’ surplus surpasses all other property & casualty insurance groups.

BHHC offers a wide portfolio of products for main street businesses as well as more difficult to place specialty risks. By focusing on specific business segments, BHHC continues to develop its expertise in underwriting, pricing, and claims. This approach results in better service, lower claims costs, and competitive premiums for policyholders. The main bulk of business is made up of five insurance products: Workers Compensation, Commercial Auto, Construction, Commercial Property, and Commercial Package insurance.

After some ups and downs over the years, able and trustworthy managers have built a stronger book of business with a well-functioning group of employees. BHHC entered the specialized area of surety reinsurance. A surety or guarantee, in finance, is a promise by one party (the guarantor) to assume responsibility for the debt obligation of a borrower if that

borrower defaults. The person or company that provides this promise is also known as a surety or guarantor.

Warren Buffett said: “We are pleased by the quality of the insurers we have attracted, and hope to add several more of the best primary writers as our financial strength and stability become better known in the surety field.”

Many years ago, BHCC had serious problems in the Homestate operation. The poorest performer had been Insurance Company of Iowa, at which large losses were sustained annually since its founding in 1973. So, they abandoned underwriting in that state, and merged the company into Cornhusker Casualty. At that time, Buffett said: “There is potential in the homestate concept, but much work needs to be done in order to realize it.” Buffett said that the insurance business will experience periods of some disappointments.

Medical Protective was also added to this insurance group, and it is covered in a separate chapter. After buying MedPro, they increased the loss reserves of MedPro by about \$125 million immediately after purchase. Buffett said: “No one knows with any precision what amount will be required to pay the claims we inherited. Medical malpractice insurance is a “long-tail” line, meaning that claims often take many years to settle.”

In his letters, Buffett has mentioned great managers that have included Rod Eldred of Berkshire Hathaway Homestate Companies, John Kizer of Central States Indemnity, Tom Nerney of U. S. Liability, Don Towle of Kansas Bankers Surety and Don Wurster of National Indemnity.

Each of the six regional insurance carriers in Berkshire Hathaway Homestate Companies's (BHHC) insurance companies have earned an A++ Rating from A.M. Best. This combination of unparalleled financial

strength and superior claims paying ability sets the company apart from its competitors. In addition, the Berkshire Hathaway Insurance Group's policyholders' surplus surpasses all other property & casualty insurance

groups. It provides compassionate care to injured workers, superior service to its policyholders and producer clients.

BHHC provides a high level of customer service and integrity to its clients. It continuously adjusts its services to meet the demands of the changing market. Moreover, it cherishes its unparalleled values imbedded on its mission of service.

Are these competitive advantages sustainable for the next 10 years? BHHC has been providing workers' compensation insurance to businesses for over 30 years. There is an increasing demand for superior customer service. The increasing population means that there will be a growing demand for insurance services. Given Berkshire Hathaway Homestate Companies's ability to maintain its credit ratings, BHHC can continue to develop its expertise in underwriting, pricing, and claims.

Charlie Munger has said, "If you don't keep learning, other people will pass you by. Temperament alone won't do it - you need a lot of curiosity for a long, long time." BHHC has a history of adjusting and enhancing its services to meet the demands of the changing insurance market. It builds its economic moats. Since BHHC carefully adjusts its services to meet the demands of the changing market, we believe that BHHC will continue to be a leading competitor in the areas of Workers Compensation, Commercial Auto, Construction, Commercial Property, and Commercial Package insurance.

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BOATU.S. COMPETITIVE ADVANTAGES

BUD LABITAN WITH PETER CHEN, SINGAPORE

Want a "big moat" reliable insurance provider for your recreational boat? Boat America Corporation has a unique economic moat that is tightly coordinated with the interests of recreational boaters.

In 2007, Boat America Corporation was purchased by National Indemnity, a subsidiary of Berkshire Hathaway. Boat America Corporation is the main supplier of towing, insurance and other services to the nonprofit boater's association, BoatUS.

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BoatU.S. and Boat America have been associated as one entity. Both have been legally distinct organizations. Boat America Corp. is the for profit supplier of towing, insurance and other services to the nonprofit boat owners' association, BoatUS, which has 650,000 members.

The nonprofit boat owners' association manages an association of about 650,000 boat owners, providing those services similar to those offered by AAA auto clubs to drivers. Among the association's offerings is boat insurance.

Boat Owners Association of The United States, BoatUS, is a non-stock association incorporated under the laws of the District of Columbia. Members are listened to intently, and drive many changes in BoatUS programs and policies. But, they but do not have a "legal" say in running the organization. BoatUS officers direct the Association activities. The officers are elected by a Board of Directors and receive advice from a National Advisory Council (NAC). A minority of the BoatUS Board is employed by Boat America Corporation.

Also affiliated with BoatUS is the BoatUS Foundation for Boating Safety and Clean Water, a 501(c) (3) charitable organization that is funded mainly through voluntary tax-deductible donations from BoatUS

members. It also receives grants from the U.S. Coast Guard, NOAA and other organizations.

The Association currently has two registered lobbyists on staff who actively lobby on federal and state issues directed at protecting and enhancing the interests of recreational boat owners.

BoatUS is an American association of boat owners offering boat insurance and boat loans, discounts on boating-related products and services, mediation services with manufacturers and dealers, a product recall alert registry, and lobbying on behalf of boat owners.

Boat America Corporation's competitive advantages include: 1) big scale: tight collaboration with the nation's largest recreational boating association; 2) widest coverage: the largest fleet of tow boats ready for 24/7 to assist customer. 3) An award-winning magazine that provides the unique boating information. 4) Low cost recreational boat insurance.

Are these advantages sustainable for the next 10 years? Yes. Among all the boating associations, BoatUS has the widest recognition. BoatUS Membership is close to 1 million and growing. With its large scale and widest coverage, BoatUS is a better choice for most boat owners when compared to other boating service providers.

The combined services from both parts (forprofit and nonprofit) of BoatUS strengthen customer loyalty. Charlie Munger has said, "We don't train executives, we find them. If a mountain stands up like Everest, you don't have to be a genius to figure out that it's a high mountain."

We believe that Boat America Corporation is a high mountain in its field. Boat America Corporation has a unique economic moat that is tightly coordinated with the interests of recreational boaters. Thus, run honestly and efficiently, it should continue to serve all stakeholders well.

BORSHEIM'S FINE JEWELRY COMPETITIVE ADVANTAGES

BUD LABITAN WITH TARIQ KHAN, UNO-CBA

Borsheim's strong single store sells a huge volume of value. Borsheim's single 62,500 square foot store anchors the upscale Regency Court mall in Omaha.

In the 1989 Letter, Warren Buffett said “NFM and Borsheim's follow precisely the same formula for success: (1) unparalleled depth and breadth of merchandise at one location; (2) the lowest operating costs in the business; (3) the shrewdest of buying, made possible in part by the huge volumes purchased; (4) gross margins, and therefore prices, far below competitors'; and (5) friendly personalized service with family members on hand at all times.”

In the Great Recession of 2009, Borsheim's needed to implement many cost-cutting measures. It was necessary to lay off employees for the first time in the store's 100-year-plus history. Borsheim's President Susan Jacques said: "The loss of our staff members is devastating. This is the absolute last thing we wanted to do. While we are hopeful that we might see signs of an economic recovery, we had to make extremely difficult decisions out of a fiduciary responsibility to Berkshire Hathaway and its shareholders to continue to remain profitable despite these challenging times.”

Borsheim's company mission is "exemplary customer service" and it attracts business nationwide because of having several advantages that competitors can't match. Warren Buffett wrote that “the most important item in the equation is our operating costs, which run about 18% of sales compared to 40% or so at the typical competitor... Just as Wal-Mart, with its 15% operating costs, sells at prices those high-cost competitors can't touch and thereby constantly increases its market share, so does Borsheim's.

Borsheim's Fine Jewelry - otherwise known as Borsheim's – has many competitive advantages spelled out by Warren Buffett in his annual letters. Primary amongst these is Borsheim's approach to have a single store with a vast inventory to provide the largest of selections across a vast range of prices; unparalleled depth and breadth of jewelry products.

Expenses are kept extremely low allowing for the lowest operating costs in the business. Having the lowest operating costs in the business is declared the key to the business allowing low prices and huge sales volume; thus allowing them to carry their vast inventory. Tremendous intelligence is focused on buying which was declared to be “shrewd” and made possible by purchases in large volumes. Rapid product turnover is a must and gross margins, and subsequently prices, are placed far below those of the competition. The store’s philosophy matches the famous Nebraska Furniture Mart motto of “sell cheap and tell the truth.” Top store management focuses on attention to detail daily and enforce a friendly and personalized customer service. Superb service and maintaining a family-friendly atmosphere is declared as the company’s mission.

A few other advantages also exist. These competitive advantages are the store’s sense of uniqueness or exclusivity - having only one location. For a city like Omaha, Nebraska the store represents a clear departure for the normal Midwestern shopper, for even high-end shoppers. The store has a vast number of items, but also items in the truly high-end spectrum. For elite buyers, a trip to the store has come to represent more than just a purchase of incredible quality jewelry, but a near symbolic tribute to Warren Buffett. The reception held there each year for the Berkshire shareholders is a one of a kind market where the world’s top jewelry designers display and trial their very best pieces.

Borsheim’s advantages are sustainable for many years to come. The store resides in the hometown of Warren Buffett and has become a symbol and a Mecca for his admirers. Its location in Omaha, in the American Midwest, adds to its sense of character, charm, and value based appeal of American success and capitalism. The store has an amazing reputation as a place where an average Midwestern shopper can view and try on, a million dollar piece of jewelry. It is thus nearly impossible to imagine any competitor trying to replace Borsheim’s.

Borsheim’s has had amazing managers. Think about what Charlie Munger said, “Management matters... You do get an occasional opportunity to get into a wonderful business that’s being run by a wonderful manager. And,

of course, that's hog heaven day. If you don't load up when you get those opportunities, it's a big mistake."

Borsheim's competitors would struggle to compete with it in terms of cost. Between low-end jewelry stores and ultra-boutique high priced jewelry artists, there exists such a gap in cost between Borsheim's and its competitors that they simply cannot compete head on. Differentiation may be the only attack front for this class of jewelry stores. To differentiate from Borsheim's, competitors would likely need to attempt to woo customers using products and branding that is either much more "popular" in terms of youth branding or appeal, or exclusive in terms of high end, pricing, or location. Younger generations may find the associations of Borsheim's to the Midwest or to Omaha as being too quaint and colloquial. Celebrity endorsements may attract these purchasers via heavy advertising campaigns. Other customers, especially international consumers, might prefer to stores like Tiffany & Co. in large cities like New York City or Paris. However, Borsheim's is here to serve, compete, and prosper.

BUFFALO NEWS COMPETITIVE ADVANTAGES

BUD LABITAN WITH PETER STEIN AND EXCERPTS FROM MR. BUFFETT'S WRITINGS.

A dominant local provider of high quality news adjusts to the new realities of the industry.

Business fundamentals are eroding in the newspaper industry due to increased competition from the Internet, TV, and Cable TV. However, when Warren Buffett and Charlie Munger were young, the newspaper business made huge returns for owners. Buffett said, "No paper in a one-paper city, however bad the product or however inept the management, could avoid gushing profits."

Buffett wrote about the old days of newspaper economics, when a paper had pricing power: "When two or more papers existed in a major city, the one that pulled ahead usually emerged as the stand-alone winner. After competition disappeared, the paper's pricing power in both advertising and circulation was unleashed. Typically, rates for both advertisers and readers would be raised annually, and the profits rolled in. For owners this was economic heaven."

In 1977, the Buffalo News came up for sale and both the Washington Post Co. and Chicago's Tribune Co. turned down. Were they discouraged because the Buffalo News was an evening paper? The Buffalo News was also a six-day evening publisher, with no Sunday edition, competing against a seven-day publisher, the Courier-Express.

The Buffalo News was the stronger of the two during the week, and Buffett concluded the paper would do well if it could establish a Sunday edition. He started to publish on Sunday after buying the paper for \$32.5 million. Both papers went for years losing money and then, in 1982, the Courier-Express closed down.

At the time, the Buffalo News had the competitive advantage of delivering one page of news for every page of advertising, a proportion not matched by any other prosperous papers.

Buffett and Munger understand that not all businesses are destined to increase profits. Said Buffett, “When an industry’s underlying economics are crumbling, talented management may slow the rate of decline. Eventually, though, eroding fundamentals will overwhelm managerial brilliance.”

For most of the 20th Century, newspapers were the primary source of information on sports, finance, politics, or weather for the American public. Their advertising was the easiest way to find job opportunities or to learn the price of groceries. The majority of families therefore paid for a daily paper.

As early as his 1991 letter to shareholders, Buffett asserted that “the media businesses . . . will prove considerably less marvelous than I, the industry, or lenders thought would be the case only a few years ago... Now, almost all newspaper owners realize that they are constantly losing ground in the battle for eyeballs. Simply put, if cable and satellite broadcasting, as well as the internet, had come along first, newspapers probably would never have existed.”

In Berkshire’s world, Buffett praised Stan Lipsey and Margaret Sullivan for doing a great job running the Buffalo News. The Buffalo News’ penetration of its market is the highest among that of this country’s large newspapers. It has done better financially than most metropolitan newspapers, even though Buffalo’s population and business trends are not good. Said Buffett, “Nevertheless, this operation faces unrelenting pressures that will cause profit margins to slide... True, we have the leading online news operation in Buffalo, and it will continue to attract more viewers and ads. However, the economic potential of a newspaper internet site, given the many alternative sources of information and entertainment that are free and only a click away, is at best a small fraction of that existing in the past for a print newspaper facing no competition.

There is no rule that says a newspaper’s revenues can’t fall below its expenses and that losses can’t mushroom. Fixed costs are high in the

newspaper business, and that's bad news when unit volume heads south. ... Unless we face an irreversible cash drain, we will stick with the News. Charlie and I love newspapers. We each read five a day, and believe that a free and energetic press is a key ingredient for maintaining a great democracy. We hope that some combination of print and online will ward off economic doomsday for newspapers, and we will work hard in Buffalo to develop a sustainable business model. I think we will be successful. But the days of lush profits from our newspaper are over."

What are the Buffalo News competitive advantages? The Buffalo News is the only major paper in the Buffalo, NY area. It has been a dominant presence for the news in Buffalo for decades and will likely continue to be the area's source for high quality news. Moreover, because Buffalo has suffered a population decline, the world is full of former Buffalo residents. Many of these former residents still feel an attachment to the Buffalo News. The internet has allowed many former residents to be able to go to the BuffaloNews.com. While this may not seem like a big deal, Buffalonians are a loyal group, as shown in the city's sports teams.

It is unlikely that the Buffalo News will ever be dethroned as the premier source for news in the Western New York Area. However, when it comes to profit margins, the Buffalo News, just like all newspapers, has suffered tremendously in recent decades.

Are the competitive advantages sustainable? As Buffett explained in his 2006 letter, the newspaper industry as whole has seen declining profitability. With the increasing diversion of readers to the internet sites, traditional regional newspapers will have a difficult time fending off the competition. The Buffalo News MOAT has shrunk.

A new website can be set up for a fraction of the set up costs for a competing newspaper. Munger said, "Every newspaper is scrambling to parlay their existing advantage into dominance on the Internet. But it is way less sure, that this will occur, than the certainty 20 years ago that the basic business would grow steadily, so there's more downside risk. The perfectly fabulous economics of this business could become grievously impaired."

Warren Buffett mentioned that regional newspapers will still have value. They will simply be lower margin businesses that must maintain high quality of content and service.

Recently, in November 2011, Berkshire Hathaway Inc. acquired the Omaha World-Herald Co., publisher of Buffett's and Munger's hometown newspaper. The reported price is \$150 million plus assumption of \$50 million of World-Herald debt. Buffett said, "It's not a crazy price... and it certainly is not a bargain." It is a fair price.

The deal would give Berkshire control of the World-Herald, six other daily newspapers and several weekly newspapers across Nebraska and southwest Iowa. Sellers include employee shareholders and the Peter Kiewit Foundation. Buffett told employees that newspapers "have a decent future, but it won't be like the past. There are still a lot of things newspapers can do better than any other media."

Regional newspapers still have value. They have local reporters who have deeper knowledge of local issues and history. Regional newspapers will simply be lower margin businesses due to increased competition. Their economic moats have shrunk. So, they must cut costs and be run efficiently. They must maintain high quality content and provide good customer service.

BURLINGTON NORTHERN SANTA FE CORP. COMPETITIVE ADVANTAGE

BUD LABITAN WITH DAVID LEOY, BUSINESS ANALYST, SINGAPORE

A big railroad system became more efficient. The highlight of 2010 was the acquisition of BNSF. Said Buffett, "It now appears that owning this railroad will increase Berkshire's "normal" earning power by nearly 40% pre-tax and by well over 30% after-tax. Making this purchase increased our share count by 6% and used \$22 billion of cash. Since we've quickly replenished the cash, the economics of this transaction have turned out very well."

Charlie Munger commented, "We used to not like them (railroads) because they needed large amounts of capital, had tough unions, and stiff

competition from the trucking business. The paradigm had shifted. Now the railroad industry has a competitive advantage in energy use efficiency and double-stacking freight.”

Railroads now have major cost and environmental advantages over their main competitor, trucking. BNSF moves each ton of freight a record 500 miles on a single gallon of diesel fuel, which is three times more fuelefficient than trucking. Our country gains because of reduced greenhouse emissions and a smaller need for imported oil. Over time, the movement of goods in the United States will increase, and BNSF should get its full share of the gain. The BNSF railroad will need to invest capital massively to bring about this growth, but no one is better situated than Berkshire Hathaway to supply the funds required.

Railroads profit from longer hauls. They have sold or leased short runs to independent short-line railroads, which pay a percentage of the haul to the major railroads. So, the major railroads have eliminated the less profitable short-line business. The Staggers Act in 1980 deregulated railroads and allowed them to set rates to compete with trucking. Railroad managements negotiated with the unions, resulting in standard trains having two rather than five people on board. And, railroad maintenance costs have been lowered by automation and mechanization.

Low-sulfur coal mined in Powder River, Wyoming is transported to electric plants around the country. Wyoming coal is also shipped to Birmingham, Alabama three times a week in 132 coal gondola cars. This train has three big engines on the front and two pushing engines in the back. After unloading in Birmingham, and without turning the unit around, the two rear engines lead the train back to Powder River.

Charlie Munger admitted: “We did finally change our minds and invested. We finally realized that railroads now have a huge competitive advantage, with double-stacked railcars, guided by computers, moving more and more production from China, etc. They have a big advantage over truckers.”

Burlington currently owns over 32,000 miles of track in the United States. It also holds over 6,700 locomotives and 85,000 freight cars. This is a formidable barrier to entry because any competitor would have to spend multi billions in capital expenditure to replicate the BNSF system. There

are also heavy ongoing maintenance capital expenditures, estimated to be US \$2.6 billion annually.

Due to the moat around Burlington's business, each time the ocean freight rate differential forces export of grain to the Pacific Northwest ports, Burlington can profit from the shift.

The US government may not spend enough to repair and expand the country's infrastructure. This could then lead to greater highway congestion and force traffic onto railroads. Already the largest intermodal freight hauler in the sector, Burlington is well positioned to further benefit from the shift of freight from highway movement to intermodal. In the latter system, truckers do the pick up and delivery in the last mile while trailers and containers travel long haul by rail.

Are the competitive advantages sustainable for the next 10 years? Despite its debt, Buffett has reiterated his optimism for America's future. Burlington represents his "All in wager" on the economic future of America. BNSF is the workhorse serving more of the nation's major grain producing regions than any other railroad competitor. Besides being the largest transporter of beer and wine by rail in the United States, Burlington transports many industrial goods such as lumber, iron and steel across America. Hence, as long as America thrives and consumes, Burlington will continue to do well.

In a likely era of heightened inflation and elevated oil prices, railroads are preferred over long-haul trucking. Looking ahead, fuel prices are likely to remain high due to scarcity of supply and higher extraction costs. This maintains rail's cost edge. This could also compel America into using and transporting more coal. Currently, more than 10 per cent of the electricity produced in the country, enough to power one out of every ten homes is being generated from coal hauled by Burlington. Furthermore, as the world becomes more environmentally conscious, regulatory policies are tilting more favorably towards the railroad sector. Rail is a more environmentally efficient form of surface transportation. Rail generates only a quarter as much in greenhouse gases. Since a government study revealed that railroads are much more fuel efficient than trucks in carrying goods, regulators are expected to focus on reducing commercial truck traffic and channeling them onto rail.

The increasing consumption of bio-fuels such as ethanol will benefit railways too. Ethanol fuel production in the US has been growing over 30 per cent in recent years. Production hit 13 billion gallons in end 2010. Production capacity and demand for ethanol is likely to further increase with the push towards the use of cleaner energy. Given that ethanol cannot be transported in pipelines, rails will shoulder a substantial portion of the load. The BNSF system has three transcontinental routes. And, BNSF has the best route from Long Beach, California, to Chicago, Illinois.

BUSINESS WIRE COMPETITIVE ADVANTAGES

BUD LABITAN WITH LARRY HARMYCH, CLEVELAND STATE
UNIVERSITY

The largest public relations business for businesses has the largest distribution network. Business Wire is a profitable business that distributes text news releases from thousands of companies and organizations worldwide to news media, financial markets, disclosure systems, investors, information web sites, databases and other audiences.

After reading an article in The Wall Street Journal dealing with Berkshire's unusual acquisition and managerial practices, Cathy Baron Tamraz decided to write Mr. Buffett a letter. She sent Buffett a letter that began, "As president of Business Wire, I'd like to introduce you to my company, as I believe it fits the profile of Berkshire Hathaway subsidiary companies as detailed in a recent Wall Street Journal article."

Buffett felt Business Wire and Berkshire were a fit because he liked this section: "We run a tight ship and keep unnecessary spending under wraps. No secretaries or management layers here. Yet we'll invest big dollars to gain a technological advantage and move the business forward."

Berkshire completed three acquisitions in 2006; PacifiCorp, Business Wire, Applied Underwriters, and ISCAR. Buffett reached agreement with Business Wire's controlling shareholder, Lorry Lokey, who founded the company in 1961.

Lokey had just made Tamraz CEO. Lokey built a company that disseminates information in 150 countries for 25,000 clients. Said Buffett, "His story is an example of what can happen when a good idea, a talented individual and hard work converge."

Business Wire distributes news via its own patented electronic network, NX, developed by its in-house tech team using XML/NewsML. It also has carriage agreements with major news agencies to deliver content directly into the newsroom editorial systems of the Associated Press, Agence

France-Presse, Bloomberg, Dow Jones, Reuters, Thomson One, and some 60 regional news agencies. It was the first service of its type to put its clients' news online, launching the company's website in May 1995.

Business Wire provides direct news feeds along with photo posting to Yahoo! Finance and other information web sites. It offers preset and free fully customized RSS news feeds. In 2007, the company added social media networking "tags" to news releases. The company's EON: Enhanced Online News service provides a platform for news announcements utilizing a variety of technologies.

Business Wire is an authorized disclosure vehicle in the US and Canada (with news networks, EDGAR filings and SEDAR filings), the UK (with Financial Securities Authority-sanctioned (FSA) services), France (with Autorité des Marchés Financiers-sanctioned (AMF) services) and other European markets.

In 2007, Business Wire established a European disclosure service designed around the European Union's Transparency Obligations Directive (TOD) requirements. This financial disclosure service also posts full-text news releases directly into major professional and individual investor systems. Journalists can set up personal web, RSS and email news feeds based on their specific beat criteria.

In anticipation of the implementation of the European Union's Transparency Obligations Directive (TOD), Business Wire established Regulatory Disclosure networks in France, Sweden, Switzerland and Luxembourg. On June 1, 2005 Business Wire entered the German AdHoc market with a disclosure network for companies with primary or secondary listings on the Deutsche Boerse.

On January 10, 2005, Business Wire established an Asian hub with the opening of its Tokyo bureau, and later that year added Japanese, making the site available in seven languages. On September 27, 2006, Business Wire and Vocus, Inc. (NASDAQ:VOCS) announced the two companies had entered into a strategic partnership in which Business Wire would use a private label version of Vocus' PRWeb press release distribution platform to provide a new search engine optimized (SEO) and social media distribution service. The platform is called EON: Enhanced Online News.

On January 1, 2007, the French Financial Markets Regulator approved Business Wire to operate as a Regulatory Disclosure Service in France.

On April 24, 2007, the United States Patent and Trademark Office awarded 'NX' Patent N. 7069244 to Business Wire for its simultaneous network news distribution capabilities.

Business Wire has been in the PR business since 1961, and it was the first to launch online press releases in May of 1995, giving it first-mover advantage. It has also developed a niche based on its brand as a trusted distribution source due to its high-quality service. It has patents and authorization in both US and Canada and is an authorized disclosure vehicle in France, Germany, Ireland, Luxembourg, the Netherlands, Sweden and Switzerland. Business Wire is the most connected out of all of the news wire services with more back links than any other news wire. Business Wire has only one significant rival: PR Newswire. Additionally, in October of 2000, the SEC implemented a ruling that required companies to disclose information simultaneously if the information is market-moving, though the ruling was amended in May of 2009 which has allowed for other distribution sources.

Are these advantages sustainable over the next ten years? The SEC ruling has been changed in recent years: allowing some companies, such as those listed on the NYSE and NASDAQ, to file a Form 8-K or use other widely-disseminated information dispersing techniques, such as conference calls and webcasts, instead of issuing press releases. However, old habits die hard and if a company wants to ensure simultaneity and security of an announcement, and meet the SEC's Regulation FD, the only sure-fire way to do so is through a press release. In fact, the NYSE still encourages the use of a press release for material information even if it is not required by law. If there's any threat it comes from the influx of low-cost competitors into this space. However, Business Wire charges a premium because it is the most trusted name with the largest distribution network.

Charlie Munger once said, "One great advantage of scale taught in all of the business schools of the world is cost reductions along the so-called experience curve. Just doing something complicated in more and more volume enables human beings, who are trying to improve and are motivated by the incentives of capitalism, to do it more and more

efficiently... The very nature of things is that if you get a whole lot of volume through your joint, you get better at processing that volume. That's an enormous advantage. And it has a lot to do with which businesses succeed and fail.”

Most businesses, especially larger companies that issue more press releases, will choose quality over price. So, while the Business Wire moat may be drying up a bit; to some extent it isn't likely to dry up overnight. Especially, if it can remain a trusted and able brand.

BYD COMPETITIVE ADVANTAGES

BUD LABITAN WITH KEVIN WALSH, UNO-CBA

Having huge cost and talent advantages, BYD is a leader in making and selling electric cars, mobile phone batteries, and solar power panels.

Charlie Munger described BYD's founder Wang Chuan-Fu as "a combination of Thomas Edison and Jack Welch." Munger suggested to Buffett that Berkshire Hathaway invest in BYD. After unsuccessfully attempting to buy 25% of BYD, MidAmerican Energy Holdings Co., a unit of Berkshire Hathaway Inc., first bought 9.9 percent of BYD for \$230 million in 2008.

After BYD went public, Wang took approximately 15% of his holdings in BYD and distributed the shares to about 20 other executives and engineers. He owns about 28% of the shares. Wang Chuan-Fu's objective is to build the BYD brand and open doors to the U.S. market, but only give up 10% of his company. Buffett may not understand batteries or cars; however, he understands Wang Chuan-Fu's "drive" and BYD's cost of production advantages.

Wang Chuan-Fu is a chemist and researcher who founded BYD in 1995 in Shenzhen, China. The letters BYD are the initials of the company's Chinese name, but it has also come to stand for "Build Your Dreams."

Initially, Wang took batteries from Sony and Sanyo and reverse engineered them to see how they worked. This led to unsuccessful patent infringement suits from both of these companies. BYD became one of the world's largest

manufacturers of cell phone batteries and accessories, designing and manufacturing mobile-phone handsets and parts for companies such as Motorola (MOT, Fortune 500), Nokia (NOK), Sony, Ericsson, and Samsung.

BYD entered the automobile business in 2003 by buying a dying Chinese state-owned car company. Then, the BYD F3 became the bestselling sedan in China. It now sells a plug-in electric car with a backup gasoline engine called the F3DM. The DM stands for "dual mode" and it can travel 62 miles on a single charge. BYD currently employs people in China, India, Hungary, Romania, along with a few employees in the United States.

One of BYD's competitive advantages was developed when Wang decided to substitute migrant workers for machines. Instead of the \$100,000 robotic arms used on Japanese assembly lines BYD was able to cut costs by employing thousands of people. Wang claims that this human resource advantage is the most important part of BYD's strategy.

Unlike most automakers, BYD manufactures nearly all its cars components by itself. BYD can afford to hire thousands because current salaries in China are a small fraction of those in Western economies. BYD engineers investigate a wide array of technologies.

The company is committed to making an environmentally friendly battery. BYD managers and engineers invent and design new products around their core competence in battery technology. The company employs over 10,000 engineers who have graduated from China's best schools. By 2002, BYD had become the largest Chinese manufacturer in Li-Ion, NiCad, and NiMH rechargeable battery technologies.

The company culture is frugal and their attention to costs is one reason that BYD has profited as it has expanded into new businesses. In electric cars, the single largest cost is the battery. The quest to design and make a large, safe, reliable, long-lasting, and fast-charging battery is complex and costly. BYD claims to have created a new superior type of lithium ion ferrous phosphate technology.

BYD currently competes on car price, and not quality in Africa, South America, and the Middle East. Critics say that the fit and finish of the company's cars need improvement.

BYD's strategy for their dual-mode hybrids is to sell the E3 and the E6 first to China's fleet users: government, post office, utilities, and taxi companies. China will build new central fast-charging facilities.

Europe, with its high gas prices, is the most promising export market for BYD's electric cars. Wang contracted Autobinck, a Dutch dealer group, to sell cars in the Netherlands and five Eastern European countries. While the economics of electric cars in the U.S. are not yet as compelling, BYD might focus on becoming a battery supplier to global automakers.

BYD researchers are also developing a set of rooftop solar photovoltaic panels with built in batteries to store power. Wang is also focused on building a stronger executive team.

The carmaker raised HK \$1.4 billion (\$180 million) in an initial public offering in Hong Kong in July 2002 by selling shares at HK \$10.95 each.

Shenzhen-based, BYD recently issued more stock in the mainland stock market to raise more funds for expansion. The company said it would raise 1.42 billion yuan (\$219 million) by selling 79 million shares at 18 yuan apiece in its Shenzhen, China share sale.

BYD planned to use 1.14 billion yuan from the share sale for additional automobile research, development and production facilities in Shenzhen. The company also plans to spend 652 million yuan to expand its auto product and accessories unit. About 400 million yuan will be allocated to a lithium-ion battery production project.

The Hong Kong shares of BYD have moved down and up this year amid slowing vehicle demand and rising competition. However, BYD is driven to innovate and compete. Competitors including General Motors Co. and Nissan Motor Co. introduced cheaper gasoline powered models.

While the BYD F3 sedan was China's most popular passenger car in 2009 and 2010, it missed its 2010 sales target by 13 percent, selling 519,806 cars. BYD is seeking to reverse recent falling sales by introducing a luxury sedan and more electric vehicles. The E6 electric car will be sold in selected Chinese cities. BYD will also roll out a luxury G6 sedan at the end of the year, and introduce a small electric vehicle in China next year.

BYD has a considerable competitive advantage due to its visionary leadership and lower cost labor. BYD's founder Wang Chuan-Fu's technical savvy and visionary leadership has led to "uncommonly motivated" employees at the company.

Since top quality human capital is one of the most valuable resources a business can have, BYD can try to continue attracting the best talent from all over China and sustain a significant competitive advantage.

In addition to its strong leadership, BYD has the potential to gain a significant competitive advantage from the combination of two of its core competencies: battery production and lower cost automobile production.

Being one of the largest automobile manufacturers in China and producing advances in batteries sold around the world, BYD is well positioned for the Chinese government's push toward electric cars.

The Chinese government hopes to have 5 million electric cars on its roads by 2020. However, BYD's automobile sales numbers dropped over the past year while the overall Chinese auto market tripled. The company has also hit delays in production of its hybrid and electric models.

If the company's "over 10,000 engineers" can find a way to translate its experience producing cell phone batteries into high quality car battery production it could sustain a competitive advantage for the next 10 years and "Build Your Dreams."

CENTRAL STATES INDEMNITY COMPANY COMPETITIVE ADVANTAGES

BUD LABITAN WITH AZALIA KHOUNOUTDINOVA, UNO-CBA

Special and unique credit card insurance products help people and businesses. CSI is a leading servicer of debt protection products.

Insurance is Berkshire Hathaway's core strength. In 1992, Buffett made an acquisition that is a prototype of what they now look for. The purchase was 82% of Central States Indemnity, an insurer that makes monthly payments for credit-card holders who are unable themselves to pay because they have become disabled or unemployed.

Charlie Munger said, "I'm glad we have insurance, though it's not a no-brainer, I'm warning you. We have to be smart to make this work." Central States is based in Omaha and managed smartly by the Kizer family. Able and Trustworthy, the family retained 18% ownership of the business after the acquisition. Buffett said that they would continue to run things just as they had in the past.

CSI's mission is to make people's financial life simpler and more secure. CSI values excellent customer service. For many years, CSI has developed innovative insurance products designed to help people maintain their income and credit history in the face of disability, family leave and unemployment. It has provided credit card payment insurance to customers of leading banks and card issuers in the United States.

In 1977, CSI (Central States Indemnity Co. of Omaha) was formed to provide a unique credit card insurance product that protected bank credit card customers by insuring their payments in the event of the customer's death, disability or involuntary unemployment. CSI experienced rapid growth as many of the largest banks in the United States chose to offer its products as an option available to their growing customer bases. CSI earned an A+ Superior rating from A.M. Best, as of 5/06/2010, in recognition of financial stability.

Central States Indemnity (CSI) is an insurance company specializing in credit protection and recently emerged with servicing a non-insurance product, Debt Protection. Arguably, its most cherished competitive advantage is the association with Berkshire Hathaway. Having "A Berkshire Hathaway Company" on its stationary serves two purposes: (1) it tells its clients/partners, majority of which also happen to be financial institutions that this is a financially solid company worthy of Warren Buffett's attention, (2) it is backed up by significant amount of capital, which is extremely important in insurance business. This also assists in maintaining its AA+ rating with AM Best, another positive when dealing with clients.

Prior to becoming a Berkshire company, CSI had to prove that it's capable of success first. That's where the other two competitive advantages come in.

First, its management team stayed pretty much unchanged over the years. With that comes knowledge of the industry and a consistent relationship with clients. Same can be said about most employees working there, with tenure averaging 5-10 years. CSI makes an effort to stay on top of recent trends in both business and technologies. When it became apparent that credit protection market has matured and is now in process of decline, other products were and are being investigated in order to compensate for this decline. This is how Debt Protection product made its way on CSI's product listing.

Second, company is licensed in all states, Guam and Puerto Rico, and has maintained its status for many years. In insurance business, licensing a product in any state takes time and money, in some cases several years. So, having all products licensed in all states provides CSI's clients with additional assurance that this can be a one-stop insurance company.

Third, CSI continues to invest in its infrastructure, both in software applications and telecommunication equipment. Provided that the company continues its track record of paying attention to the market, industry, and does not change its attitude towards its employees - and there is no indication that those things will be changing - all three competitive advantage can be maintained over the next ten years.

Disclaimer - Azalia Khouchnoutdinova, of UNO-CBA, has been an employee at CSI for the last 11 years. At the time of this writing, she is studying for an MBA degree.

CLAYTON HOMES COMPETITIVE ADVANTAGES

BUD LABITAN WITH ERIN SESTAK, UNO-CBA

Clayton Homes leads its industry. Its path to Berkshire Hathaway was a group of finance students from the University of Tennessee, and their teacher, Dr. Al Auxier. His class gave Warren Buffett the autobiography of Jim Clayton, its founder.

Buffett knew the company to be the class act of the manufactured housing industry. His knowledge was acquired from making a mistake of buying some distressed junk debt of Oakwood Homes. Buffett did not understand how atrocious consumer-financing practices had become throughout most of the manufactured housing industry. But he learned, and Oakwood quickly went bankrupt.

Buffett said: “Manufactured housing, it should be emphasized, can deliver very good value to home purchasers. Indeed, for decades, the industry has accounted for more than 15% of the homes built in the U.S. During those years, moreover, both the quality and variety of manufactured houses consistently improved.”

However, distribution and financing practices were flawed. The industry’s business model was centered on the ability of both the retailer and manufacturer to unload terrible loans on naive lenders.

Interestingly similar to the housing bubble of the late 2000s, securitization became popular in the 1990s for Manufactured housing. This securitization process distanced the supplier of funds from the lending transaction and the industry’s conduct deteriorated.

Much like the Great Housing Bubble, buyers who shouldn’t have bought were financed by lenders who shouldn’t have lent. The consequence was a huge number of repossessions and pitifully low recoveries on the units repossessed. While Clayton could not isolate itself from industry practices, it behaved better than Oakwood and other major competitors.

Professor Al Auxier suggested that Buffett call Kevin Clayton, Jim's son and Clayton's CEO. As Buffett talked with Kevin Clayton, Buffett said that it became clear that Kevin was both able and a straight-shooter.

Said Buffett, "I made an offer for the business based solely on Jim's book, my evaluation of Kevin, the public financials of Clayton and what it had learned from the Oakwood experience."

Today, the manufactured housing industry remains awash in problems. Delinquencies continue, repossessed units still abound and the number of retailers has been halved. A different business model is required, one that eliminates the ability of the retailer and salesman to pocket substantial money up front by making sales financed by loans that are destined to default. Such transactions cause hardship to both buyer and lender and lead to a flood of repossessions that then undercut the sale of new units.

Under a proper model, one requiring significant down payments and shorter-term loans, the industry will likely remain much smaller than it was in the 90s. But, it will deliver to home buyers an asset in which they will have equity, rather than disappointment, upon resale. After Oakwood failed, Clayton agreed to buy its assets. Now, Clayton's manufacturing capacity, geographical reach and sales outlets are much bigger.

Clayton Homes provides outstanding comfort and quality in a new home for less money. One can choose a floor plan from hundreds of modular and manufactured homes. Customers can customize the new home to satisfy different needs.

Clayton modular homes and manufactured homes are precision built in state-of-the-art facilities throughout the country. As the nation's largest home builder, their modular homes and manufactured homes provide the best housing value for every lifestyle imaginable. The quality, name brand materials are purchased in bulk so that savings are passed on to the customer.

Buffett said, "We are in no hurry to record income, have enormous balance-sheet strength, and believe that over the long-term the economics of holding our consumer paper are superior to what we can now realize through securitization. So Clayton has begun to retain its loans."

Buffett and Munger believe it is appropriate to finance a soundly selected book of interest-bearing receivables almost entirely with debt, just as a bank would. Therefore, Berkshire borrowed money to finance Clayton's portfolio and re-lent these funds to Clayton at their cost plus one percentage point. This markup fairly compensates Berkshire for putting its exceptional creditworthiness to work. And, it delivered money to Clayton at an attractive price.

How did Clayton build up its economic moat? In 2003, Berkshire did \$2 billion of such borrowing and re-lending, with Clayton using much of this money to fund several large purchases of portfolios from lenders exiting the business.

Why borrow money while sitting on a mountain of cash? Buffett believes that any subsidiary lending money should pay an appropriate rate for the funds needed to carry its receivables and should not be subsidized by its parent. "Otherwise, having a rich daddy can lead to sloppy decisions" said Buffett.

Clayton Homes is the country's leading producer of modular and manufactured homes. It is the largest housing company that builds, sells, finances, and insures its homes. Clayton's large market share gives them a large competitive advantage because of their brand recognition and innovative manufacturing processes. Also, the Berkshire Hathaway association helps with its ever growing name recognition.

Clayton has 36 manufacturing plants operating in 49 states. It provides mortgages to over 435,000 customers and insurance services for over 135,000 families. Another advantage is that it is vertically integrated; and it provides services from the building stage to the retailing and insurance buying stage.

Providing the financing for customers was a major factor in their success. Clayton homes includes brand names such as Schult, Crest, Golden West, and Karsten's and these multiple formats help Clayton homes better serve their extended customer base. One of Clayton's biggest strengths is the ability to construct the homes indoors where weather does not play a factor. These homes are constructed quicker, with less energy and waste, while maintaining lower costs.

Are these advantages sustainable for the next 10 years? Initially, Clayton Homes forecasted a decreased market value in 2012. The slow to recover national unemployment rate is a frictional factor to consider. These economic headwinds show the troubling times in the current and near future of Clayton Homes. However, Clayton has competitive advantages that will sustain for the next 10 years. Consider the extensive design variety, quality materials utilized, innovations, financing, and the direct and implied support from parent company Berkshire. Clayton Homes also has a distinct advantage with its large geographical sales outlets. Recall that this was also expanded with the Oakwood acquisition.

Charlie Munger said, “We’ve bought business after business because we admire the founders and what they’ve done with their lives. In almost all cases, they’ve stayed on and our expectations have not been disappointed.” Clayton Homes has good managers who work to build its economic moat. Clayton Homes’ innovations have improved both the quality and the image of modular homes. Clayton focuses on efficient designs and customizable floor plans. It uses quality brand construction materials, purchased in bulk, at state-of-the-art construction facilities.

With the added support from Berkshire Hathaway and drive to be the best innovator in this industry, Clayton Homes gives consumers a sense of security about its future.

COCA COLA (KO) COMPETITIVE ADVANTAGES

BUD LABITAN WITH SEBASTIAN JUNG, UNO-CBA

Coca Cola is a business with a differentiated and continuing competitive advantage. Its economic moat is deep and wide. Since it has a combination of a special brand advantage, large scale cost of production advantage, and a global network distribution advantage, we could say that it has three moats around its economic castle. Its managers work to build that moat bigger every day.

In 1988, Warren Buffett and Charlie Munger began buying stock in the Coca-Cola Company for the Berkshire Hathaway portfolio. They purchased about 7% of the company for \$1.02 billion. It turned out to be one of Berkshire's most lucrative investments. Berkshire Hathaway now owns 200 million shares or about 11.35 percent of Coca-Cola.

A customer generally asks for a Coke by name. Customers do not buy a 'cola'. Charlie Munger said, "The social proof phenomenon which comes right out of psychology gives huge advantages to scale—for example, with a very wide distribution, which of course is hard to get. One advantage of Coca-Cola is that it's available almost everywhere in the world."

Warren Buffett knows that commodity companies sell products or services that can be easily copied and reproduced. In 1982, Buffett said this about commodity companies: 'Businesses in industries with both substantial over-capacity and a "commodity" product (undifferentiated in any customer-important way by factors such as performance, appearance, service support etc) are prime candidates for profit troubles.'

Some companies can obtain a continuing competitive advantage by being part of a structure that operates as a monopoly. An example of this protected status was Freddie Mac. The Federal Home Loan Mortgage Corporation was established by Congress to buy, securitize mortgages, and resell them as guaranteed mortgage pass-through certificates. Until the

dynamics changed into a mismanaged over-capacity housing bubble, this had been an earlier investment of Buffett and Berkshire Hathaway.

There are also companies that market commodity products so well that they distinguish their commodity product from that of their competitors. These put their own special 'brand' upon their product. They can achieve this by the marketing mix of price, product, placement, and promotions. In addition, continuous improvement in terms of higher quality production and service is always a plus.

McDonalds sells hamburgers and their hamburgers may not be much better than those of their competitors. However, McDonalds has made itself a brand name primarily through the marketing mix of price, product, placement, and promotions. It has a uniformity of product, and strategic accessibility.

Gillette sells razor blades and we would not expect them to be a unique product. However, Gillette, now part of Procter and Gamble, became a dominant brand in the market because it developed an ideal marketing mix of price, product, placement, and promotions. It innovated better products and its products are reliable.

In 1993, Warren Buffett said this about companies with competitive advantages: 'Is it really so difficult to conclude that Coca Cola and Gillette possess far less business risk over the long term than, say, any computer company or retailer? Worldwide, Coke sells about 44% of all soft drinks, and Gillette has more than a 60% share (in value) of the blade market.' Leaving aside chewing gum, in which Wrigley is dominant, I know of no other significant businesses in which the leading company has long enjoyed such global power.'

Coca Cola has a strong brand identity in the global market and it has pricing power. It is one of most respected brands in the world. In 2011, the brand value of the company was estimated at 25.8 billion US dollars.

This creates a barrier to entry; a competitor would have to invest heavily into creating his own brand to compete with Coca Cola. Coca Cola utilizes a great amount of positive advertising to maintain the Coke brand. The amount of advertising is also a barrier to entry; it makes it impossible for brands with low capital to gain a comparable amount of brand awareness.

Recently, KO's 5Yr Gross Margin (5-Year Avg.) is approximately 64.4% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 23.7%, while the industry Net Profit Margin (5-Year Avg.) is 18.0%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%. Coca Cola also has better earning power efficiency in term of Free Cash Flow per unit of sale.

In 2010, Coca Cola had a net income of 11.8 billion dollars and total assets of about 79.2 billion dollars. This great amount of capital available creates an advantage in Coca Cola's relationship to its business partners. For example, if a bottler captures too much profit, Coca Cola can use its capital for forward integration to capture the entire profit.

Coca Cola's distribution system is also a competitive advantage. Coca Cola has established a worldwide distribution system that makes the company independent of local inconsistencies.

Are they sustainable for the next 10 years? Yes. However, Coca Cola has recently dropped out of the top ten brand value list for the first time. This may be underpinned by a consumer trend in developed markets towards healthier, non-carbonated drinks. In the 2010 annual report, Coca Cola recognizes "obesity and health concerns" as potential risks for the company. Still, there is no doubt that Coca Cola's loyal brand following will sustain its competitive advantage. Coca Cola recognizes the need to sustain marketing and increase innovation. In its 2010 annual report they acknowledged the need to continue to selectively expand into other profitable segments of the nonalcoholic beverages segment. Coke strives to strengthen capabilities in marketing, innovation, and costcontrol. As a result, Coca Cola's competitive advantage will sustain.

A wonderful business, Coca Cola's able and trustworthy managers are motivated to invest in its supply chain network to "leverage the size and scale of the Coca-Cola system to gain a competitive advantage." With this "moat building" in mind, we believe that that Coca Cola will be successful in maintaining its economic franchise and current barriers to entry.

CONOCOPHILLIPS (COP) COMPETITIVE ADVANTAGES

BUD LABITAN WITH ADAM D. STUDTS, PE, UNO-CBA

ConocoPhillips is the third largest integrated energy company in the United States and second largest refiner in the United States. Worldwide, ConocoPhillips has the fifth largest proved reserves and is the fourth largest refiner.

In 2008, Warren Buffett purchased a large amount of ConocoPhillips stock when oil and gas prices were near their peak. Warren Buffett said that this was a major mistake of commission. He did not anticipate the dramatic fall in energy prices that occurred in the last half of 2008. He still believes that the odds are good that oil will sell far higher in the future than \$40-\$50 price. Now, in 2011, a barrel of oil sells between \$90 - \$100.

ConocoPhillips has other competitors who are focused on downstream and upstream operations. These competitors include companies like Anadarko, Dynegy, Valero, and Halliburton. ConocoPhillips has a competitive advantage over these companies because COP is involved in both downstream and upstream operations. This allows COP to continue being profitable when one operation lags.

ConocoPhillips operates in more than 40 countries and has assets of \$162 billion. Because of this, ConocoPhillips is one of the major players in the field of over 20 Integrated Oil and Gas companies. It is in a position to put competitive pressure on other competitors.

ConocoPhillips has built a moat around itself that will protect it from attack on multiple fronts. ConocoPhillips is a top-five private (nongovernment) energy company worldwide and the second largest oil refiner in the United States, with assets of over \$156 billion and annual revenues of near \$200 billion. The cost of entry to the energy and oil exploration market serves as a large barrier, providing a competitive advantage to ConocoPhillips. Additionally, ConocoPhillips' diversified resource base throughout the world serves to protect the company from regional or localized factors affecting oil production (wars, political turmoil, etc.). The technologies ConocoPhillips is developing enable the company to explore areas that

were once too expensive or too environmentally impactful to pursue. Additionally, the company's ability to operate efficiently and provide returns to shareholders will give COP the continued investment needed to continue its capital investment and exploration projects, further separating ConocoPhillips from its competition. Competitors like ExxonMobil and Chevron should aggressively pursue advanced technologies and focus on providing shareholder returns if they want to cross the moat that Conoco has created for itself.

Recently, COP's 5Yr Gross Margin (5-Year Avg.) is approximately 18.2% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 2.8%, while the industry Net Profit Margin (5-Year Avg.) is 10.9%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

While the world is focused on the "green" movement, too much of the world's business infrastructure is dependent on oil consumption to largely affect the company's competitive advantages over the next decade.

ConocoPhillips must monitor its size and operations so that it does not become bureaucratic. Charlie Munger has said, "The great defect of scale is that as you get big, you get the bureaucracy. And with the bureaucracy comes the territoriality - which is again grounded in human nature."

ConocoPhillips' profitability is largely dependent on the world's economy and the company's ability to maintain high utilization of its assets. While the medium-range certainty of the economy is in question, the effect of this decline is partially offset by ConocoPhillips' technology focus to drill smarter. This operational focus allows the company to better identify the existence of resources prior to drilling, reducing the impact to the environment and the cost to obtain these resources. With able and trustworthy managers, these factors should provide for continued success and advantage for ConocoPhillips over the next decade.

CORT BUSINESS SERVICES COMPETITIVE ADVANTAGES

BUD LABITAN WITH ERIN SESTAK, UNO-CBA

Operating out of 117 showrooms, CORT is the national leader in “rent-to-rent” furniture, primarily used in offices but also by temporary occupants of apartments.

In 1999, after an aborted buyout of CORT Business Services, Cort turned to Warren Buffett and Berkshire Hathaway. Buffett knew nothing about CORT, but immediately printed out its SEC filings and liked what he saw. He asked for a meeting with Paul Arnold, CORT’s CEO. Buffett knew at once that they “had the right ingredients for a purchase: a fine though unglamorous business, an outstanding manager, and a price that made sense.”

The business has no similarity to “rent-to-own” operations because those usually involve the sale of home furnishings and electronics to people having limited income and poor credit. Rent-to-rent customers generally desire high-quality furniture to meet temporary needs, have established credit, and pay on a monthly basis. Buffett and Munger purchased CORT for Wesco, then an 80%-owned subsidiary, paying about \$386 million in cash.

In a typical rent-to-rent transaction, the customer agrees to rent furniture for a minimum of three months. This is subject to extension by the customer on a month-to-month basis.

CORT’s customer base includes primarily Fortune 500 companies, small businesses, professionals, and owners and operators of apartment communities. CORT’s management believes its size, national presence, brand awareness, consistently high level of customer service, product quality, breadth of selection, depth and experience of management, and efficient clearance centers have been key contributors to the company’s success.

CORT offers a wide variety of office and home furnishings and it emphasizes its ability to furnish an apartment, home or entire suite of offices with high-quality furniture, housewares and accessories in two business days. The keys to CORT's growth are: Expanding its commercial customer base; Enhancing its ability to capture an increasing number of Internet customers through its on-line catalog services; Making selective acquisitions; and Continuing to develop various products and services.

In order to capitalize on the significant profit potential available from longer average rental periods and the higher average monthly rent typically available for office products, CORT's strategy is to place greater emphasis on growth in rentals of office furniture.

In order to promote longer office lease terms, CORT offers lower rates on leases when lease terms exceed six months. A significant portion of CORT's residential furniture rentals is derived from corporate relocations and temporary assignments. Thus, CORT offers its corporate rental customers a way to reduce the costs of corporate relocation and travel while developing residential business with new and transferred employees. CORT also provides short-term rentals for trade shows and conventions.

In January 2008, CORT expanded its operations to the U.K. through the purchase of Roomservice Group, now doing business as CORT Business Services UK Ltd. In November 2008, CORT acquired a business division of Aaron Rents, Inc., expanding its national presence in the U.S.

Aaron's is a competitor that serves the moderate-income customer, offering affordable payment plans and rent to own services. Brook Furniture Rental offers residential and office furnishings for temporary use in San Francisco, Sacramento, Los Angeles, San Diego, Chicago, Milwaukee, Madison, Washington D.C., Baltimore, Atlanta, Dallas, Fort Worth, Austin, and Philadelphia. CORT is in all 50 states, the District of Columbia, and London, UK.

Although the economic contraction in 2008 and 2009 has contributed to a weakening of the furniture rental business, CORT has made several selective acquisitions following its purchase by Wesco. So, CORT continued to build its economic moat.

The principal competitive factors in the furniture rental industry are product value, furniture condition, the extent of furniture selection, terms of the rental agreement, speed of delivery, exchange privileges, options to purchase, deposit requirements, and customer service. There are several large regional competitors, as well as a number of smaller regional and local rent-to-rent competitors. The availability of low priced, lower-quality furniture from overseas manufacturers is also providing additional competitive pressure. In addition, numerous retailers offer residential and office furniture under rent-to-own arrangements.

CORT provides a nation-wide apartment locator service through its website www.apartmentsearch.com and customer call centers. Through its network of foreign contacts, CORT also provides such services internationally.

The majority of CORT's furniture sales revenue is derived from its clearance center sales. The sale of previously leased furniture allows CORT to control inventory quantities and to maintain inventory quality. On average, furniture is typically sold through the clearance centers from three to five years after its initial purchase.

Wesco management believes that price and value are CORT's principal competitive advantages. CORT has approximately 2,211 full-time employees, including 72 union members. Management considers labor relations to be good.

CORT Furniture rents to both corporations and individuals. CORT's typical customers are those that travel for business, for a long-term stay in a hotel, but not long enough to move. CORT supplies everything from housewares to appliances. CORT has found its small niche in the market place. It has a competitive advantage because they are able to buy furniture at low prices because of the large quantities. CORT then rents the furniture with an average 10 month contract which essentially pays for the furniture. CORT rents it two more times then sell it at one of their clearance centers that average about 10% more than CORT paid for the item.

Another competitive advantage of CORT is its comprehensive range of rental relocation services. Most companies prefer to work with a single service provider to address the rental needs, and CORT can offer just that.

CORT also has a strong balance sheet, with debt only about a third of their capital. CORT has also done extremely well in acquiring the right companies to increase their market base and services.

Are these advantages sustainable? If CORT continues to explore strategic acquisition opportunities, it can greatly increase its market share. In turn this will give CORT greater brand recognition.

Because of the recent recession many companies are strapped for cash. However, CORT Furniture is expanding its position in this market. Charlie Munger said, “We don’t care about quarterly earnings though obviously we care about how the business is doing over time and are unwilling to manipulate in any way to make some quarter look better.”

Outsourcing has played a major role in CORT’s success. Ten years ago, companies didn’t think to outsource and they looked to own. New generations are looking for less long term solutions. Companies are now more willing to accommodate the mobile lifestyles of today’s workforce, so they are providing more flexible working environments.

Looking to the future, Berkshire Hathaway can provide greater visibility of the CORT brand. CORT should be a long term profit center by focusing on business clientele. Through its well established distribution channels, CORT can service a small businesses and a Fortune 500 company. No competitors have this kind of network and financial backing advantage. Competitors may attempt to duplicate part or Cort’s entire business model. However, we believe they will fall short of CORT’s special mix of scale, management, efficiency, quality service, and profit margin.

COSTCO WHOLESALE (COST) COMPETITIVE ADVANTAGES

BUD LABITAN WITH JUBIN JACOB, AUC

In free market capitalism, competitors repeatedly attack any business “castle” that is earning high returns. Costco’s mission is to focus on bringing high quality goods and services at the lowest possible prices every day. Executing this mission effectively is its competitive advantage or economic moat.

Charlie Munger is a big fan of the Costco business model, and Berkshire Hathaway currently owns 4,333,363 shares in Costco Wholesale (NASDAQ: COST).

In the 2006 annual report, Costco stated that it aims to deliver with integrity at every level of the company while valuing the interests of the stakeholders. This mission statement is understood throughout this wholesale business model. They want to sell larger quantities of selected products.

Costco offers customers low prices on selected private and nationally branded products in a wide range of merchandise categories. Both businesses and families can rely on Costco to offer high quality goods and services at every day low prices.

Creating value to a Costco membership card holder is a top priority throughout the company. Costco does this using rapid inventory turnover, high sales volume per warehouse, and an efficient operating structure with reduced handling of merchandise. These key elements make Costco a successful low cost operator.

In addition to offering low prices on high quality goods and a several convenient services, Costco strives to be a valuable asset to every community where they do business. This means providing good jobs at good pay. Costco is involved in community charities. It contributes to local tax revenues and offers profitable business opportunities to suppliers. Most importantly, Costco takes care of its members.

There are over 1,178 warehouse club locations that exist across the U.S. and Canada, including Costco's North American warehouses. Currently, the leading stores in this category of warehouse membership clubs are Wal-Mart's Sam's Club, Costco, and BJ's Wholesale Club.

Wal-Mart, the largest retailer in the world, is a tough competitor. Other significant competitors are Target and Kohl's. Low-cost operators selling single categories or a narrower range of merchandise are Lowe's, Home Depot, Office Depot, PetSmart, Best Buy, and Barnes & Noble. They have significant market share in their own categories. So, these stores can be known as category killers to the market because they have the ability to dominate their targeted merchandise segment.

Recently, COST's 5Yr Gross Margin (5-Year Avg.) is approximately 12.6% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 1.7%, while the industry Net Profit Margin (5-Year Avg.) is 3.4%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

Costco's Competitive Advantages:

1. All business, no frills: Costco is an excellent example of how not to spend money on the bells, whistles, and flashiness in a store. There are no ceiling tiles. The floors are simply concrete and there are not many flashy displays.
2. More the merrier: When you pay for a membership, you would want to take advantage of it. It is a simple but powerful strategy. With 55 million memberships and counting, Costco boasts bargaining power to their side; especially when they focus on buying from companies who hold surplus stock. But at the same time, it is interesting to see how they do not just buy everything they see. Costco is value selective. There is a considerable "lack" of choice in merchandise compared to department stores. But since the products they carry are of good quality, and of good value, these appeal to their customers.

Like Wal-Mart, some profitable items are strategically placed, so the customer has to walk through a few isles before reaching the 'most popular items'.

3. New arenas: Adding 'auto' to the equation was a great step in Costco's success. Costco gas stations are putting many local stations out of business. Having a car repair center on site means the customer can get a tune up or an oil change while they shop. This is an area, which can develop a lot further. Costco's has a partnership with other business giants such as American Express. This further stabilizes their moat by attracting that business oriented customer.

Costco travel, Costco insurance, Costco photo center, and Costco pharmacy are added advantages that make Costco the one stop solution for most customers.

Will these advantages be sustainable for ten more years? Yes. Like WalMart, Costco is one of the few companies that have attracted more customers due to the recent economic downturn. Buying in bulk and shopping in one trip are becoming a habit for many American families.

Costco has the infrastructure with room for growth. This is a strong position to be in; especially when competitors such as BJ's Wholesale Club are posting losses.

Online shopping is another major area where Costco can and should put additional focus. Costco can develop a subscription model similar to Amazon, and it can attract younger shoppers with online advertisements.

Most of the Costco member benefits remain unknown to the public. So, there is a vault of potential business that Costco can expand with additional marketing and advertising campaigns. We believe that Costco will continue to be a competitive leader going forward if it continues to execute its mission of selling larger quantities of selected quality goods and services at the lowest possible prices every day. While others can copy their model, the process of executing this mission effectively is Costco's competitive advantage or economic moat.

CTB, INC. COMPETITIVE ADVANTAGES

BUD LABITAN WITH TODD SULLIVAN, RAND STRATEGIC PARTNERS

CTB is a worldwide leader in equipment for the poultry, pig, egg production and grain industries. In 2002, two companies came to Berkshire Hathaway with managers responsible for their impressive records: Vic Mancinelli at CTB and Seymour Lichtenstein at Garan.

CTB International Corp. is a leading designer, manufacturer and marketer of systems for the poultry, pig, egg production, and grain industries. Celebrating its 60th anniversary this year, the company operates from multiple locations in various countries around the world and serves its customers through a worldwide network of independent dealers and distributors.

The CTB Brands include:

Agro Logic® (Agro Logic Ltd.) which includes Electronic controls, Weigh systems, and Egg counters.

Brock® includes Grain and industrial storage bins, Grain and industrial conveyors, and Aeration and grain drying systems.

Chore-Time® includes Poultry feeders and drinkers, Pig feeders and drinkers, Feed conveying and storage systems, Ventilation systems, Nests, cages and egg collectors, Heating and cooling systems, Controls and management software, Incinerators, Weigh systems, and Pig gestation and farrowing stalls, penning and flooring.

Fancom® includes Controls and management software, Poultry and pig feeders, Ventilation systems, Weigh systems, Egg counters, Mushroom cultivation and composting systems, Fruit and vegetable storage systems.

Ironwood Plastics includes highly engineered, precision-molded plastic components, Close tolerance molding, insert molding, reel-to-reel molding, overmolding, foam in place, high-temperature materials, tooling/engineering, laser scanning and secondary operations.

Laake® includes Pig gestation and farrowing stalls, penning and flooring, Equine stalls and feeders, Architectural doors and windows.

Mannebeck® includes Electronic sow feeding systems, Pig stalls, and Plastic flooring for piglets and sows.

PigTek® includes Pig feeders and drinkers, Electronic sow feeding systems, Feed conveying and storage systems, Ventilation systems, Heating and cooling systems, Controls and management software, Weigh systems, and Pig gestation and farrowing stalls, penning and flooring.

Porcon® includes Pig stalls and penning.

ProTerra® includes Ventilation systems, Controls and management software.

Roxell® (Roxell N.V.) includes Poultry feeders and drinkers, Pig feeders and drinkers, Feed conveying and storage systems, Nests and egg collectors, and Weigh systems.

Roxell® (Roxell U.S.A.) includes Poultry feeders and drinkers, Feed conveying and storage systems, and Weigh systems.

Shenandoah® includes Nests and egg collectors, Heating systems, and Incinerators.

Shore™ includes Moisture testers for grain and coffee.

Uniqfill® includes Air cleaning system.

CTB continues to focus on its strategy for growth, which includes extending its competitive advantage through accretive acquisitions and/or other beneficial business arrangements, as well as expanding its global physical presence, emerging as the best cost manufacturer in the industries it serves, emphasizing its product-driven focus, and enhancing its financial strength.

Typically for a company to have a strong “moat” it must pass the following 4 tests (smaller moats will pass some of them): 1. Low-Cost Producer, 2. High Switching Costs, 3. The Network Effect, and 4. Intangible Assets (Brand):

Does CTB, Inc. pass these tests? Yes. CTB, utilizing lean manufacturing techniques is a low cost producer. Further, having the AAA rated Berkshire Hathaway as an owner enables it access to lower cost financing than any other participant in its industry. This low cost has allowed the company to acquire 8 other businesses since 2002 to the point that Buffett's \$171M investment in 2002 is now approaching \$800M in sales annually and over \$100M a year in pretax profits. As

CTB provides financing for purchases of its products in some cases, Berkshire's backing allows it to be a low cost provider of this also.

High Switching Cost: Once a CTB system is installed, switching to another is a highly costly transaction. Since these are being installed on farms, the chance of switching to another product before CTB products end their useful life is minimal at best. Further, given the depth of offering from CTB, they are also able to essentially equip the entire farm saving the farmer the trouble of attempting to get disparate systems to operate together.

Network Effect: While there is not a traditional effect of more users making the experience better, there is a network effect within the CTB product suite. Think of it like Apple and its universe of products. Mac's, iPods, iPhone and iPads are all seamlessly designed to work together and enhance the user experience the more of them that are owned. CTB has a similar user experience as their ability to outfit the entire farm enables the farmer's experience to be magnified.

Intangible Assets: The Berkshire Hathaway name and the stability it provides cannot be understated. Outfitting a farm can be a multi-year commitment. Knowing that the company you are buying from has a global network and the backing of a Berkshire provides peace of mind to the purchaser.

Charlie Munger has said, "Two thirds of acquisitions don't work. Ours work because we don't try to do acquisitions - we wait for no-brainers." CTB is the leading designer, manufacturer and marketer of systems for the poultry, pig, egg production, and grain industries.

Is the moat sustainable? Yes. It is hard to picture another producer getting access to capital at more competitive rates than CTB is now able to.

Further, having Berkshire's backing allows CTB to continue to grow through acquisition and the scale this gives CTB actually allows it to grow its moat rather than solely focusing on protecting it. Its core business, food & farming, isn't something that is at risk of seeing large declines in demand so its macro environment, while it may see some down years, will see steady long term growth as the earth's population continues to grow.

FECHHEIMER BROTHERS COMPANY COMPETITIVE ADVANTAGES

BUD LABITAN WITH BENJAMIN ALBAITIS, OHIO STATE UNIVERSITY

Since 1842, Fechheimer has been manufacturing quality uniforms to serve working men and women. Today, Fechheimer's resources are global, with manufacturing partners in Central and South America, Europe, Africa and Asia. Its famed Flying Cross brand is synonymous with quality.

Fechheimer is a company with excellent economics, run by the kind of people Buffett and Munger like. The Fechheimer Bros. Company was acquired by Berkshire Hathaway in 1986. It is based in Cincinnati, Ohio. Fechheimer has the largest in-stock collection of work uniforms readily available. Fechheimer also offers custom programs made to detailed specifications to meet an agency's particular needs. Fechheimer's goal is to bring the customer, products and programs that keep customers looking their sharpest and feeling your best. Their uniforms provide protection in all climates and conditions.

Every year in Berkshire's annual report, Warren Buffett includes a description of the kind of business that they would like to buy. This "ad" paid off in 1986. He received a letter from Bob Heldman of Cincinnati, a shareholder for many years, and also Chairman of Fechheimer Bros. Bob wrote that he ran a company that met Buffett's tests and suggested that they get together.

Fechheimer, a uniform manufacturing and distribution business, began operations in 1842. Warren Heldman, Bob's father, became involved in the business in 1941 and his sons, Bob and George, along with their sons, subsequently joined the company. Under the Heldmans' management, the business has been highly successful.

In 1981 Fechheimer was sold to a group of venture capitalists in a leveraged buy out (an LBO), with management retaining an equity interest. The new company, as is the case with all LBOS, started with an exceptionally high debt/equity ratio. After the buy out, however, operations continued to be very successful. So debt was paid down substantially and the value of the equity increased dramatically. However, for a variety of reasons, the venture capitalists decided to sell and Bob Heldman thought of Berkshire.

Buffett wrote: "Fechheimer's economic record is superb; its managers are talented, high-grade, and love what they do; and the Heldman family wanted to continue its financial interest in partnership with us. Therefore, we quickly purchased about 84% of the stock for a price that was based upon a \$55 million valuation for the entire business."

The circumstances of the Fechheimer purchase were similar to those in the purchase of Nebraska Furniture Mart. Most of the shares were held by people who wished to employ funds elsewhere. Some family members who enjoyed running their business wanted to continue both as owners and managers. The managing family wanted a purchaser like Berkshire Hathaway who would not re-sell, and who would let the business be run in the future as it had been in the past.

In considering an acquisition, Buffett and Munger try to evaluate and understand the economic characteristics of the business. They look for its competitive strengths and weaknesses. Then, they look at the quality of the people they will be joining. "Fechheimer was a standout in both respects."

In addition to Bob and George Heldman, there are three members of the next generation, Gary, Roger and Fred, to insure continuity.

Here is what Buffett and Munger look for: (1) large purchases, (2) demonstrated consistent earning power (future projections are of little interest, nor are "turn-around" situations), (3) businesses earning good returns on equity while employing little or no debt. (4) management in place, (5) simple businesses (if there's lots of technology, they won't understand it), (6) an offering price (They don't want to waste time or that of the seller by talking about a transaction when price is unknown).

Buffett and Munger do not engage in unfriendly takeovers. They promise complete confidentiality and a very fast answer as to whether they are interested. They prefer to buy for cash, but will consider issuing stock when they receive as much in intrinsic business value as they give.

Fechheimer's Flying Cross brand is recognized throughout many public service organizations. The Flying cross has uniforms for Police, Fire, EMS, Corrections, Transportation, Military, Military Schools, Umpires, Postal Workers, and Corporate Wear.

Fechheimer's competitive advantage is quality, experience, and scale. The public service sector of entire cities and counties count on Fechheimer's service and products. Most other competitors involved in the production and distribution of public service wear only offer products directed toward one branch such as police or fire departments.

In an age where more is being offered through the internet, Fechheimer tries to make face to face contact with its customers. An advantage that helps make this possible is that Fechheimer has hundreds of locations nationwide. The geographic spread of Fechheimer's stores is unmatched by competitors. Charlie Munger has said, "We tend to buy things - a lot of things - where we don't know exactly what will happen, but the outcome will be decent." Fechheimer is rightfully the current leader in public service wear.

The competitive advantages offered by Fechheimer can be sustained. It would take a massive amount of capital for any competitor to build an empire as far reaching as Fechheimer's. Its Flying Cross brand has a long history of quality throughout the industry, and there is no evidence to indicate that the level of quality would decrease in the next 10 years.

The long history of quality goes hand in hand with a long history of Fechheimer's positive relationships with customer organizations. These valued relationships can cause organizations to continue to buy the Flying Cross simply because Fechheimer is known to do good business.

Other companies may offer cheaper products but the Flying Cross is the Cadillac of uniforms. The biggest risk we see is that economic cuts in funding could cause organizations to look for cheaper alternatives.

In addition to this, individual organizations could try to design and purchase their own uniforms from other suppliers. However, the value mix of experience, high quality, durability, and price makes the future of The Fechheimer Brothers look bright.

FLIGHTSAFETY COMPETITIVE ADVANTAGES

BUD LABITAN AND PETER STEIN

FlightSafety International is the world's leader in the training of pilots. In 1951, while still at Pan Am, Al Ueltschi founded FlightSafety. He built the business into a simulator manufacturer and a worldwide trainer of single-engine, helicopter, jet and marine pilots.

In 1990, Richard Sercer, a Tucson aviation consultant, wrote Bob Denham, CEO of Salomon Inc, suggesting that he explore the possibility of a merger between FlightSafety and Berkshire Hathaway. Buffett had been familiar with FlightSafety's business, and in about 60 seconds he knew that Al Ueltschi was their kind of manager.

Because Charlie Munger and Warren Buffett wanted to minimize the issuance of Berkshire shares, the transaction they structured gave FlightSafety shareholders a choice of cash or stock. This led to about 51% of FlightSafety's shares being exchanged for cash, 41% for Berkshire A and 8% for Berkshire B.

FlightSafety operates in 41 locations outfitted with simulators of planes ranging from the small Cessna 210s to Boeing 747s.

About half of the company's revenues are derived from the training of corporate pilots, with most of the balance coming from airlines and the military.

FlightSafety is a good business. However, its economics requires repetitive investments in capital expenditures to stay that way. A simulator can cost more than \$19 million dollars, and FlightSafety has more than 273 of them. Simulators are not cheap. So, this business is capital intensive.

FlightSafety delivers benefits to its customers. It also possesses a durable competitive advantage that Warren Buffett described this way: "Going to any other flight-training provider than the best is like taking the low bid on a surgical procedure."

Berkshire Hathaway purchased FlightSafety in 1996. At that time, its pre-tax operating earnings were \$111 million on fixed assets of \$570 million.

Capital expenditures go mainly for new simulators to match new airplane models that are constantly being introduced.

The fixed assets, after depreciation, give Berkshire Hathaway a good return. But, it is unlike See's Candies great return relative to incremental reinvestment of earnings. Therefore, if measured only by economic returns, FlightSafety is an excellent but not an extraordinary business.

Charlie Munger has said, "The more hard lessons you can learn vicariously rather than through your own hard experience, the better." While he was speaking about investing, this quote can also be applied to simulator training. Continuous learning and training helps pilots make safer decisions.

What is FlightSafety's competitive advantage? "Enhancing Safety Through Superior Training." FlightSafety is the world's leading aviation training company. They work diligently to maintain and enhance their reputation for customer service in providing the industry's best, most comprehensive safety training. They deliver more than a million hours of professional instruction each year, training more pilots than any other company at the highest standards.

FlightSafety trains pilots for fixed-wing, rotorcraft and tilt-rotor aircraft. Thousands of pilots train to proficiency at 40 Learning Centers in the United States, Canada, France and the United Kingdom. Training locations include the new comprehensive center at Farnborough Airport just outside London and the recently opened rotorcraft Learning Center in Lafayette, Louisiana.

FlightSafety's comprehensive type-specific maintenance technician training covers most business aircraft models and a wide range of commercial aircraft. Its close working relationships with the majority of aircraft manufacturers enables FlightSafety to deliver accurate, up-to-date training. FlightSafety also offers training for flight attendants and flight dispatchers. FlightSafety offers a growing library of online eLearning courses. These include in-depth preparation for full flight simulator training and standalone instruction on a wide variety of aviation topics.

FlightSafety operates the world's largest fleet of full flight simulators, most of which are qualified to FAA Level D or the equivalent. FlightSafety

designs and manufactures simulators that are the most advanced on the market today. And, FlightSafety develops the comprehensive software to run them.

The Leader Since 1951, FlightSafety's decades of proven performance, 1,800 professional instructors and wide range of training opportunities all serve their uncompromising mission: safety.

FlightSafety is the brand leader in flight training equipment and continuous flight safety training. If FlightSafety continues to run as it was designed, lead the industry in innovation, training, and service; then, it should be able to maintain its competitive advantages and expand its economic moat.

FOREST RIVER COMPETITIVE ADVANTAGES

BUD LABITAN WITH RICHARD KONRAD, CFA, VALUE ARCHITECTS
ASSET MANAGEMENT

Forest River's mission is to help customers enjoy their outdoor activities to the fullest. And, it is becoming the leader in this consolidating industry.

In June of 2005, Warren Buffett received a two-page fax telling him why Forest River met the acquisition criteria. Buffett had not heard of this recreational vehicle manufacturer with \$1.6 billion of sales.

Forest River was founded by its CEO, Peter Liegl in 1996 and was sold to Berkshire in 2005. The company, built on the bankrupt assets of Cobra Industries, a firm that Liegl had run and been terminated from, has flourished in this tough, cyclical industry. Forest River produces commercial buses (shuttle buses rather than urban buses), pontoon and fishing boats, cargo trailers, mobile offices, manufactured housing, park trailers, and a full line of towable and motorized recreational vehicles.

Each Forest River product is conscientiously built and undergoes thorough, detailed inspection. Forest River has 60 plants, 5,400 employees and has consistently gained share in the RV business, while also expanding into other areas such as boats.

Forest River operates multiple manufacturing facilities throughout the mid-west and west coast. Forest River's brands include Berkshire, Blue Ridge, Cardinal, Cedar Creek, Charleston, Cherokee, Coachmen, EVO, Flagstaff, Forester, Georgetown, Lexington, Palomino, Prime Time, Ridgeview, Rockwood, Salem, Sandpiper, Shasta, Sierra, Solera, Stealth, Sunseeker, Surveyor, V-Cross, Viking, Wildcat, Wildwood, Wolf Pack, Work and Play, and XLR for the RV, travel trailer, and motorhome segments of its business.

Almost one in 12 US vehicle-owning households owns an RV. The typical RV campground customer is 50, married, and has an annual household income of around \$70,000, according to the Recreational Vehicle Industry

Association (RVIA). The industry is a beneficiary of the demographics of baby-boomers.

The recreational vehicle business has been challenging and unforgiving for many companies. According to the RVIA, 2009 shipments totaled only 165,700 units; down 30.1% from 2008 when shipments totaled 237,000 units, down 32.9% from 2007 due to the recession. Shipments in 2007 totaled 353,400 — the fourth highest in the past quarter century. 390,500 RVs were shipped in 2006, the best total in the past 25 years. In 2010, the industry showed a decent recovery to 242,300 units, an increase of 46.2% from 2009.

After the difficulties of the last few years, the industry has been strewn with either bankruptcies including Fleetwood Enterprises and Monaco Coach, sales to larger competitors, or just shutdowns. The top three RV competitors now constitute about 75% of the market. The industry continues to have excess capacity but is far better balanced today as pricing and the previous promotional environment is improving. This is evidenced by the profitability of public competitors such as Thor despite relatively low volumes.

When talking about investing, Charlie Munger has said, “All of you have to look for a special area of competency and focus on that.” Peter Liegl and Forest River’s competency and focus is in building products that “help customers enjoy their outdoor activities to the fullest.” And, Forest River is becoming a leader in this consolidating industry.

Forest River is well positioned in the industry with a strong moat. It is regarded as a low-cost producer throughout its value chain.

One of the impediments for the industry has been obtaining wholesale financing for dealers. In 2007, Forest River acquired Priority One Financial Services Inc. Priority One is a finance and insurance

outsourcing company which services many marine and recreation vehicle dealers throughout the US. The acquisition has enabled dealers to secure financing and to negotiate better terms as compared to dealing with third party finance providers. Priority One is now the nation's leading retail Finance & Insurance outsource company for recreational and commercial dealers. This is a unique advantage relative to others in the industry. Thor, with the largest share in the industry is dependent on Ally Financial, the former GMAC for its financing. Winnebago obtains its dealer financing through BankAmerica.

Forest River has a powerful brand which has improved customer loyalty and helped achieve economies of scale as the firm has grown its market share. Two years ago, Forest River commanded about 20.1% of industry RV sales. Last year, its share was 27.2%. The share of "second-tier" manufacturers has faded from 24.2% to 18.5% over this time frame. The company achieves significant cost savings and working capital efficiencies in its relationships with suppliers. In addition, Forest River is regarded as a low cost manufacturer operating through 80 specialized manufacturing plants.

Forest River enjoys the capital halo of Berkshire with the access to cheap capital representing a long term sustainable advantage in the financing of dealers and perhaps ultimately to the consumer. The access to capital in a consolidating industry should also allow Forest to maintain its growth trajectory and profitability in an industry which is turning into essentially a duopoly. Favorable demographics should continue to propel demand.

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FRUIT OF THE LOOM® COMPETITIVE ADVANTAGES

BUD LABITAN WITH DR. MAULIK SUTHAR, GUJARAT, INDIA

Fruit of the Loom is a respected brand with a huge distribution network. For more than 150 years, Fruit of the Loom has fulfilled a promise of quality, value and trust to its customers. As a vertically integrated manufacturer, Fruit controls the quality of its garments at every step of the way. Fruit manufactures its own yarn, knits the cloth, cuts the fabric, sews the garments, and packages the product.

Berkshire Hathaway purchased Fruit of the Loom in 2001. Fruit of the Loom had entered bankruptcy a few years back because of high debt and poor management.

In August 1955, Warren Buffett was one of five employees, working for the three managers of Graham-Newman Corporation, a New York investment company. Graham-Newman controlled Philadelphia and Reading Coal and Iron, an anthracite producer that had excess cash, a tax loss carryforward, and a declining business.

At the time, Warren Buffett had a significant portion of his net worth invested in P&R shares, reflecting his faith in the business talents of his bosses, Ben Graham, Jerry Newman and Howard (Micky) Newman. This faith was rewarded when P&R purchased the Union Underwear Company from Jack Goldfarb for \$15 million. Union Underwear, though it was then only a licensee of the name, produced Fruit of the Loom underwear.

The company possessed \$5 million in cash; \$2.5 million of which P&R used for the purchase, and was earning about \$3 million pre-tax, earnings that could be sheltered by the tax position of P&R. And, fully \$9 million of the remaining \$12.5 million due was satisfied by noninterest-bearing notes, payable from 50% of any earnings Union had in excess of \$1 million.

Subsequently, Union Underwear bought the licensor of the Fruit of the Loom name and, along with P&R, was merged into Northwest Industries. John Holland was responsible for Fruit's operations in its most bountiful years. In 1996, however, John retired, and management loaded the company with debt, in part to make a series of acquisitions that proved disappointing. Bankruptcy followed. John was then rehired, and he undertook a major reworking of operations.

Before John Holland's return, deliveries were chaotic, costs soared and relations with key customers deteriorated. While correcting these problems, John Holland reduced employment from a bloated 40,000 to 23,000. In short, he restored Fruit of the Loom in a much more competitive environment.

Charlie Munger has said, "I think track records are very important. If you start early trying to have a perfect one in some simple thing like honesty, you're well on your way to success in this world." Stepping into Fruit's bankruptcy proceedings, Buffett and Munger made a proposal to creditors. They also insisted on a very unusual proviso: John Holland had to be available to continue serving as CEO after they took over. To Buffett and Munger, John and the brand are Fruit's key assets.

When you buy Fruit of the Loom products, you can be assured of comfortable, up-to-date styles at value prices. Fruit of the Loom continues this tradition today with an Unconditional Guarantee. If you are not satisfied with any products for any reason, simply return the garment. You will promptly receive a new replacement, if available, or your money back. Fruit of the Loom stands behind everything it sells.

What are the competitive advantages of Fruit of the Loom? Fruit of the Loom is a dominant player and powerful global brand. The product portfolio includes well established brand names like B.V.D. (Bradley, Voorhees and Day), Funpals/FunGals, Screen Stars and Underoos. Apart from these, Fruit of the Loom also owns and markets brand names like Gitano, Munsingwear, Salem Sportswear and Pro Player. It has been the world's largest manufacturer, distributor and retailer of underwear,

sleepwear and socks for men, women and children for more than 150 years. The familiar logo with the apple, purple grapes, green grapes, currants and leaves is a widely recognizable trademark. And, the company has a significant market share for basic apparel.

The most important competitive advantage of Fruit of the Loom is its respected brand combined with a huge geographical distribution network. These markets offer strong growth and visibility to the company. Fruit of the Loom is widening its moat by leveraging its brand building exercise with advertising that is fuelling growth. The market size of undergarments is huge, with a fast-growing premium segment.

Fruit of the Loom offers an unconditional guarantee on all the products it sells. The company's strong distribution network is a barrier that prevents losing market share to competition from international premium innerwear brands.

Fruit of the Loom's distribution network includes all major discount chains and mass merchandisers, wholesale clubs, and screen printers. The company also sells too many department, specialty, drug and variety stores, national chains, supermarkets and sports specialty stores.

Fruit of the Loom has a sustainable competitive advantage because it has a strong foothold in North American and European markets. It is also entering into emerging markets to tap the benefits of higher disposable incomes, better lifestyles and rising aspirations. Fruit of the Loom is also entering Asian and African markets through niche branding campaigns that enhance brand visibility. Both Asian and African markets are large addressable markets which are still underpenetrated. Increasing advertising will create added awareness about the premium segment.

Considering the fact that only one-third of the total inner-wear market is organized, coupled with a retail revolution spreading across the world, there is a huge market open for growth. An aggressive push of these existing brands in domestic and global markets can widen Fruit of the Loom's moat.

Fruit of the Loom is one of the few players in the industry to have a vertically integrated business model. Although the company does not process the yarn in-house, it follows stringent checks at each level of the value chain. It procures and supplies yarn to its dedicated suppliers for knitting and processing operations. This model helps the company maintain strict controls on the quality and packaging of its products.

The Fruit of the Loom brand names have plenty of scale to expand into new markets and grow its moat.

GARAN INCORPORATED COMPETITIVE ADVANTAGES

BUD LABITAN WITH DR. EDWIN FUENTES

Garan is a manufacturer of apparel, whose largest and best-known brand is Garanimals®. Garan, Inc. is engaged in the design, manufacture, and sale of men's, women's, and children's apparel under the Garanimals, Garan, Bobbie Brooks, and private label names.

In 1957, Garan was incorporated as a merger of seven companies. Its name originated from "Guarantee." Garan went public in 1961, and most of its output is sold to mass merchandisers, major national chain stores, department stores, and specialty stores. Wal-Mart Stores Inc. accounts for over 85 percent of company sales, while nearly 10 percent of sales stem from the company's relationship with JC Penney Company Inc.

By 1961, Garan was the nation's leading manufacturer of men's and boys' knitted sport shirts. Knitted products were being made from cotton, acrylics, polyester and cotton blends, and texturalized nylon yarn. Woven products were being made from cotton and rayon and from cotton, acetate, and polyester blends. About two-thirds of its output was being sold under private labels, with the remainder selling under the Garan name. Accounts included Macy's, JC Penney, Woolworth's, and Sears, Roebuck.

Garan was headed by the president and chairman, Samuel Dorsky, and the executive vice-president, Seymour Lichtenstein. Its property in 1962 consisted of six leased factories in Kentucky, Mississippi, Pennsylvania, and Tennessee. Net sales rose to \$12 million in 1962 and the company then declared a dividend for the first time.

All nine of the company's plants were situated in the less unionized South. JC Penney and Sears were taking about two-thirds of total production. Garan's net profit increased for the eighth year in a row.

Profits fell for the first time in 1966 because of inventory write-offs in velour, high costs for a computer system subsequently phased out, and the

costs of decentralizing companywide operations. Net income passed the \$1 million mark in 1967, and doubled in 1968, but fell to \$920,000 in 1969 as the company's Ban-Lon sweaters and shirts met with increased competition. By 1972, higher productivity, tighter cost controls, fewer markdowns, and a wider mix of products were credited for Garan's turnaround.

The company started making men's pants in 1969, jeans for girls in 1971, and children's apparel in 1972. By the mid-1970s, Garan was a broad-based producer of apparel for all ages.

Branded children's apparel was introduced in 1972 under the Garanimals label, a system of coordinating tops and bottoms with color-keyed mix-and-match animal tags and hangers.

A licensing division established in 1975 began distributing sweatshirts, sweaters, knit shirts, and T-shirts bearing designs of professional sports leagues and teams.

There were 23 Garan plants at the end of 1977, a year in which net sales reached \$122.8 million and net income rose to \$7.7 million. The Garanimals label accounted for 30 percent of sales volume. Sears and JC Penney remained the largest of Garan's more than 2,000 accounts. Longterm debt was only \$1.9 million. About 44 percent of the company's shares of common stock was closely held.

Garan averaged an excellent annual return on equity of more than 17 percent between 1979 and 1983. Sales of children's clothing represented about 70 percent of the 1983 sales total. Garanimals enjoyed higher profit margins than the firm's private labels.

Licensed sweatshirts and T-shirts continued to be marketed. Garan Advantage, a line of discounted men's sportswear with the same tagging system as Garanimals, was introduced in 1982. Garan Man, a sportswear line of knit and woven shirts, casual slacks, and pullover and cardigan sweaters, was unveiled the following year. Also in 1983, the company introduced Garan By Marita for women.

At the end of 1985, there were 20 company plants distributed throughout seven southern states: Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Oklahoma, and Tennessee. A manufacturing facility was established in Costa Rica in 1984, and two facilities were opened in El Salvador during fiscal 1985. Seymour Lichtenstein had succeeded Dorsky as chairman and chief executive officer.

In 1985, Garan sales fell to \$105 million. In 1986, earnings dropped to a low of \$2.2 million the following year. A number of factors were blamed, including cheap imports, the demise of the preppy look, and the miniskirt disasters.

The company cut back on branded products, which accounted for only 47 percent of sales in 1988, compared with 75 percent in 1986. It introduced Bobbie Brooks, an in-house label for Wal-Mart Stores' women's clothing, and began a licensed menswear line featuring the insignia of professional sports teams. Company plants were retooled for lower costs and greater efficiency. Sales and profits improved in 1990.

By 1992, Wal-Mart was growing and it accounted for 45 percent of Garan's annual sales. A licensing agreement in 1990 gave Garan the right to carry the insignias of various colleges and universities on sweatshirts and knit shirts. In 1991, it became one of the few apparel companies allowed to use characters from Disney movies.

During 1988-92, the company earned an annual average of almost 18 percent on equity. But, 1995 results were disappointing. Its market value, once nearly \$190 million, dipped to less than \$90 million. Some analysts blamed the company's heavy dependence on Wal-Mart. WalMart accounted for 63 percent of sales during fiscal 1995. Oversaturation in licensing, rising raw material costs, and competitive cut-throat pricing were also cited as reasons for the firm's poor performance.

During 1995, Garan became the exclusive licensee of the Everlast trademark for men's, boys', and girls' activewear, and of the trademark Hang Ten for boys' sportswear. Children's apparel accounted for 72

percent of Garan's net sales, with women's apparel accounting for 18 percent. Men's apparel accounted for 10 percent. Sales of sports and colleges licensed apparel accounted for about 12 percent of sales. Garan's own label accounted for about 6 percent. The Bobbie Brooks label accounted for another 7 percent. Disney characters, scenes, and logos accounted for about 8 percent.

In addition to Wal-Mart, JC Penney was an important customer that provided 20 percent of Garan's sales. Some 3,500 or so clients took the rest of the company's output. Garan maintained 18 manufacturing plants.

Dividends had been paid every year since 1962. Competition remained fierce in the apparel industry well into the late 1990s and beyond. Charlie Munger has said, "You need to have a passionate interest in why things are happening. That cast of mind, kept over long periods, gradually improves your ability to focus on reality. If you don't have the cast of mind, you're destined for failure even if you have a high IQ." So, the same idea can apply to Garan. Since competition is fierce, its managers must keep an eye on where the apparel industry is going and be ready to make adjustments.

Garan continued to rely heavily on its relationship with Wal-Mart and its other large customer. Sales in 2001 reached \$257 million, an increase of 8.9 percent over the previous year. Net earnings rose as well, climbing from \$17 million in 2000 to \$22.6 million in 2001. The company phased out its sports team and college and university licensed activewear and management began laying the groundwork for a major change that would secure a financially sound future.

In 2002, the firm struck a deal with Berkshire Hathaway Inc. Buffett made a \$60 per share cash offer for the firm, believing it would fit nicely into Berkshire Hathaway's apparel division along with Fruit of the Loom Co., the underwear manufacturer purchased earlier in the year. Seymour Lichtenstein remains at the helm, confident that Garan will succeed in the years to come as a Berkshire Hathaway subsidiary.

GATEWAY UNDERWRITERS AGENCY COMPETITIVE ADVANTAGES

BUD LABITAN WITH DANIEL RUDEWICZ, CFA, FURLONG FINANCIAL, LLC

Gateway Underwriter's Agency is a leader in serving independent insurance agents. Gateway Underwriters Agency ("Gateway") has been a successful profitable general agency serving independent agents in Missouri, Illinois, Kansas, Arkansas, Iowa and Nebraska.

Founded in 1954, Gateway is now a subsidiary of Berkshire Hathaway Inc. Its product segments include transportation garage, property & casualty, specialty & professional and personal insurance. With the acquisition of Gateway into the Berkshire Hathaway family of companies, Gateway's economic moat grew bigger. Its historical client relationships have additional access to other Berkshire Hathaway insurance subsidiaries and non-insurance businesses.

Gateway Underwriter's Agency is a professional wholesale insurance agency that acts as a general agency for independent agents. It serves as a general agent, intermediary, or middle man for the independent insurance agent.

The independent agent has the relationship with the insured (or potential insured) client and the general agent provides a link to the companies that actually provide the insurance. Gateway Underwriters Agency strives to be the best servicing general agency throughout the United States. Gateway Underwriters provides its customers competitive products and excellent customer service.

Specializations:

Gateway Underwriters Agency's team of insurance professionals has developed in-depth product knowledge in the following areas:

- Transportation: Commercial risks from a single unit to large fleets. We write just about anything that has wheels. Its largest classes are

concrete mixers, contractors' vehicles, dump trucks, garage, public auto, used car dealers, towing operations and social service.

- Property & Casualty: Apartment, Bars/tavern/restaurants, habitational, mercantile stores, child care, vacant buildings with and without renovations, contractors – general & artisan, and special events.
- Specialty & Professional: Directors & Officers – for and non profit, employment practices liability, Errors & Omissions – all classes, event cancellation, prize indemnification
- Personal lines: Vacant dwellings with and without renovations, personal umbrella, apartment & condo renters and dwelling package, and comprehensive personal liability.
- Cyber Liability Insurance is a new product from Gateway. It offers protection for both the expenses and the legal liabilities associated with data security privacy breaches. These are exposures that are not typically covered by traditional insurance policies.

Customers or employees who entrust businesses with personal or private information, such as credit card or social security numbers put businesses at risk. If that data is lost, stolen or compromised, a business could face substantial legal liability. When personally identifiable information is compromised, businesses may be legally obligated to alert those impacted by the breach. Cyber Liability coverage helps mitigate the financial impact of data breaches associated with: Credit card information, Personal financial information, Personal health information, Business information of others (trade secrets), and customer or employee confidential information. A study of the data breach experience of 43 U.S. companies puts the average cost of an incident at \$202 for each customer record compromised.

Cyber Liability Coverage Provides for the expenses associated with such incidents. These include: Compliance with data breach notification laws, Securing legal counsel to advice on incident response, Providing credit file monitoring to victims, Hiring forensic experts to investigate the breach, and Paying regulatory defense and penalties from privacy law violations.

Prior to joining the Berkshire Hathaway Group, Gateway Underwriters Agency has been a successful and profitable professional wholesale insurance agency. Gateway is both a sales and underwriting organization committed to partnerships with retailers and work together with retailers to mutually grow their businesses. Gateway Underwriters Agency's managers are professionals who developed a successful regional franchise because they were able and trustworthy.

Their customers valued this relationship and did not want to switch to substitutes. The addition of access to other Berkshire Hathaway insurance subsidiaries is a plus. It is an additional step in building up Gateway's economic moat.

Warren Buffett wrote, "Insurers sell a non-proprietary piece of paper containing a non-proprietary promise. Anyone can copy anyone else's product. No installed base, key patents, critical real estate or natural resource position protects an insurer's competitive position. Typically, brands do not mean much either. The critical variables, therefore, are managerial brains, discipline and integrity. Our results have been exceptional for one reason: We have truly exceptional managers."

Gateway managers have managerial brains, discipline and integrity. They are experienced at providing next day binding quotes from the strongest insurers. Managers should remember Charlie Munger's helpful idea about thinking; "Rationality is not just something you do so that you can make more money, it is a binding principle. Rationality is a really good idea. You must avoid the nonsense that is conventional in one's own time. It requires developing systems of thought that improve your batting average over time."

The original Gateway franchise as well as the added backing of Berkshire Hathaway's financial strength gives Gateway a distinct advantage over its competitors. Are these advantages sustainable for the next 10 years? To look at the sustainability of Gateway's moat, it is helpful to look at it from a competitor's view. For another general agent to compete with Gateway offers, that general agent would need to build up a regional franchise that develops a network of trusting relationships. Such an agency would need to align with an A++ insurer. The independent agents that use Gateway trust Gateway's ability to deliver its services reliably and on time. These

independent agents need a strong and trustworthy partner. They have clients who are looking for insurance policies with the highest ratings. Over the next 10 years, it is not likely that another general agent will be able to profitably cross Gateway's economic moat. Gateway is a regional brand that can build its moat bigger by exercising its "brains, discipline and integrity."

GEICO AUTO INSURANCE COMPETITIVE ADVANTAGES

BUD LABITAN WITH FLORIAN BEIL, UNO-CBA

Warren Buffett said that GEICO represents the best of all investment worlds. It has a hard to duplicate business advantage and extraordinary management. Geico's main competitive advantage is lower cost in providing auto insurance. This is achieved because of direct sales to the customer without using middlemen. It was founded in 1936 and is now the third-largest private passenger auto insurer in the U.S.

GEICO had enjoyed an advantage that had produced staggering success. Charlie Munger said, "GEICO, got to thinking that, because they were making a lot of money, they knew everything. And they suffered huge losses. All they had to do was to cut out all the folly and go back to the perfectly wonderful business that was lying there." Then, from the edge of bankruptcy in 1976, the managerial brilliance of Jack Byrne helped restore GEICO's fundamental lower cost business advantage. This low cost advantage was still intact, but it was submerged in a sea of financial and operating troubles.

GEICO was established by Leo and Lillian Goodwin in 1936. It was designed to be the low-cost operation in an enormous marketplace of auto insurance. Run as designed, it could offer unusual value to its customers while earning good returns. In 1948, investment banker Lorimer Davidson joined the company and expanded its pool of investors. In 1951, Columbia University business student Warren Buffett made his first purchase of GEICO stock. "Davey" was a major influence on Buffett's learning about the insurance industry. In 1958, Leo Goodwin retired and was succeeded by Lorimer Davidson.

At the time that Berkshire Hathaway's GEICO holding cost \$47 million, it produced \$20 million of earning power in a business with first-class economic characteristics and bright prospects. Buffett said that an alternative investment would cost a minimum of \$200 million and more in some industries.

Sometimes, insurance competitors who hold bonds that are declining in price have major financial problems. These competitors try to defer problems by adopting a "sell-at-any-price" policy. Buffett has said that companies selling bonds at price levels forcing recognition of major losses can find themselves frozen in investment posture for a decade or longer. Companies that have made extensive commitments to long-term bonds may have lost, not only many of their investment options, but many of their underwriting options as well.

In 1980, GEICO introduced 24-hour, 365-telephone customer service. In 1993, Chairman Olza "Tony" Nicely became the new CEO and he implements a new strategy to expand the customer base. Nicely increased focus on advertising that resulted in higher national visibility.

GEICO became a wholly owned subsidiary of Berkshire Hathaway in 1996. Since then its market share has risen from 2.5% to 8.21% as of 2009. In 2002, GEICO passed the 5 million policyholder mark. In 2007, GEICO passes the 8 million policyholder mark. In 2009, GEICO passes the 9 million policyholder mark and opened for business in Massachusetts. This made GEICO coverage and services available in all 50 states. In 2010, GEICO passed the 10 million policyholder mark.

GEICO is the first insurance company to offer the ability to purchase a policy in a mobile-friendly format via iPhone and Android mobile devices. Today, GEICO's assets have reached \$28 billion, and the company looks forward to even more growth.

It has more than 10 million auto policyholders and insures more than 16 million vehicles. Furthermore, it offers insurance for other vehicle types, homeowner, renters, life insurance and some other insurance types.

Geico also has high ratings in the industry for financial strength and claims-paying ability: AA+ from Standard and Poor's, Aa1 from Moody's and A++ from A.M. Best.

One of Geico's competitive advantages is that they use a direct-to-consumer sales model. They do not rely on agents, but mostly sell and support policies 24 hours a day, 7 days a week, 365 days a year through telephone and internet. This gives them a significant cost advantage over other competitors that rely on agents.

Geico is well-known for its advertising. Their commercials are very popular, especially because they aim to amuse the viewer and not to simply convey the benefits Geico offers its customers. While they always include "15 Minutes can save you 15% or more on car insurance," their commercials always focus on different entertaining themes. On Youtube their commercials get 7 digit numbers. One of their latest commercials "Piggy" got over 8 million views. These numbers affirm the popularity and the quality of the advertisements. Getting consumers to look up commercials is a great achievement. None of Geico's competitors achieved a similar success with their commercials. Moreover, their mascot the Gecko is one of the most recognizable

"characters" in the industry.

Geico is now a wholly-owned subsidiary of Berkshire Hathaway, which is ranked 15th in Forbes Global 2000 list and 8th if sorted by market value. Berkshire Hathaway is a large conglomerate that is especially strong in the investment and insurance sector. Being part of Berkshire Hathaway is another competitive advantage of Geico, because this gives financial backing for future growth.

Warren Buffet, widely regarded as one of the most successful investors in the world, can also be viewed as a competitive advantage in capital allocation.

In 2009 Geico had an \$800 million annual advertising budget, close to twice that of the runner-up advertiser in auto insurance field. These high expenses and the resulting success of their advertising given it a very well-known brand. This can also be seen as a competitive advantage.

In the highly competitive insurance industry, Geico's direct sales model keeps prices low. Prices and service have helped them build and grow this successful brand and economic moat.

Geico is without any reasonable doubt sustainable for the next 10 years. In about 15 years they grew into the United States' third-largest private passenger auto insurer. Their direct-to-consumer sales model is lean, efficient and future-oriented. Their brand is strong and their advertising is successful.

In a Berkshire Hathaway letter to the shareholders, Warren Buffett wrote that their "low-cost producer" status is sure to give them significant gains in the future. Founded on lower cost, quality coverage, and outstanding customer service, GEICO should continue to be a strong competitor.

GENERAL RE COMPETITIVE ADVANTAGES

BUD LABITAN WITH RAGHU DASARI, UNO-CBA AND THEODOR TONCA

Gen Re is a leading provider of reinsurance products and services to support clients in their risk management tasks. It was acquired by Berkshire Hathaway in 1998, and called "first-class in every way" by Warren Buffett. Despite this, the company was plagued by a myriad of problems almost immediately after it was purchased.

When Buffett agreed in 1998 to merge Berkshire with Gen Re, he thought that the company followed these three rules: "(a) underwrite with unwavering discipline; (b) reserve conservatively; and (c) avoid an aggregation of exposures that would allow a supposedly "impossible" incident to threaten its solvency."

Buffett had studied Gen Re's operation for decades and he had observed underwriting discipline that was consistent. He also noted that their reserving was conservative. However, after the purchase, he detected slippage in Gen Re's standards. Gen Re's culture and practices had changed. The company was grossly mispricing its business.

In the past, Charlie Munger has said, "People calculate too much and think too little." In this case, Gen Re had accumulated an aggregation of risks that could have been fatal if the U.S. had a mega-catastrophe. Both Buffett and Munger knew the problem. Had Gen Re remained independent, the World Trade Center attack alone would have threatened the company's

existence. Gen Re has since managed to reduce its aggregation of nuclear, chemical and biological risk (NCB) to a tolerable level.

Also, Gen Re's underwriting attitude has been altered towards writing only properly-priced reinsurance contracts, whatever the effect on volume. Warren Buffett has always emphasized the importance of proper reserving and risk (minimization) management. He said, "Any insurer that has no idea what its costs are is heading for big trouble."

At the end of 2001, General Re attempted to reserve adequately for all losses that had occurred prior to that date, and were not yet paid. However, they failed. Therefore, the company's 2002 underwriting results were penalized by an additional \$1.31 billion to correct the estimation mistakes of earlier years.

General Re is now well positioned to deliver huge amounts of no-cost float to Berkshire. Its lethal catastrophe risk has been eliminated. The company still possesses the important competitive strengths that Buffett outlined in the past. And it gained another highly significant advantage in 2002 when each of its three largest worldwide competitors, previously rated AAA, was demoted by at least one rating agency. General Re rates AAA in respect to its financial strength.

When Buffett and Munger purchased Gen Re, it came with General Re Securities, a derivatives dealer that they did not want. They judged it to be dangerous. After failing to sell the operation, they decided to terminate it.

Buffett said that the reinsurance and derivatives businesses are similar because once you write a contract, which may require a large payment decades later, you are usually stuck with it or some other form of residual liability. And, contracts involving multiple reference items and distant settlement dates increase the opportunities for counterparties to use fanciful assumptions. He warned, "In extreme cases, mark-to-model degenerates into what I would call mark-to-myth."

Unwinding these derivatives was no easy job. "General Re Securities at yearend 2002 (after ten months of winding down its operation) had 14,384 contracts outstanding, involving 672 counterparties around the world."

Many derivatives contracts require that a company suffering a credit downgrade immediately supply collateral to counterparties. This can impose an unexpected demand for cash. The need to meet this demand can throw a company into a liquidity crisis. In some cases, more downgrades can spiral down to a corporate meltdown. In that 2002 annual letter, Buffett went on to warn about “corporate linkage” and a “chain reaction” threat within an industry. So, it pays to minimize links of any kind.

In retrospect, the following passage now appears predictive of the credit bubble burst of the late 2000’s: “Large amounts of risk, particularly credit risk, have become concentrated in the hands of relatively few derivatives dealers, who in addition trade extensively with one other. The troubles of one could quickly infect the others... Linkage, when it suddenly surfaces, can trigger serious systemic problems.”

In 2006, after a long unwinding road, Warren Buffett was happy to report his: “last discussion of the losses at Gen Re’s derivative operation. When we started to wind this business down early in 2002, we had 23,218 contracts outstanding. Now we have 197. Our cumulative pre-tax loss from this operation totals \$409 million, but only \$5 million occurred in 2006.”

However, some legal difficulties continued. Gen Re was investigated by the New York Attorney General, the Securities & Exchange Commission and the U.S. Justice Dept. These probes looked into the company’s questionable deals with AIG. Two former Gen Re executives plead guilty to conspiracy to commit fraud charges, and to making dubious underwriting decisions which resulted in losses of close to \$3 Billion in 2001.

Despite this rocky start, Berkshire decided not to sell the business. It appointed some very capable managers to operate it, including the company’s present Chairman, President & CEO Tad Montross. Underwriting losses eventually reversed under Montross’s leadership and today Gen Re is one of the largest Life & Health/Property & Casualty Re-insurance companies in the world.

Gen Re provides reinsurance solutions to all segments of the insurance industry on both a Treaty and Facultative basis. Its core product offering

consists of Property & Casualty reinsurance in North America through General Reinsurance Corporation.

Life & Health reinsurance is sold via their General Re Life Corp. in North America and internationally through General Reinsurance AG. The company also operates several other complimentary business lines including Gen Re Intermediaries, which is a reinsurance intermediary, Genesis, an alternative risk insurance provider and USAU, which underwrites aviation insurance.

Charlie Munger commented on the re-insurance industry in the following manner: “The reinsurance business has the defect of being too attractive-looking to new entrants for its own good and will therefore always tend to be the opposite of, say, the old business of gathering and rendering dead horses that always tended to contain few and prosperous participants.”

The following facts help us understand the insurance industry:

- The insurance industry is highly homogeneous so far as the service provided is a commodity.
- The industry was an oligopoly in the middle of the last century with somewhat significant barriers to entry, now it is very competitive, with no impediments to information flow and practically no barriers to entry.
- In this homogeneous and highly competitive industry, one of the keys to differentiation is the management team. How competent, intelligent and honest are they?

Indeed, if we were to look back at several successful Berkshire owned insurance firms over the years, the key ingredient to their success was competent management.

Tad Montross, current Chairman & CEO, appointed in April 2008, has been with the company since 1978. He understands it intimately. He has re-positioned the firm to focus on its core competency of underwriting; and away from derivatives and other lines of business.

Gen Re's operations have also become more streamlined. Its cost of float, which is perhaps the most important metric by which to judge an insurer's business, has decreased.

These two attributes, low cost of capital (float) and competent management go a long way towards giving an insurer a competitive advantage.

Direct underwriting, risk management, claims management, and client relationships are the heart of the advantages Gen Re provides to clients. Gen Re management believes that direct distribution offers significant benefits to both clients and itself. Gen Re is in the position of having clients' interests clearly aligned with Gen Re's.

Another competitive advantage of Gen Re is its leadership experience in underwriting research and development that they undertake and share with clients on topics of mutual interest. From emerging issues research to a broad range of publications, client training and seminars, Gen Re underwriters share critical information to help clients make better informed underwriting decisions.

The quality of Gen Re's commitment to pay claims is unparalleled. Supported by a strong network of expert referrals, Gen Re's claim experts stand ready to work with clients to help them achieve better outcomes for their complex claims. Gen Re's transactional excellence works from initial contract to the final claims payment.

Within Berkshire Hathaway, the General Re subsidiary is bigger and it has a presence in 45 countries. General Re now has a bigger "economy of scale" in the underwriting of Life, Health, Property, and Ocean insurance.

General Re has excellent financial strength and an excellent rating from A.M. Best, Moody's, and S&P. This financial strength is a sustainable moat because unlike most reinsurers, General Re and Berkshire Hathaway retain all of the risks assumed. Therefore, ability to pay is not dependent on others. This independent financial strength can be very important when the industry experiences a mega-catastrophe.

Warren Buffett wrote, "Insurers sell a non-proprietary piece of paper containing a non-proprietary promise. Anyone can copy anyone else's product. No installed base, key patents, critical real estate or natural

resource position protects an insurer's competitive position. Typically, brands do not mean much either. The critical variables, therefore, are managerial brains, discipline and integrity. Our results have been exceptional for one reason: We have truly exceptional managers."

H.H. BROWN SHOE GROUP COMPETITIVE ADVANTAGES

BUD LABITAN WITH MERVYN H. TEO, SINGAPORE

Berkshire Hathaway acquired the H. H. Brown Company in 1991 and the Lowell Shoe Company 1992. Dexter Shoe was added to this group in 1993. Note that the H. H. Brown Shoe Group has no connection to the Brown Shoe Company of St. Louis. The H. H. Brown Shoe Group is the leading North American manufacturer of work shoes and boots. It had a history of earning high margins on sales and assets.

Warren Buffett's enthusiasm for buying H. H. Brown came from Frank Rooney's willingness to continue as CEO. Buffett was impressed by the H. H. Brown managers and its unusual compensation system. Managers were paid a low base salary plus a designated percentage of the company profits after these were reduced by a charge for capital employed.

However, Warren Buffett admitted that "Shoes are a tough business... most manufacturers in the industry do poorly. The wide range of styles and sizes that producers offer causes inventories to be heavy; substantial capital is also tied up in receivables." In 1994, Buffett wrote, "I made an even worse mistake when I said "yes" to Dexter, a shoe business I bought in 1993 for \$433 million in Berkshire stock (25,203 shares of A). What I had assessed as durable competitive advantage vanished within a few years... By using Berkshire stock, I compounded this error hugely. That move made the cost to Berkshire shareholders not \$400 million, but rather \$3.5 billion. In essence, I gave away 1.6% of a wonderful business – one now valued at \$220 billion – to buy a worthless business... To date, Dexter is the worst deal that I've made."

From 1991 to 1993, Buffett spent \$650 million to buy three sellers of midprice shoes: H.H. Brown, Lowell, and Dexter. Did he underestimate the brutal competition in this area? Some say that he was betting that the

appeal of imports might wane. Certainly, he must have overweighed the value of excellent managers. And, he must have underweighted or missed a durable competitive advantage in this largely commodity business. Imports account for most of the domestic shoe purchases. And, since 1994, profits of Berkshire's shoe group have plummeted.

At its peak, the Dexter subsidiary, as an independent company, manufactured over 7.5 million pairs of shoes annually, and generated annual sales exceeding \$250 million. Established in 1956, Dexter Shoe operates 77 retail outlets throughout New England, New York, and New Jersey. Dexter Shoe manufactures overseas, and it distributes rugged recreational footwear, golf and bowling shoes, and comfort casual shoes for men and women. Dexter Shoe also supplies a national and international wholesale market from its 485,000 square foot complex in Dexter, Maine.

With the advent of China and other emerging markets as a super low cost producer of consumer goods, the competitive advantage of H. H. Brown Shoes slowly eroded. This problem is exacerbated by the fact that the firm focused on the low margin, low priced segments which the emerging producers excelled in. More importantly, H. H Brown shoes did not have a proprietary or strong patented design and models which made it difficult for the firm to defend its moat. Competing purely based on scale and price proved to be deadly, as in the demise of Dexter Shoes. In trying to build a moat, the firm is venturing into online stores and higher margin products.

How have they dealt with increased competition and decreasing margins? Since being acquired by H.H. Brown, Dexter Shoe has been searching for improved efficiencies by increasing warehouse capacity and reducing costs. The H.H. Brown team was interested in creating a multi-division distribution center which would allow consolidation of all product lines, and require less warehouse facilities. Due to its large capacity and existing conveyor automation, Dexter was chosen as the site for the new consolidated center. It began implementing a new multidivision capable warehouse software management system. The new system, built by The Integrated Solution Group, was designed to bring about efficiency improvements and integration with their automated conveyor systems and customized Pitney Bowes shipping system. H.H. Brown is striving to be more competitive with operational consolidation, and maximizing the

utilization of Dexter Shoe's facilities. This allowed disposition of excess H.H. Brown real estate in other parts of the country.

In trying to build a moat, H.H. Brown is affiliated with two internet stores, www.shoeline.com and www.supershoes.com. H. H. Brown is also affiliated with SuperShoes, a 43 store chain extending from Maine to South Carolina. H.H. Brown's Fine Leather Goods flagship store, located on prestigious Greenwich Avenue in Greenwich, CT, specializes in fine leather footwear and unique accessories for both Men and Women. And, H. H. Brown's Eservice for retailers is a powerful new web interface to help retailers.

In February, 2011, H.H. Brown opened its new permanent showroom in the heart of New York City. The 21,000-square foot showroom, located on the 14th floor of 1441 Broadway, welcomed buyers, retailers, and the media. H.H. Brown unveiled the Fall 2011 collections on the first day of the Fashion Footwear Association of New York (FFANY) show.

This new location near Times Square is located between 40th and 41st street. It offers convenience and accessibility for both uptown and downtown bound travelers. The year-round exhibition space will be the permanent showroom for H.H. Brown's well-known brands including Børn, Söffft, Vintage Shoe Company, Kork-Ease, and Walk-Over.

About change, Charlie Munger has said, "Those who will not face improvements because they are changes, will face changes that are not improvements." While the H. H. Brown Shoe Group has been the leading North American manufacturer of work shoes and boots in the past, it has had to cut costs, improve distribution efficiency, and seek profit in new areas of growth. The move into higher-margin brands and brand building will be an interesting process to monitor.

HELZBERG DIAMONDS COMPETITIVE ADVANTAGE

BUD LABITAN WITH NATALJA CALLAHAN, UNO-CBA

Helzberg Diamonds is one of the nation's leaders in selling fine jewelry. Why Helzberg Diamonds? Warren Buffett and Charlie Munger are known for buying companies that are "wonderful businesses" and are considered to be "best in their class."

Warren Buffett negotiated three acquisitions in 1995, a bullish year in the stock market. Two of these were Helzberg's Diamond Shops and R.C. Willey Home Furnishings. The largest purchase, GEICO, closed after the end of the year.

Helzberg Diamonds is a well run retailer whose experts hand-inspect the craftsmanship and quality of every piece of jewelry. They sell and stand behind products with a comprehensive, 60-day guarantee. So, shopping with Helzberg is a chance to own something uniquely special.

We examine why Buffett and Munger chose Helzberg Diamonds by taking a closer look at the competitive advantages that sets Helzberg apart from similar companies. Its economic moat appears to be an experienced management team running a business model with high superior per-store productivity.

In May 1994, Warren Buffett was crossing the street at 58th and Fifth Avenue in New York. Barnett Helzberg, Jr., who owned four shares of Berkshire, said he had a business Berkshire might be interested in. Not long after, Barnett sent Buffett the financial statements of Helzberg's Diamond Shops. Started by Barnett's grandfather in 1915 from a single store in Kansas City, it had developed into a profitable franchise with 134 stores in 23 states. Sales had grown from \$10 million in 1974 to \$53 million in 1984 and \$282 million in 1994.

Barnett loved the business but also wanted to feel free of it. In 1988, he brought in Jeff Comment, formerly President of Wanamaker's department stores in Philadelphia, to help him run things. Barnett still found that he couldn't shake a feeling of ultimate responsibility. Additionally, he owned a valuable asset that was subject to the vagaries of a single, very

competitive industry, and he thought it prudent to diversify his family's holdings.

Charlie Munger admires a well run retail chain with a scale advantage. He said, "On the subject of economies of scale, I find chain stores quite interesting. Just think about it. The concept of a chain store was a fascinating invention. You get this huge purchasing power - which means that you have lower merchandise costs. You get a whole bunch of little laboratories out there in which you can conduct experiments. And you get specialization."

Helzberg's was the kind of profitable business that Buffett and Munger like and, Jeff Comment was their kind of manager. In fact, Berkshire would not have bought the business if Comment had not been there to run it. Buffett wrote, "Buying a retailer without good management is like buying the Eiffel Tower without an elevator." Sadly, Jeff Comment died suddenly at age 60. Jeff Comment, who spent more than 30 years working in high-level retail positions, had been with the 264-store retail jewelry chain for 16 years. Upon joining Helzberg in 1988 as president, Comment worked alongside company chairman Barnett Helzberg, Jr.

In 1995, the Helzberg's Diamond Shops purchase was made with a taxfree exchange of stock. It was the only kind of transaction that interested Barnett Helzberg. Though he was under no obligation to do so, Barnett Helzberg shared a meaningful part of his proceeds from the sale with a large number of his associates.

Helzberg's is an entirely different sort of operation from Borsheim's, and the two companies operate independently of each other. The average Helzberg's store has annual sales of about \$2 million, far more than competitors operating similarly-sized stores achieve. This superior perstore productivity is the key to Helzberg's excellent profits.

At Helzberg Diamonds®, all of their diamonds are closely scrutinized for rarity, beauty, and high standards. Helzberg's sales associates have the ideas, suggestions, and creativity to help customers make the right selection for the right person.

Helzberg provides an exceptional level of service. They offer fast, affordable and secure shipping. Online returns are free. Customers can take up to 60 days to ship it back, or exchange it at any of their 234 stores.

Helzberg Diamonds is one of the nation's leaders in fine jewelry. It offers a wide range of high grade diamonds which has helped the company to build a strong reputation worldwide. The company utilizes some of the best cutters in the industry and quality assurance programs which result in a superior quality product. Helzberg diamond products are priced high but not as high as fine jewelry of other wholesalers in the industry.

Another competitive advantage of Helzberg arrives from using the DataStage XE Analytical system, the on-time sales tracking tool. The software enables the management to view comprehensive business performance data within hours. As a result, the management of each store can quickly make adjustments to the supply of its merchandise while the corporate executives can make broad strategic decisions such as expanding to new markets.

Helzberg Diamond's competitive intelligence in conjunction with fine product offered by the company ensures its sustainability in the future. By having a real time data, the company is able to adjust to changes in the business environment before serious issues arise. This allows them to be one step ahead of its competitors. Continuous data also enables Helzberg Diamonds to develop new strategies to gain additional competitive advantage.

Its economic moat includes an experienced management team running a profitable business model with high superior per-store productivity. This high quality Helzberg brand was built with superior service, and high quality diamonds, into a special franchise. Maintaining and building upon this economic moat will ensure Helzberg Diamonds competitive position in the future.

HOME SERVICES OF AMERICA COMPETITIVE ADVANTAGE

BUD LABITAN WITH SEBASTIAN JUNG, UNO-CBA

HomeServices' one-stop-shopping model for real estate was the idea of Ronald Peltier. In Peltier's view, the residential real estate brokerage business model was highly fragmented, and it needed consolidation. Peltier transformed Edina Realty, a leading real estate company in Minnesota, into an industry pioneer. In 1983, Edina became one of the first to start offering mortgages. It added title services in 1986.

After Peltier took the leadership role in 1992, Edina Realty began expanding beyond the Twin Cities area. In order to fuel growth, Peltier sought out a partner with deep pockets to help fund a buying plan. He found it in 1997 with Omaha-based MidAmerican Energy Holdings Company. HomeServices was created as a holding company for this collection of regional real estate businesses.

When Buffett bought 80.5% of MidAmerican in 2000, HomeServices, and its \$471 million in revenue, came along as a small subsidiary of MidAmerican.

HomeServices of America Inc. now has more than 350 offices. Ron Peltier seeks out the No. 1 or No. 2 player in a region, and the firm's management team must be willing to stick around and keep running the show. Like Warren Buffett, he is not willing to pay a premium for these acquired businesses.

HomeServices main competitor is Realogy Corporation, a global provider of real estate and relocation services. Realogy has a diversified business model that includes real estate franchising, brokerage, relocation and title services. Realogy's brands and business units include Better Homes and Gardens® Real Estate, CENTURY 21®, Coldwell Banker®, Coldwell Banker Commercial®, The Corcoran Group®, ERA®, Sotheby's International Realty®, NRT LLC, Cartus and Title Resource Group. Collectively, Realogy's franchise systems have approximately 14,300 offices and 253,000 sales associates doing business in 101 countries

around the world. Realogy is owned by affiliates of Apollo Management, L.P., a private equity investor.

One competitive advantage of HomeServices is a local region focus and non-branding of the local offices. Peltier usually doesn't re-brand the real estate firms he buys. In most cases, he keeps the original name, like Berkshire does.

Realogy's NRT has a different strategy. NRT, which began buying local firms in 1997, operates almost entirely under its national brand names.

Peltier believes a local brand can be just as powerful. Collectively, the smaller HomeServices sold more extra services than NRT. For example, 60% of HomeServices' customers use it for title insurance and other title services, while 20% or so sign up for mortgages.

Since the acquisition by Berkshire Hathaway, Peltier has bought more than 20 firms. He likes high-growth markets like North Carolina, and they purchased Prudential Carolinas Realty and Graham & Boles Properties Inc. Sellers usually keep their business name and they retain much of their autonomy to decide on marketing, set commissions, and map out strategy for growth.

Collectively, the HomeServices group can cut costs by buying in bulk. Plus, adding mortgage, title, insurance, and escrow services can boost profitability.

Peltier's "regional brand" strategy may get tested if national brands such as Coldwell Banker gain added exposure. However, many smaller competitors may have been forced out of the market by the recent housing and credit bubble bursting.

Peltier also says there may be more bargains for a value-conscious acquirer such as Home-Services. Buffett echoed that sentiment at his annual Omaha confab in April. "If there is indeed some kind of a [real estate] bubble and it's pricked at some point, the net effect might be quite positive in terms of what we could do with our capital," he told shareholders. Warren Buffett said, "Though this business will always be cyclical, it's one we like."

HomeServices mission is to create and deliver an unparalleled customer experience throughout the home transaction process.

HomeServices Guiding Principles are: Adhere to the letter and the spirit of the law. Promote a highly trained, technologically sophisticated, diverse and contemporary workforce. Never take a single person for granted. In this business, the assets of the company go home each evening.

Provide exceptional service to customers and Realtors®. Create a learning environment and share best practices with colleagues. People want to associate with winners, so set a positive example. Recruit management and Realtors® with a commitment to performance with integrity. Establish and monitor financial controls to ensure adherence. Provide honest and accurate disclosure of business facts and financial data. Respect and protect the reputation of HomeServices and its affiliated brands.

Today, the US residential real estate brokerage and management industry includes about 165,000 companies with combined annual revenue of about \$170 billion. The industry is fragmented, with the 50 largest companies accounting for less than 30% of the market share. In a fragmented industry, competitive advantages are achieved by good positioning in the top markets.

When Warren Buffett acquired HomeServices of America Inc. in 2000, the company had 4000 real estate agents. By 2007, the number had increased to 20,000 agents in 20 markets. HomeServices of America's lending division avoided offering risky adjustable-rate loans that have burned many lenders. Furthermore, HomeServices has used the recent real estate crisis to build its economic moat and acquire high quality realty firms that ran into financial problems. Many acquisitions since 2007 were struggling top competitors, which now contribute to HomeServices's strong position in leading markets.

The list of affiliates includes: Carol Jones Realtors, CBSHOME Real Estate, Champion Realty, Edina Realty Home Services, EsslingerWooten-Maxwell Realtors, Harry Norman, Realtors, HOME Real Estate, Huff Realty, Iowa Realty, Koenig & Strey, Long Realty, Prudential California Realty, Prudential Carolinas Realty, Prudential First Realty, Prudential York Simpson, Underwood Realty, Prudential Yost & Little, RealtySouth, Rector-Hayden Realtors, Reece & Nichols, Roberts Brothers Realtors, Semonin Realtors, and Woods Bros. Realty.

HomeServices of America's respected real estate companies have each been in existence for an average of 52 years, and they are well regarded for their unparalleled service.

As this system grows its economic moat, managers should think about Charlie Munger's idea that may be applicable when the macro housing market returns to normalized growth. Munger said, "Spend each day trying to be a little wiser than you were when you woke up. Discharge your duties faithfully and well. Step by step you get ahead, but not necessarily in fast spurts. But you build discipline by preparing for fast spurts."

A major point of pride for HomeServices is the consistent level of quality and dedication exemplified by its sales associates. The company is building its moat and spreading its business model around the country. Regardless of how a home buyer or home seller chooses to do business with HomeServices, its "one-stop shopping" philosophy ensures complete customer satisfaction.

In October 2011, HomeServices of America announced the acquisition of Mobile-based Dauphin Realty, a leading residential real estate firm based in Mobile, Ala., and its surrounding communities. Dauphin Realty will merge with Roberts Brothers real estate company, which was acquired by HomeServices in 2005. With the merger, Roberts Brothers will have a greater number of associates available to help customers buy and sell their home.

Are these competitive advantages sustainable? Yes. Government intervention has stabilized the housing market, and Buffett has reason to believe that the housing market will recover in the coming years. When macroeconomic changes are positive, HomeServices is positioned to be competitive and profitable.

IBM, INTERNATIONAL BUSINESS MACHINES, COMPETITIVE ADVANTAGES

BUD LABITAN WITH TIM BISHOP AND PETER STEIN

IBM is uniquely positioned to profit from global infrastructure growth around the world; and, Warren Buffett realized this in 2011.

International Business Machines Corporation (IBM) is an information technology (IT) solutions company. The Company operates under five segments: Global Technology Services (GTS), Global Business Services (GBS), Software, Systems and Technology, and Global Financing.

Berkshire Hathaway Inc has accumulated a 5.5 per cent stake in IBM. It is the biggest bet in the technology field he has historically shunned. Berkshire Hathaway Inc. recently bought about 64 million shares of IBM at a cost of \$10.7 billion.

With IBM, he invested in a 100-year-old franchise with an impeccably profitable track record. IBM is a business uniquely positioned to profit from global infrastructure growth around the world.

Charlie Munger has often said two things about thinking that can apply here: “Invert, always invert” and “Opportunity comes to the prepared mind.” Next, note that Warren Buffett said that he has read the IBM annual report every year for 50 years. And, this year he got a different slant on it. He said, “I read it through a different lens... just like I did with the railroads... I don't think there's any company that's—that I can think of, big company, that's done a better job of laying out where they're going to go and then having gone there.”

Buffett said that Lou Gerstner saved the company from bankruptcy. Buffett read Gerstner's book "Who Said Elephants Can't Dance?" a second time. Then, Buffett “just came away with a different view of the position that IBM holds within IT departments and why they hold it and the stickiness and a whole bunch of things.” Buffett also had praise for Sam Palmisano, IBM's Chairman and former President.

BUFFETT TO CNBC: “The other thing I would say about IBM, too, is that a few years back, they had 240 million options outstanding. Now they probably are down to about 30 million. They treat their stock with reverence which I find is unusual among big companies. Or they really are thinking about the shareholder.”

Charlie Munger has said in the past, “We all are learning, modifying, or destroying ideas all the time. Rapid destruction of your ideas when the time is right is one of the most valuable qualities you can acquire. You must force yourself to consider arguments on the other side.” In IBM and BNSF, Buffett and Munger have shown a willingness to change their views when the facts have changes.

Buffett acknowledged to CNBC that he bought railroads and control of GEICO on market price highs too. Readers should think about the intrinsic value bargains.

BUFFETT TO CNBC: “I look at everything but most things I decide I can't figure out their future. IBM helps IT departments do their job better. We've got dozens and dozens of IT departments at Berkshire. I don't know how they run. I mean, but we went around and asked them and you find out that they very much get working hand in glove with suppliers. And that doesn't mean things won't change but it does mean that there's a lot of continuity to it. And then I think as you go around the world, IBM, in the most recent quarter, reported double-digit gains in 40 countries. Now, I would imagine if you're in some country around the world and you're developing your IT department, you're probably going to feel more comfortable with IBM than with many companies.

BUFFETT TO CNBC: I said I competed with IBM 50 years ago. I was chairman of the board, believe it or not, of a tech company one time, and computers used to use zillions of tab cards and IBM in 1956 or '7 signed a consent decree and they had to get rid of half the capacity. So two friends of mine, one was a lawyer and one was an insurance agent, read the newspaper and they went into the tab card business and I went in with them. And we did a terrific job and built a nice little company. But every time we went into a place to sell them our tab cards at a lower price and with better delivery than IBM, the purchasing agent would say, nobody's ever gotten fired from buying—by buying from IBM. I mean, we probably

heard that about a thousand times. That's not as strong now, but I imagine as you go around the world that there are—there's a fair amount of presumption in many places that if you're with IBM, that you stick with them, and that if you haven't been with anybody, you're developing things, that you certainly give them a fair shot at the business. And I think they've done a terrific job of developing that. And if you read their reports—if you read what they wrote five years ago they were going to do and the next five years, they've done it, you know, and now they tell you what they're going to do in the next five years, and as I say, they have this terrific reverence for the shareholder, which I think is very, very important.

And I want to give full credit to Lou Gerstner because when he came in, I was a friend of Tom Murphy's and Jim Burke's, and they were on the search committee to find a solution when IBM was almost broke in 1992, and everybody thought they were going pretty far afield when they went to Lou Gerstner.

BUFFETT TO CNBC: Well, you don't have to think of another one, Joe. And if you read his book, you know, "Who Said Elephants Can't Dance?" it's a great management book. Like I said, I read it twice.

There were lots of things in that annual report but the truth is, there were probably lots of things in the report a year earlier or two years earlier that you say, why didn't I spot it then? And I think it was Keynes or somebody that said that the problem is not the new ideas, it's escaping from old ones. And, you know, I've had that many times in my life and I plead guilty to it.

I will tell you one very smart thing that Thomas Watson Sr. said. I knew Thomas Watson Jr. just a little bit. Tom Watson Sr., this applies to stocks. He said, "I'm no genius but I'm smart in spots and I stay around those spots." And that's terrific advice.

"I don't know of any large company that really has been as specific on what they intend to do and how they intend to do it as IBM," Buffett told CNBC in an interview. Buffett said he was convinced by IBM's longterm roadmap and by IBM's entrenched position with major businesses. This "entrenched position with major businesses" is a big part of the durable competitive advantage that he looks for when investing.

Recently, IBM's 5Yr Gross Margin (5-Year Avg.) is approximately 44.0% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 12.3%, while the industry Net Profit Margin (5-Year Avg.) is 11.2%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

IBM customers have a desire to buy professional technology services and products from them. Customers do not want substitutes from less experienced newcomers handling their important data. Therefore, IBM has a respected brand and pricing power to earn a superior return. Customers know that IBM has a network of able and trustworthy support professionals. So, IBM is uniquely positioned to profit from global infrastructure growth around the world.

INTERNATIONAL DAIRY QUEEN, INC. COMPETITIVE ADVANTAGES

BUD LABITAN WITH TARIQ KHAN, UNO-CBA

For many years International Dairy Queen, IDQ, had an uneven performance. Then, in 1970, a Minneapolis group led by John Mooty and Rudy Luther took control and built a strong organization.

In 1998, the International Dairy Queen was purchased by Berkshire Hathaway. Warren Buffett encouraged IDQ holders to opt for cash, the type of payment he prefers. However, only 45% of IDQ shareholders elected cash. They sensed more value in BRK shares.

Charlie Munger has said, "Our ideas are so simple that people keep asking us for mysteries when all we have are the most elementary ideas." Consider that there are over 5,900 Dairy Queen stores operating in 23 countries. All but a handful are run by franchisees. In addition to IDQ franchises, there are 409 Orange Julius operations and 43 Karmelkorn operations. In 190 locations, "treat centers" provide some combination of the three products.

The founders of the Dairy Queen system introduced a new kind of dessert treat and developed the foundation of the franchising industry. The history is of a unique product that created an industry. In the late 1930s, in Kankakee, Illinois, a father and son in the mix plant business were experimenting with a soft frozen dairy product. They contacted Sherb Noble, a good friend and customer, who agreed to run the "all you can eat"

trial sale at his walk-in ice cream store. Within two hours, he dished out more than 1,600 servings.

Food franchising was new, but the new soft serve ice cream machine seemed like a great fit for such a distribution system. After WW2, the system grew at a rapid pace. With only 100 stores in 1947, it grew to 1,446 in 1950 and then to 2,600 in 1955. Today, the Dairy Queen system is one of the largest fast food systems in the world.

Over the years, Dairy Queen acquired Orange Julius® of America and Karmelkorn® Shoppes, Inc. Dairy Queen stores are still the place to satisfy Little League teams celebrating a victory, business people on their lunch break, and families taking time out to enjoy great food and soft serve treats. Each owner of the independently owned and operated establishments worldwide is committed to the slogan "We Treat You Right."

Some of the "hits" include: 1949: DQ introduces malts and shakes. 1955: The Dilly® Bar debuts. 1957: The Dairy Queen/Brazier® concept is introduced. 1958: The Dairy Queen/Brazier food products are introduced. 1961: The Mr. Misty slush treat cools throats in the warm South. 1968: The Buster Bar® bursts forth. 1972: First DQ store opens in Japan and Dennis the Menace becomes the spokes character for DQ. 1979: The DQ system debuts in the Middle East. 1985: More than 175 million Blizzard Treats sold in its first year. 2001: The first DQ Grill & Chill® restaurant opens in Chattanooga, Tenn. 2004: The MooLatte® Beverage line debuts in Mocha, Vanilla and Caramel flavors. 2005: GrillBurgers™ were introduced.

International Dairy Queen's competitive advantages are its name and brand image recognition, its scale in number of stores worldwide, and its straight forward focus on its core products. IDQ's great tasting softserve ice cream is an American icon.

The Dairy Queen Stores do not require a large real estate footprint, so overhead and staffing costs are kept low. International Dairy Queen has a menu of various items, but it has never strayed far from its core product of ice cream. New products tend to complement the sweet tastes of typical American flair including malts, shakes, banana splits, slush treats, hot fudge brownie delights, and mudslide treats. Recently, burgers, hot dogs,

and chicken strips have been added to some stores. The shape or design of the store and its name has become synonymous with a sense of simple “family values,” and 1950s “Americana.” and a staple of weekend post-game parties. The long history of these associations and brandings makes it very difficult for competitors to challenge Dairy Queen in the low cost soft serve ice cream realm.

Warren Buffett said, “Charlie and I bring a modicum of product expertise to this transaction: He has been patronizing the Dairy Queens in Cass Lake and Bemidji, Minnesota, for decades, and I have been a regular in Omaha.”

International Dairy Queen’s advantages are sustainable for many years. The popular brand, tasty products, low overhead, franchise model, and easily reproducible small building design, enable IDQ to expand into new markets like Chinese and Asian locales where space may be at a premium. Its association with historical American foods and past-times and its recognition as “the neighborhood ice cream parlor around the corner,” is generally a popular sell in many emerging markets. Since Dairy Queen served generations in previous symbolic decades of American history, this service record gives it a branding quality that new competitors simply cannot reproduce or replicate.

So, how could a competitor attack such a well branded corporation? It would be almost impossible to attack the brand image of Dairy Queen head on, but a competitor could attempt to associate Dairy Queen to being dated or “your parent’s ice cream shop.” New generations often want new products and tastes of their own. This may be the only way to compete against Dairy Queen. Other possible options are differentiation with the product itself. Diet dairy products, frozen yogurt, and frozen coffee drinks are very popular and continue to gain market appeal. Companies like TCBY and fast food chains have seen success with these products, but Dairy Queen has also offered similar products and could these corporations really displace Dairy Queen in market, brand, and international presence? Fast food establishments like McDonald’s may be able to compete from a cost approach on certain items, but again a lack of product variety and product taste and quality will make any effort by fast food franchises to displace Dairy Queen very difficult.

A possible approach at a cost attack is being seen today with partnerships of Subway Sandwiches and Goodrich Ice Cream. The two organizations share small stores – of which Subway has very many nationwide - to reduce overhead cost and obtain cross-customer purchases. Will this approach of offering a sandwich and less expensive ice cream challenge the full menu, quality, and image of Dairy Queen? This remains to be seen, but again appears unlikely. This approach also places ice cream corporations like Goodrich as the late-comer to the international market that has seen so much growth. IDQ has the firstmover brand loyalty and costs advantages due to its large scale network of associated franchise stores.

ISCAR METALWORKING COMPANIES COMPETITIVE ADVANTAGES

BUD LABITAN WITH KEVIN WALSH, UNO-CBA

Iscar is a leader in precision metalworking tools. It profits from selling a full line supply of high quality precision carbide metal working tools. These include a wide range of carbide inserts and carbide end mills covering most metal cutting applications.

Berkshire Hathaway purchased 80% of ISCAR for \$4 billion in 2006. Its chairman is Eitan Wertheimer, and its CEO is Jacob Harpaz.

Warren Buffett received a short letter from Eitan Wertheimer who described a cutting tool business operating in 61 countries. Buffett said, "Eitan's letter made the quality of the company and the character of its management leap off the page. It also made me want to learn more, and in November, Eitan, Jacob and ISCAR's CFO, Danny Goldman, came to Omaha. A few hours with them convinced me that if we were to make a deal, we would be teaming up with extraordinarily talented managers who could be trusted to run the business after a sale with all of the energy and dedication that they had exhibited previously."

ISCAR's products are small, consumable cutting tools that are used in conjunction with large and expensive machine tools. It is a business run by able and trustworthy managers. In Iscar, Munger said that he and Buffett found management with "super talent and super integrity." Iscar's people develop tools that make their customers' machines more productive.

In 1952, Iscar was established by Israeli entrepreneur and industrialist, Stef Wertheimer, as a one-man shop on the family's kitchen porch. In 1968, "ISCAR blades" plant was established, later renamed to "Blades Technology," when it joined forces with Pratt & Whitney and Rolls Royce. Blades Technology is now one of the largest manufacturers of blades for turbofan engines.

Iscar Metalworking Companies (IMC) is a group made up of Iscar, TaeguTec, and Ingersoll. Iscar Metalworking is one of 60 companies situated at the Tefen park complex and currently employs over 4,000 workers. Iscar Metalworking is represented in nearly 100 countries, where

its products are used in the automotive, aerospace, die and mold, medical and electronics industries.

Over 50% of Iscar Metalworking's sales volume comes from products developed within the last five years. The company devotes approximately 10% of its total resources to R&D activities with over 10% of its employees involved in the process. Iscar has prominent customers in Israel and the rest of the industrialized world. The U. S. Corporate Headquarters and manufacturing facilities are located in Arlington, Texas.

In 2007, Warren Buffett inaugurated an Iscar plant in Dalian, China. Built at a \$50 million investment, it is a smaller copy of the mother plant in Tefen, Israel. 2007-IMC acquired Unitac, a Japanese cutting-tool manufacturer.

IMC has grown into the world's second largest metalworking manufacturer, with over 6,000 employees worldwide and subsidiary offices and agents located in 52 major industrial countries. IMC reports an average of 15% annual growth and generates approximately \$1 billion in exports per year.

Iscar Metalworking Companies has made a commitment to innovation in small, consumable cutting tools that are used in conjunction with large and expensive machine tools. This dedication to high quality has allowed them to become a world leader in major manufacturing industries by providing economical solutions for precision manufacturing firms in a wide variety of industries such as automotive and aerospace. Iscar is also committed to educating its customers on the proper use and enhancement of its products, which also gives the company a big advantage. The combination of innovation and unparalleled customer service creates a significant barrier to the company's competitors.

This advantage can be sustained if the company continues to invest in providing high quality R&D, production, customer service, and customer education in these precision made tools. The combination of innovative products and dedicated customer service leads to high customer satisfaction and ultimately, retention. As Buffett said, "ISCAR makes money because it enables its customers to make more money. There is no better recipe for continued success."

JOHNS MANVILLE COMPETITIVE ADVANTAGES BUD

LABITAN WITH MANPREET SINGH SARAN

Johns Manville is the nation's leading producer of commercial and industrial insulation and also has major positions in roofing systems and a variety of engineered products. The business has earned good, if cyclical, returns.

In December 1999, Buffett agreed to buy Johns Manville Corp. for about \$1.8 billion. This company had been a manufacturer of asbestos products. The much-publicized health problems that affected many people exposed to asbestos led to JM's declaring bankruptcy in 1982. Subsequently, the bankruptcy court established a trust for victims. The major asset of this trust was a controlling interest in Johns Manville, JM.

The trust wanted to diversify its assets. It agreed to sell the business to an LBO buyer that was unable to obtain financing. Warren Buffett and Charlie Munger called Bob Felise, chairman of the trust. They made an all-cash offer with no financing contingencies. The next day the trustees voted to accept the offer.

Jerry Henry, JM's CEO, had announced his retirement plans but Buffett and Munger convinced him to stick around after the acquisition.

Two economic factors probably contributed to the rush of acquisition activity that year. First, many managers and owners foresaw near-term slowdowns in their businesses. A second factor was that the market for junk bonds dried up as the year progressed. Because Buffett and Munger analyze purchases on an all-equity basis, their evaluations did not change. This means that they saw a value bargain in a market leader while their position to finance an acquisition was becoming more competitive.

Johns Manville is based in Denver, Colorado. It has been a leader in manufacturing insulation, roofing materials, and engineered products. JM's stock was included in the Dow Jones Industrial Average from January 29, 1930 to August 27, 1982. That year, it was replaced by

American Express. Chairman & CEO Jerry Henry retired in 2004; Steve Hochhauser became Chairman, President & CEO. Todd Raba succeeded him in the summer of 2007; Raba came from Mid-American Energy Holdings.

JM was founded as the H. W. Johns Manufacturing Company in New York City in 1858 as an early asbestos manufacturer of roofing materials. The Manville Covering Company was founded in Wisconsin in 1885 by C. B. Manville.

H. W. Johns and Manville merged in 1901 to form H. W. JohnsManville, renamed Johns-Manville in 1926. Industrialist Lewis H. Brown was president of the Johns-Manville Corporation in the 1930s.

The corporation faced major class action lawsuits in the 1980s based on asbestos-related injuries such as mesothelioma. When Manville filed for chapter 11 bankruptcy protections in 1982, it was the largest company in United States history to have done so.

The chapter 11 filing shocked financial analysts who forced Manville to post a bond to guarantee payment to their clients. The bankruptcy was resolved by the formation of the Manville Trust to pay asbestos tort claimants in an orderly fashion by giving the trust the lion's share of the equity in the company. The bankruptcy took over 5 years to process.

The company emerged from Chapter 11 in 1988 as Manville Corporation. In 1997 the company changed its name back to Johns Manville. In 2001, Johns Manville became a wholly owned subsidiary of Berkshire Hathaway (NYSE: BRK.A, BRK.B).

Charlie Munger says, "Opportunity comes to the prepared mind." With a depressed stock price arising from the fallout, the company was a good bargain opportunity and it was bought by Berkshire Hathaway in 2000 for about 2.2 billion in cash, and where Berkshire assumed \$300 million in debt. Its stock price was trading at an estimated 7 x P/E when it was acquired.

Products include: Building Insulation (i.e. fiber glass insulation in commercial and residential units), Roofing systems, Commercial and

Industrial piping and duct insulation, and Thermal insulation for Automobiles and Aircraft and Marine vessels.

JM's competitive advantages are: 1. Efficient production and Valuable brand recognition 2. History of offering innovative products over a period of 150 years. And, 3. Efficient Supply Chain Management.

It has about 9 manufacturing facilities across North America which is closely situated to key regional population centers. Such a model allows it to keep shipping distances within a 500 mile radius. This allows it to improve its supply chain, shorten lag times, and reduce transportation costs, thereby improving its overall operating efficiency.

Johns Manville offers a suite of innovative roofing solutions that allows homes to increase overall energy efficiency. Its Formaldehyde-free™ fiber glass building insulation is one such competitive advantage.

Are these advantages sustainable over 10 years? The Obama administration has outlined a series of initiatives to help homeowners increase their overall energy efficiency through the "HOMESTAR" federal program. The idea behind these initiatives is to improve energy efficiency, cut dependence on expensive imported oil and reduce greenhouse emissions (in align with administration's green initiatives). Johns Manville's innovative roofing solutions will likely benefit from these initiatives. Currently, it is the main manufacturer to offer Formaldehyde-free™ fiber glass building insulation which is considered to be more energy efficient and environmentally friendly compared to its competitors' products.

Johns Manville has a strategic alliance with Lowe's. This is a key distribution network of Lowe's 1700 stores that allows JM to tap a wider consumer market. Having a wide distribution network would be crucial to help JM weather the weak housing market over the coming years.

As a subsidiary of Berkshire, JM has access to Berkshire's strong fortress-like balance sheet. It is able to borrow at lower interest rates compared to its main rival, Owens-Corning. Based on Owen-Corning's latest quarter figures (as of 3/31/2011, it has a debt to equity ratio of roughly 0.5). With a higher gearing ratio than JM, Owen-Corning's cost of capital is higher.

Thus, it can struggle to compete for growth financing compared to Johns Manville.

JM's can sustain its competitive advantages if it continues to: 1. Produce products efficiently, 2. Continue to build its brand recognition 3. Innovative new products, and 4. Deliver customer satisfaction with efficient supply chain management and cultivate superior customer relationships.

JOHNSON & JOHNSON (JNJ) COMPETITIVE ADVANTAGES

BUD LABITAN WITH BERYL CHAVEZ LI, UNIVERSITY OF MANCHESTER

Johnson & Johnson (NYSE: JNJ) is a leading global American pharmaceutical, medical devices and consumer packaged goods manufacturer founded in 1886. Its common stock is a component of the Dow Jones Industrial Average and the company is listed among the Fortune 500. On 9/30/2011, Berkshire Hathaway's stake in J&J was 37,446,788 shares with a market value of about \$2.4 billion (\$2,384,985,000).

Johnson & Johnson consistently ranks at the top of Harris Interactive's National Corporate Reputation Survey. It has ranking as the world's most respected company by Barron's Magazine. JNJ was the first corporation awarded the Benjamin Franklin Award for Public Diplomacy by the U.S. State Department for JNJ's funding of international education programs.

The corporation's headquarters is located in New Brunswick, New Jersey, United States. Its consumer division is located in Skillman, New Jersey. The corporation includes some 250 subsidiary companies with operations in over 57 countries. Its products are sold in over 175 countries. Johnson & Johnson's brands include numerous household names of medications and first aid supplies. Among its well-known consumer products is the Band-Aid Brand line of bandages, Tylenol medications, Johnson's baby products, Neutrogena skin and beauty products, Clean & Clear facial wash and Acuvue contact lenses.

Consumer brands include: Acuvue, Actifed, Ambi, Aveeno , Bactidol, Band-Aid, Benadryl, Benecol, Bengay, Benylin, Bonamine, Caladryl,

Carefree, Clean & Clear, Coach, Coach Professional, Coach Sport, Codral, Combantrin, Compeed, Conceptrol, Cortaid, Cortef, Delfen, Desitin, Dolormin, E.P.T., Efferdent, First-Aid, Gynol, Healthy Woman, Imodium, Johnson's Baby, Johnson & Johnson Red Cross, Jontex, K-Y, Lactaid, Listerine, Listermint, Lubriderm, Luden's, Micatin, Monistat, Motrin, Motrin Children, Myadec, Mylanta, Nasalcrom, Neko, Neosporin, Neutrogena, Nicoderm, Nicorette, Nizoral, Nu-Gauze, O.B., OneTouch, Pediacare, Penaten, Pepcid, Pepcid AC, Polysporin, Ponstan, Priligy, Purell, Quantrel, REACH, Reactine, Regaine, Rembrandt, Remicade, RoC, Rogaine, Roluids, Shower to Shower, Simply Sleep, Simponi, Sinutab, Splenda, St. Joseph, Stayfree, Steri-Pad, Stim-u-dent, Sudacare, Sudafed, Tucks Pads, Tylenol, Tylenol Baby, Tylenol Children, Unicap, Vania, Visine, and Zyrtec.

Johnson and Johnson, an American company, is the world's sixth-largest consumer health company. It is the world's largest and most diverse medical devices and diagnostics company and the fifth-largest biologics company. It ranks eighth in pharmaceutical companies world-wide. J&J has 250 operating companies in 60 countries employing approximately 115,000 people with worldwide headquarters in New Jersey, USA. Investing nearly \$7 billion for research and development, it focuses on its development bringing innovative ideas, products and services to advance the health and well-being of people. They put priority to the welfare of all doctors, nurses, patients.

Its recent innovation is Abiraterone acetate for treatment of metastatic advanced prostate cancer is from the acquisition of Cougar Biotechnology. It recently filed TMC278 for HIV in both the U.S. and Europe for review. With targeted acquisitions for expansion, including Micrus Endovascular and Crucell N.V., it seeks to grow in the coming years.

It tries to reduce costs and market its products at competitive prices. Some of the products J&J takes pride in technology are hip replacements, implant coronary stents, and run tests for metastatic breast cancer that give people hope for a longer, more active life. These products help people conquer life-threatening obesity, ward off colon cancer, and control diabetes. One Touch –ping is to be the first full feature insulin pump that wirelessly communicates with a blood glucose meter-remote. OcuVue contact lenses

and Listerine mouth rinse saw strong growth. 70% of sales came from products with great market shares. It saw sales growing 14 percent operationally in Brazil, Russia, India and China in 2010. It is working on affordable products and products focused on diseases that are more common in emerging markets than in developed markets to increase profits in the coming years.

Given Earnings per share increasing to \$4.78 US dollars in 2010 from \$3.73 in 2006, Net Sales of \$61.6 billion dollars in 2010 from \$53.3 in 2006, and Dividends per share increasing to \$2.11 in 2010 from \$1.455, J&J is seen to be constantly increasing its market presence, and profits. It is maintaining its performance. Investors will continue supporting the company given the dividend growth it receives per year.

Several factors impacted the health care industry in general. Medical devices and consumer businesses felt the effects of a continued economic slowdown. There was a loss in sales and remediation costs resulting from consumer over-the-counter product recalls, as well as generic competition in J & J's pharmaceuticals business. However, in a tough global economy, J&J maintained financial discipline. It generated free cash flow of approximately \$14 billion and held an AAA credit rating. The decline in sales operationally by 9 percent in a year was due to greater consumer sensitivity to spending, reflected in a broad move towards store brands and smaller sizes in certain markets. The market price of J&J had plateaued around 2006, but the business was still producing consistently good free cash flow for its shareholders. Buffett and Munger saw a bargain buying opportunity in a good quality business that has decent long term prospects.

Charlie Munger said, "At Johnson & Johnson, they make everybody revisit their old acquisitions and wade through the presentations. That is a very smart thing to do. And by the way, I do the same thing routinely." The world has an increasing need for various medicines to cure diseases. The mission and core values J&J takes pride in, will continuously serve many. It will improve lives world-wide.

Recently, JNJ's 5Yr Gross Margin (5-Year Avg.) is approximately 70.6% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 19.9%, while the industry Net Profit Margin (5-Year Avg.) is 16.8%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

With constant technological advancement and acquisition of leading innovations, JNJ can sustain itself and grow its economic moat in the next 10 years. However, it may need to adjust its marketing mix of products, prices, positions, and promotions in order to cater to those who are sensitive spenders in fluctuating markets. J&J has shown its ability, experience, and economic scale in providing competitive value to its customers.

While there will be fast-moving technological advancements and challenging competitors, J&J has shown its ability to build, acquire, and maintain leadership in multiple brands of healthcare products.

JORDAN'S FURNITURE COMPETITIVE ADVANTAGES

BUD LABITAN WITH JEHAO SUN

Offering low prices on quality furniture, owners Barry and Eliot Tatelman improved upon Jordan's successful business model by making shopping for furniture fun and entertaining. Jordan's Furniture stores have successfully built customer traffic by making lavish use of what the brothers call "shoppertainment."

Charlie Munger has said, "We don't need an operating guy; we have people running the businesses, and the main thing is not to destroy or damage the spirit they have." In 1999, Jordan's Furniture was bought by Berkshire for cash. Jordan's Furniture has prospered in blue-collar Waltham, Massachusetts through three generations of the Tatelman family. Barry and Eliot Tatelman improved upon Jordan's successful business model by making shopping for furniture fun.

The Tatelman brothers began by opening late on Saturday night while humorously advertising a spoof of the television show "Saturday Night Live" on the radio by saying, "It's live. It's Saturday night! It's Saturday night at Jordan's Furniture where underprices begin." This was a chance for customers to do a little shopping on the way to or from a movie, or before or after dining, while competing stores were closed.

Encouraged by the response and realizing that others could also open discount stores late, the Tatemans sought additional competitive

advantages. Adding to their idea of making furniture shopping more fun, they put new and different types of entertainment into new suburban stores.

To encourage customers to get the most benefit from this innovation, each suburban store offers a different theme and type of entertainment. This permits Jordan's to appeal to more types of customers in more ways while encouraging customers to visit more than one of their stores.

In 1998 Jordan's opened a 110,000 square foot store in Natick, Massachusetts that offers a free Mardi Gras show in the center using techniques similar to the robotic entertainment at Disneyland.

From there you can now stroll past lovely furniture displays to a 3-D IMAX theater in one corner. In another corner, one of the most popular sandwich shops in the area provides great eating.

By developing this "shoppertainment" approach over 25 years, Jordan's grew to report the highest sales per square foot of any furniture retailer in the United States. Shoppertainment is such a valuable innovation that Jordan's now spends less as a percentage of sales to offer and advertise these attributes than the most effective competing stores do for advertising alone.

The company was started by Samuel Tatelman in 1918 in Waltham, Massachusetts. Samuel sold furniture out of the back of a truck until 1926. In the late 1930s, his son Edward joined the business. In 1973, Barry and Eliot Tatelman took over the business from their father, Edward. They stopped advertising on the back page of the Waltham paper and switched to radio. In 1983, Barry and Eliot built the location in Nashua, New Hampshire.

In 1987, they opened the Avon, Massachusetts location, creating the largest traffic jam ever recorded on Route 24. Barry and Eliot had to go on the radio to beg people not to come. Customers stood in line for hours waiting for their turn to go into the showroom.

On Mother's Day 1992, the Motion Odyssey Movie (MOM) opened in the Avon store, after five years of planning and a \$2.5 million investment. Over 1 million people have experienced MOM, raising more than \$300,000 for non-profit organizations.

On April 17, 1998, Barry and Eliot opened the biggest Jordan's Furniture to date with 120,000 sq ft. of showroom space and a Mardi Gras/Bourbon Street theme at the the Natick, Massachusetts location.

In October 1999, the Tatelman brothers sold the company to investment firm Berkshire Hathaway. The sale was intended to provide increased financial backing of Jordan's for future growth. To celebrate, each employee received a financial gift of 50 cents for every hour ever worked at Jordan's. Barry and Eliot Tatelman continued leading the staff and starring in all the radio and TV commercials of the company.

In August of 2002, the IMAX 3D Theater at Jordan's Furniture in Natick opened to the public. This new spot offered a new level of "shoppertainment." In 2004, the Waltham store closed, and a new one in Reading, Massachusetts opened. This store includes a complete showroom, warehouse, and 3D IMAX movie theater. In addition, Jordan's opened a 750,000 sq ft. warehouse and office complex in Taunton, Massachusetts. In 2005, the warehouse underneath the Avon store was transformed into the 60,000 square feet, Colossal Clearance Center, for selling clearance merchandise.

Warren Buffett said, "Jordan's Furniture is truly one of the most phenomenal and unique companies that I have ever seen." Jordan's, which sells more furniture per square foot than any company in the United States, was approaching \$250 million in annual sales at the time of its sale to Berkshire Hathaway.

The Tatelman brothers took over the business in the early 1970s, bringing it from eight employees to over 1,200 today. The company has a reputation for treating its employees well. The brothers said many of the employees have been with them for 10 to 20 years. Once, the Tatemans chartered four jumbo jets and took all 1,200 employees to Bermuda for a day.

In April 1998, they opened their fourth store in Framingham-Natick with a Disneyland-style environment. Customers walk onto a replica of Bourbon Street and can watch a nine-minute Mardi Gras show, complete with life-size robots in the image of jazz greats like Louis Armstrong and the brothers themselves.

In December 2006, Barry Tatelman left Jordan's Furniture to pursue other interests in show business. He is a principal of a new film company called "Filmshop" and is working on a TV series. After Barry left for Hollywood, Eliot Tatelman began sponsoring the Boston Red Sox radio and television broadcasts.

Jordan's Furniture maintains a single-price policy and never holds sales. A major moat or competitive advantage is the differentiated advantage. Because the company has the skilled employees and efficient operational system, these help company to reduce the cost. Jordan's Furniture also tries use alternative ways to attract customers. For instance, as a promotion in 2007, Jordan's offered full rebates on some select pieces of furniture bought between March 7 and April 16 - provided the Boston Red Sox won the World Series.

The store took out an insurance policy for approximately twenty million US dollars. Since the Red Sox did win the World Series, Jordan's Furniture gave an estimated 30,000 qualified orders away for free. The Company positioned its brand image to be associated with the fun of Red Sox baseball games. These actions attract happy customers who also love baseball.

In order to prosper in a competitive environment, Jordan's managers and associates should keep building the brand and making operations more fun and efficient. Where Jordan's furniture prices are below that of its competitors, there is additional advantage.

Jordan's has become a regional network phenomenon. Jordan's is also a branded franchise built up with selling good value furniture from an economy of scale position. It maintains a single-price policy and never holds sales. The skilled employees and efficient operational system help reduce costs. So, if Jordan's sticks to its original plan of building up the happy shoppertainment experience and offer good values, customers will keep buying and its economic moat is sustainable.

JUSTIN BRANDS COMPETITIVE ADVANTAGES

BUD LABITAN WITH DR. MAULIK SUTHAR, GUJARAT, INDIA

In 2000, Berkshire Hathaway acquired Justin Industries, the leading maker of Western boots and the premier producer of brick in Texas and five neighboring states. Buffett went to Fort Worth to meet John Roach, chairman of the company and its founder John Justin, its major shareholder. Soon after, Berkshire Hathaway bought Justin Industries for \$570 million in cash.

John Justin loved Justin Industries and he had groomed two outstanding managers, Harrold Melton at Acme and Randy Watson at Justin Boot. Each manager runs his company autonomously. Acme, the larger of the two operations, produces more than one billion bricks per year and it is discussed in Chapter 1.

The Justin Boots story began in 1879. That year, H.J. Justin, a boot repairman, left Lafayette, Indiana to start a new life in Spanish Fort, Texas. H.J. Justin soon began his own boot company working out of his home. In 1889, H.J. moved his family and business to Nocona, Texas to capitalize on the bigger market opportunity provided by a new railroad. In 1908, John and Earl Justin started to work for their father, and the company was renamed H.J. Justin and Sons. By 1910, Justin boots were sold in 26 states, Canada, Mexico, and Cuba for \$11 a pair. In 1925, the brothers John, Earl, and Avis moved the company headquarters to Fort Worth. In 1948, John Justin, Jr. purchased controlling interest in the company, and grew the business. In 1968, the company made a deal with Acme Brick of Fort Worth to form Justin Industries.

Nocona Boot Company became part of Justin Industries when John Jr. purchased the controlling shares from his aunt, Enid Justin, in 1981. Three years later, Chippewa Shoe Company was added to the Justin family of brands. And in 1990, Justin Industries purchased competitor Tony Lama Boots after years of intense rivalry. In August of 2000, Justin Boots was purchased by Berkshire Hathaway. With strong financial backing, a lasting tradition of quality, and a talented management team, Justin Boots today is stronger than ever.

The competitive advantages of Justin are its high quality brands. Justin Brands has subsidiaries that operate in manufacturing and the sale of footwear. It is a business model that is easy to understand. Justin Brands has five strong brands in its product portfolio. The company is constantly

rolling out new designs for each of its main brands: Chippewa Boots, Nocona Boots, Justin Boots, Tony Lama Boots and Justin Original Workboots. The company also manufactures and sells work, safety, and sports footwear.

Its western boots come in a variety of exotic leathers, including lizard and ostrich. Justin Brands sells its footwear through all the available marketing routes like department stores, shoe chains, specialty stores (Academy, Cavenders Boot City), catalogs and online (Zappos.com).

Justin Brands has “Strong Brand Value” because of distinctive mass appeal and brand differentiation. The product has such a dependable brand contract with customers that they are willing to pay a higher price compared to other similar generic products. Thus, Justin Brands has “Pricing Power.”

In investing, Charlie Munger says, “We just throw some decisions into the too hard file and go onto others.” Justin Brands was an easy decision for Buffett and Munger because the business provides extraordinary value through its market dominance and operational excellence. Therefore Justin Brands has both “cost advantages of scale.” It is capable of outpricing its competitors or offering more value at a certain price.

Altogether Justin Brands produces 3.5 million+ pairs of cowboy boots annually. The look of the nineteenth-century cowboy boot has three important components: the high heel, the below-the-knee cut, and the side seams on the legs. Justin cowboy boots have had a strong hold in the market as the true leader because of their reputation for quality craftsmanship and materials. They also have uniquely superb styling.

Justin has developed premium brands. The brands under the Justin Brands umbrella are so ingrained in American life. This creates a more expensive barrier to entry for potential competitors.

While demand can be driven higher by advertising and product needs. In footwear, higher display tends to drive higher sales. The profitability of individual companies is closely linked to effective sales operations.

Justin’s competitive advantages are sustainable. Justin has developed premium brands. Justin Brands also has scale advantages in buying raw

materials in bulk at lower price, serving large customers with regional or national needs, and making efficient use of resources. Smaller competitors cannot compete effectively in this category of cowboy boots. This is another barrier to entry. Management plans to add focus to nonretail operations in order to drive volume growth.

Justin Brands has the characteristics of a wide moat business like consistent earning power. It has good returns on equity, no debt, and able and trustworthy management.

Additionally, restoration of national economic health, improving consumer sentiment, income levels, employment levels, and resurgence in discretionary spending will improve and strengthen the company's position in future.

The profitability of individual companies depends on product mix and production efficiency. Justin Brands is now a larger company that has economies of scale; not only in buying raw materials but in marketing its products as well.

Justin brands is in the enviable position of being one of the last high quality footwear manufacturers with a recognized reputation for tough, durable, dependable classic cowboy boots by providing highest quality and ultimate value in his outdoor lifestyle footwear.

While the global footwear market is estimated to be about \$ 195 billion, Justin Brands will continue to enjoy the strong pricing power and dominant position in this higher end segment of stylish boots.

KRAFT FOODS (KFT) COMPETITIVE ADVANTAGES

BUD LABITAN WITH ANDREA TAGART, UNO-CBA AND MATTHEW DELDUCHETTO, MBA

Kraft Foods is an industry leader. Kraft Foods Inc. (KFT) through its subsidiaries, manufactures and sells packaged foods and beverages in the United States, Canada, Europe, Latin America, Asia Pacific, the Middle East and Africa.

Why did Berkshire Hathaway buy stock in Kraft? Brands? Costs Controls? Expanding Markets? Chairman Irene Rosenfeld? In 2008, Warren Buffett and Berkshire Hathaway bought more than 132 million shares of food company Kraft because he thought it was an undervalued franchise with many respected brands.

Kraft manufactures and markets packaged food products, consisting principally of beverages, cheese, snacks, convenient meals and various packaged grocery products. The Company operates in two segments: Kraft North America Commercial and Kraft International Commercial. It has operations in 72 countries and sells its products in more than 155 countries. Soon, it plans to split into two separate companies that will focus on snacks and groceries.

Kraft Foods Inc. began in 1903 as a cheese manufacturer. The company is now the largest North America-based food and beverage company and the second largest in the world after Nestlé SA. From 1988 to March of 2007, tobacco giant Phillip Morris Company, now Altria Group (MO), owned and grew Kraft Foods. It merged Kraft with Nabisco and General Foods. In 1985, Berkshire Hathaway benefitted from owning shares in General Foods. Then, the Altria Group (MO) took Kraft public in 2001, maintaining an 88.1% stake in the stock until the completion of the spin off in 2007.

Kraft has nine brands with revenues exceeding \$1 billion: Kraft cheeses, dinners and dressings; Oscar Mayer meats; Philadelphia cream cheese; Maxwell House coffee; Nabisco cookies and crackers and its Oreo brand; Jacobs coffees, Milka chocolates and LU biscuits. Kraft has more than 50

additional brands with revenues of at least \$100 million. It added to this Cadbury's brands: Bubbaloo, Bubblicious, Cadbury Creme Egg, Cadbury Dairy Milk, Clorets, Dentyne, Eclairs, Flake, Green & Blacks, Halls, Hollywood, Stimorol, The Natural Confectionery Company, and Trident. Respected brands translate into some measure of pricing power.

Kraft Foods, KFT was looking forward to a 7-9% forward growth rate. Recently, KFT's 5Yr Gross Margin (5-Year Avg.) is approximately 35.1% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 6.2%, while the industry Net Profit Margin (5-Year Avg.) is 8.9%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

Kraft's net profit margin was affected by the acquisition of Cadbury Plc. Kraft wanted Cadbury because Cadbury has strong growth in emerging markets like India and Latin America. However, the real friction about the deal was about the proper valuation of both KFT and CBY stock shares, as independent businesses, and as a joint business entity. Buffett did not want Kraft managers to overpay for Cadbury. He also did not want Kraft managers to dilute shareholder value by issuing more shares. Kraft already had 1.5 billion shares outstanding. Now, it has 1.767 billion shares outstanding. Now, Kraft is splitting into two companies.

In 2010, Kraft Foods sealed a friendly deal to buy British candy maker Cadbury for about \$19.6 billion (11.9 billion pounds). To win over Cadbury Chairman Roger Carr and calm down Warren Buffett, Kraft's CEO Irene Rosenfeld added more cash into her final bid. She also dropped the number of new shares in the offer. The deal created the world's biggest confectioner.

The cash-and-stock agreement valued each Cadbury share at 840 pence. Shareholders also got a 10p special dividend, bringing it to a total of 850 pence per share of Cadbury. The final offer marked a 14 percent increase over Kraft's initial bid of 745 pence. The price tag was 50 percent above where Cadbury's stock was trading the day before Kraft's initial bid.

The combined company overtakes privately owned Mars-Wrigley as the world's top sweets maker. It united Cadbury's Dairy Milk chocolate and Trident gum with Kraft's Milka, Toblerone and Terry's chocolate brands.

The new bid won approval from the Cadbury board. It consisted of 500p of cash and 0.1874 new Kraft shares. Originally, Kraft had offered 300p cash and 0.2589 share. At the time of this deal, \$1 = .6086 Pound.

Buffett, who owns a 9.4 percent of Kraft, had warned managers not to overpay and issue too much stock. Kraft said that it was issuing 265 million new shares instead of 370 million it had earlier planned. Cadbury shareholders received a deal that valued their shares at 13 times the company's estimated earnings before interest, tax, depreciation and amortization in 2009.

A quick glance at Berkshire Hathaway's BRK.A BRK.B 13-F filing for the second quarter of 2011 revealed the sale of 5.8 million shares of Kraft Foods KFT. Based on an average closing price of \$34 per share, the Kraft transaction likely generated close to \$200 million.

Never completely warming to the Cadbury acquisition that Kraft engineered in 2010, and with the stock up more than 10% through the first two quarters of 2011, Buffett may have decided to take some money off the table. On 9/30/11, Berkshire Hathaway held 89,746,708 shares with a market value of \$3,013,694,619. And, Buffett went on the record to note that he expects to stay invested in Kraft for the longer term.

Interestingly, the biggest corporate bond deal of 2010 was Kraft Foods Inc. (KFT)'s sale of \$9.5 billion of debt for its takeover of London- based Cadbury Plc. After five months of negotiating a price, Cadbury agreed to an 11.9 billion pound (\$19.2 billion) offer from Kraft.

"At the end of the day, we would pay what we thought this outfit was worth," Rosenfeld told Reuters. "I believe paying 13 times EBITDA for an asset of this quality is a very good price." Although Kraft is paying more, Rosenfeld said she expected confirmation of the company's investment-grade credit rating from Moody's.

With the Kraft-Cadbury deal, competitor Hershey was constrained from bidding for Cadbury because it is controlled by a charitable trust. This merger makes the new Kraft and Mars-Wrigley the giants of this market.

What competitive advantages does the parent company Kraft have? Brands, Technology, Cost of Production, Distribution Network? Kraft

sells its products in more than 155 countries. Are possible advantages sustainable? Kraft purchases milk, cheese, plastic, nuts, green coffee beans, cocoa, corn products, wheat, pork, poultry, beef, vegetable oil, sugar, other sweeteners and numerous other commodities. If Kraft is unable to increase its prices to offset increased cost of commodities, Kraft Foods can experience lower profitability.

Kraft appears to pass Buffett's and Munger's first three filters of understanding, enduring competitive advantages, and able trustworthy managers. However, these managers have been showing puzzling moves.

In 2007, Chief Executive Irene Rosenfeld said: "We'll fully realize the financial benefits of our investments and deliver our long-term targets of at least 4% organic net revenue growth and 7% to 9% EPS growth." In addition to "rewiring" the company, Rosenfeld said Kraft intended to "reframe" its product categories to make them more relevant to consumers, to better exploit its sales abilities and to drive down costs.

One key is to expand the focus in larger, faster-growing categories. As an example, Rosenfeld cited moving away from dying sectors like processed cheese slices and into sandwich, snacking and high-end cheeses.

With brands like Jack's and Tombstone, Kraft had long been a major player in the frozen pizza \$4 billion category. Then, about 10 years ago it went after the \$11 billion chain business with higher-end offerings like DiGiorno. The, in an about turn, the Kraft pizza business brands, DiGiorno, Tombstone, California Pizza Kitchen, Jack's and Delissio were sold off to Nestle for \$3.7 billion. Management said that this was done to fund the Cadbury offer.

Now, Kraft plans to split the company into two businesses. Kraft Chairman and CEO Irene Rosenfeld will head the larger and unnamed world-wide snacks business and Anthony Vernon, Executive Vice President and President of Kraft North America, will head the smaller and slower-growing North American grocery business which will probably retain the Kraft Foods name. After the breakup at the end of 2012, they must sort out the ownership of several brands.

Kraft continues to reframe categories in order to make them more relevant and contemporary with consumers. They use a "Growth Diamond"

strategy to contemporize the business and identify health and wellness trajectory-changing ideas. Kraft moves resources toward categories, countries and brands that have the highest potential for return. Kraft has strategically strengthened its category mix through acquisitions, divestitures and product pruning over the last few years.

Kraft will continue to use its large scale as a competitive advantage. Its “Wall-to-Wall” initiative for Kraft North America combined the benefits of direct-store-delivery used in its Biscuit business unit with the economics of its warehouse delivery to drive faster growth.

Kraft strives to drive down costs without compromising quality. It found new ways to drive sustainable cost savings significant increases in product costs. Kraft will continue to focus on quality as a growth driver by increasing the percentage of products rated superior and preferred. It also plans to improve gross margins with its new operating structure in Europe. Kraft Foods demonstrates efficient operations with an operating margin of around 11.5% in 2010. One of its top competitors, Nestle, with over double the revenues of Kraft, has an operating margin of around 14%.

In competition, Kraft’s operating margin indicates just how highly competitive it can be. This profitability also turns into a cost savings on their operations and creates a price advantage for consumers.

Kraft is known for their high quality products at affordable prices. These high quality branded products, and make it difficult for the cheaper economy brands to compete. Customers are willing to pay a few cents more to get the higher quality and taste of Kraft products.

Just as brand recognition and awareness are at a high level with Kraft products, so is brand loyalty with eleven of their subsidiary brands having profits of over \$1 billion each, and most having the number one market share spot in their category.

Kraft is always looking for products to add to their line that will enhance their operational efficiency even more. By acquiring other companies with diverse products, as well as strong brands, Kraft can capitalize on newer operations and reduce waste, time, energy, and overall cost of production. This allows Kraft to offer even more diversified products at a low cost to consumers.

Mr. Vernon might have the tougher job in the groceries business. His \$17 billion business has about half the revenue and half the number of billion-dollar brands as the global snacks business. Being smaller could affect the company's ability to get the best prices and contract terms for commodities. His sales force also could be at a disadvantage with retailers since they won't have the same leverage. Their negotiating power will be lower because they won't have the same scale and halo without Oreo or Nabisco. Which company will end up owning the Philadelphia cream cheese brand? One company may have to license some brands from the other.

Kraft expects the spin-off to be tax-free but it is waiting for a final tax ruling from the Internal Revenue Service. Both companies will be headquartered in the Chicago area.

Are Kraft's competitive advantages sustainable? Kraft makes plans to compete and stay on top of its protective barriers. It is constantly looking to acquire companies with strong brand names and quality products, much like their own. New acquisitions can produce a savings in production efficiencies. Productive acquisitions can give Kraft competitive advantages and increase profitability. So, this may be considered an example of economic moat building. Operations efficiency achieved can drive down costs.

Kraft has diversified its product group to cater to all types of prepared food markets. This allows for fluctuations in sales of the different products from year to year.

As Kraft prepares itself for the split into snacks and groceries businesses, managers can think about this quote from Charlie Munger: "I think corporate managers should learn to be better investors because it would make them better managers." With its rich history of good performance, some stakeholders are puzzled by these recent managerial moves.

The Kraft brands, which represent good quality food and snacks at affordable prices, will be competitive. Most of Kraft's brands are iconic and traditional for many families. Kraft's commitment to charitable organizations to fight hunger, as well as enhance nutrition, has lead this industry. Kraft is about respected brands and we expect both new

businesses will focus on building these brands and prosper in both snacks and groceries.

LARSON-JUHL COMPETITIVE ADVANTAGES

BUD LABITAN AND TIM BISHOP

Larson-Juhl is the nation's leading provider of custom picture frames. In 2001, Craig Ponzio, the owner of Larson-Juhl's parent company, Albeca, called Warren Buffett. Ponzio told him about his business' sustainable competitive advantages and its financial characteristics. Berkshire Hathaway then acquired this small business. Albeca sells custom picture frames under the brand name of Larson-Juhl, and it is the nation's leading provider.

Larson-Juhl has a large economic moat because it has built up a respected brand built on high quality products and service, with less reliance on price. Also, it has a great distribution system. In servicing their customer base, Larson-Juhl calls on its 18,000 customers about five times a year.

Buffett always asks himself how much it would cost to compete effectively with a business. Charlie Munger said this about investing: "The number one idea, is to view a stock as an ownership of the business, and, to judge the staying quality of the business in terms of its competitive advantage." With businesses like Larson-Juhl, they feel that there is a higher probability that things will work out well.

Said Warren Buffett, "The company has \$300 million in revenues, earns \$50 million in pre-tax profits, ties up no capital, is growing slowly, and distributes every dime of profit. There are about 18,000 picture framing shops in the United States, mostly very small businesses with a few hundred thousand dollars per year in sales. They can't afford to have much inventory, so they show a catalogue to a customer who chooses the frame. Then, if they call Larson-Juhl before 3 pm, 85% of the time the frame will be there the next day.

Larson-Juhl competitors include Roma Moulding, a manufacturer and seller of moulding and picture frames. In 1984, Roma Moulding Inc. was

established to cater to the frame and photo supply business by John Gareri. Gareri believes that moulding should be more than a decorative border. He envisioned a place where tradition and exquisite design would create something special. Roma has fashioned its business model around the “Made in Italy” legacy. However, Roma Moulding does not have a large economic moat because it has a more limited selection of products and a smaller distribution network.

Other frame manufacturers in the country include Picture Woods, LaMarche, Gryphon, Studio, Max, and Nielsen metal frames. They do not currently have the size or distribution network to displace LarsonJuhl.

How would we attack this business? Said Buffett, “You wouldn't want to anyway, as the market is not big enough. Larson-Juhl has a HUGE moat. I always ask myself how much it would cost to compete effectively. With businesses like these, nothing's going to go wrong. If you bought 20 of them, 19 of them would work out well.”

Reevaluate the economic characteristics of a business. The long-term competitive advantage can change. Said Buffett, “Usually, if something can gain competitive advantage very quickly, it can lose it very quickly, so be careful of industries in flux.”

LUBRIZOL (LZ) COMPETITIVE ADVANTAGES

BUD LABITAN WITH SCOTT THOMPSON, MBA

Lubrizol is a leading specialty chemical manufacturer, distributing its more than 1,000 products domestically & internationally. Lubrizol’s products include: industrial fluids, transmission fluids, lubricants, coatings, inks, metal working compounds, and other additives.

We begin with \$580,000,000 free cash flows, an estimated annual growth rate of 10.75% over next 10 years, then assuming conservative 0% growth rate over years 11–15, with 64,290,000 shares outstanding.

Warren Buffett is believed to choose discount rates based on the U.S. government bond risk-free rate, instead of “weighted average cost of capital (WACC)” as taught in business school.

Our Discounted Cash Flow (DCF) analysis shows an estimated intrinsic value for Lubrizol (LZ) of about \$171/share, compared with Berkshire Hathaway's acquisition price for Lubrizol in March-2011 of \$135/share. This implies a price-to-value ratio of 80%, and a (Benjamin Graham) "margin of safety" ratio of 20%.

This lower 20% "margin of safety" ratio likely played an important role in why Warren Buffett initially declined David Sokol's recommendation to buy Lubrizol (LZ). Later, Berkshire Hathaway agreed to acquire Lubrizol for \$135/share x 64,290,000 shares outstanding = \$8.7 billion.

Historically, throughout the 1970s & 1980s, Buffett's minimum "margin of safety" was believed to be around 50%, back when he was allocating millions of dollars. Buffett's current "margin of safety" is now believed to be around 30%, since he now allocates and invests billions instead of millions. Warren Buffett confirms, "Size is an anchor to performance."

One of Warren Buffett's "4-filters" investment criteria is to invest in 1. businesses he understands. 2. with honest & capable management. 3. possessing durable competitive advantages, known as an "economic moat. 4. Selling for an attractive price.

Charlie Munger has said, "The great lesson in microeconomics is to discriminate between when technology is going to help you and when it's going to kill you. And most people do not get this straight in their heads. But a fellow like Buffett does."

What are the economic moats of Lubrizol (LZ)? Its main competitive advantages are superior specialty chemical products, groundbreaking patents, outstanding service, industry leading research, customer focus, and a fierce dedication to new product innovation. Lubrizol has established itself as a global leader in specialty chemical manufacturing and distribution with 1,000+ products worldwide.

Are the advantages sustainable? What are Cost Advantages and/or Differentiation (Brand) Advantages? The following are some quantitative methods Warren Buffett uses to identify "economic moats" using a company's financial statements:

Gross Margins: LZ shows consistent increasing gross margins now above 33%, & showing good consistent upward trend – indicating a sustainable economic moat.

SGA/Gross Profit Ratio: A lower than competitors' SGA/Profit ratio indicates capable management & an economic moat.

Interest/Operating Income Ratio: LZ shows consistent history of significantly reducing this ratio – indicative of company with capable management & an economic moat.

Net Income: LZ shows consistent history of increasing Net Earnings, except during 2008, which incurred higher-than normal “restructuring, merger, & acquisition” charges of \$394 million.

Buffett analyzes Net Income as well as Earnings Per Share (EPS) to see through any manipulation from firms either increasing or decreasing their number of shares outstanding. Companies do this through new equity offerings or share repurchase programs.

Short-term debt: LZ currently carries no short-term debt, and it shows an attractively high Current Ratio of 3.5% – indicative of capable management & an economic moat.

Long-term debt: LZ currently carries long-term debt of \$1.3 billion, and it is trending downward.

Retained Earnings: LZ shows upward trend, with exception of 2008 (as noted above).

Common Stock Repurchase: LZ shows common stock repurchase on cash flow statement, indicative of capable management. Share repurchases increase Earnings Per Share (EPS) values for shareholders.

10 year CapEx / 10 year Net Earnings Ratio: LZ shows ratio of about half of CapEx to net Earnings ratio, indicating capable management and a good economic moat.

Free Cash Flows: LZ shows an upward trend in Free Cash Flows, indicating capable management and a good economic moat, with the exception of 2008 (as noted above).

Buffett's acquisition of Lubrizol is perhaps a bet that LZ will continue its trend of decreasing expenses, and increase revenues, gross margins, net income, & free cash flows.

With headquarters in Wickliffe, Ohio, The Lubrizol Corporation owns and operates manufacturing facilities in 17 countries, as well as sales and technical offices around the world. Founded in 1928, Lubrizol has approximately 6,900 employees worldwide. Revenues for 2010 were \$5.4 billion. Return On Equity (5-Year Avg.) 17.9 and it shows a progressive growth in book value from 12/01 of \$15.12 to 12/10 book value of \$34.25.

In our view, Lubrizol is a company that Buffett and Munger found to be understandable, found to have sustainable competitive advantages, found to have able and trustworthy managers, and found to be available at a relative bargain price.

It has shown solid leadership. If it continues to be run as efficiently as it has in the past, Lubrizol will prove to be a strong competitor in the specialty chemical industry.

M&T BANK CORP (MTB) COMPETITIVE ADVANTAGES

BUD LABITAN WITH CLIFF ORR, KELLOGG-NORTHWESTERN
UNIVERSITY AND RICHARD KONRAD, CFA, VALUE ARCHITECTS
ASSET MANAGEMENT

M&T Bank Corporation (MTB) is the sixteenth largest commercial bank holding company in the U.S. with over \$80 billion in assets. M&T is one of very few banks that have come out of the recession with its earnings power intact.

It was founded in 1856 in western New York. The name M&T is an abbreviation of Manufacturers and Traders Trust Company. MTB is its stock symbol. It is headquartered in Buffalo. It has over 770 branches located in New York, Maryland, Pennsylvania, Virginia, Washington, D.C., West Virginia, Delaware and New Jersey.

In 2003, M&T Bank acquired Allfirst Bank of Baltimore, a subsidiary of Allied Irish Banks (NYSE: AIB). Allfirst was acquired by M&T after a currency trading scandal produced a loss of \$691 million in 2002. The Allfirst acquisition was M&T's largest. Allfirst had been formed after Allied Irish Banks bought Dauphin Deposit Corp. and merged it with its First Maryland Bank and The York Bank.

Berkshire's 20-year investment in M&T Bank began in 1991 with a modest \$40 million convertible preferred stock investment. The 1991 M&T investment occurred during the banking industry downturn associated with the early-1990s recession and coincided with Berkshire's initial investment in Wells Fargo. These two investments represented Berkshire's first banking investments since its 1979 sale of Illinois Bank of Rockford. As with the Wells Fargo investment, Buffett was impressed with M&T's management and culture. As Buffett noted at the time, "normally I would think a purchase of this size too small for Berkshire, but I have enormous respect for Bob Wilmers, (M&T's long time CEO), and like being his partner on any scale." In 1996, Berkshire converted its investment to common shares, and had an ownership share of about 4.5% of the company.

The Berkshire investment provided M&T with capital during the downturn that it used for acquisitions of struggling banks. Berkshire Hathaway currently holds 5.66% of M&T's shares. Of note, the largest shareholder of M&T is Bob Wilmers, the CEO who owns 8.6% of the bank both personally and through family trusts.

In 2009, MTB acquired Baltimore-based Provident Bankshares, increasing its market share in Maryland to #2 (behind Bank of America) and tripling its presence in Virginia; both markets are higher growth than its core footprint. MTB completed the acquisition of Wilmington Trust in May 2011, which significantly increased MTB's market share in Delaware to #2 (was #23) and added approximately \$9.5 billion in assets.

The bank has made 23 acquisitions over 24 years but the expansion has been very controlled. M&T's growth has been primarily internal through ongoing lending. Despite the acquisitions, the bank only needed to issue 5% more shares since 2007. The relatively small share issuance is particularly noteworthy. Its peers have issued over 66% more shares over this time frame. Hence, most of the acquisitions have come about as a result of M&T's own capital generation not issuance of shares.

There has been over \$52 billion in new loan origination and renewals between 2008 and 2010, a period when most banks were busily recapitalizing themselves rather than lending. As well, the company has undertaken significant share repurchases at opportune valuations.

M&T Bank provides a wide variety of lending products to meet the needs of the auto, recreational vehicle, and marine industries. With operations throughout New York, Pennsylvania, the Mid Atlantic, and New England M&T's team of professionals remain active in both local and national dealer associations and manufacturer associations. This allows M&T BANK a competitive advantage in offering resources necessary to support today's dealership.

Another competitive advantage is that M&T Bank's relationship managers have the education and training to provide expertise and insights to help a business succeed. Like other banks, M&T BANK offers highly competitive interest rates, generous term availability, flexible financing

options, automatic approval services, electronic application processing, and more.

Outstanding Dealer and Customer Service are exemplified by Fax funding. This allows dealers to have access to cash faster and avoid “contracts in transit” issues. A well-trained Dealer Service Center operating all days of the week ensures a fast application response time and quality service.

M&T Bank’s Indirect Auto Financing auto program provides competitive consumer financing for a vast network of franchise dealerships. With M&T BANK’S program and dedicated personal service, dealers can have everything they need to sell more vehicles and increase profit.

M&T Bank’s Indirect Marine and RV Financing have relationship managers focused solely on the unique needs of this industry. M&T Bank’s programs are built to simplify the complexities of the recreation financing industry.

M&T Bank’s Floor Plan Financing unit provides inventory and term financing, as well as a full range of financial services to franchised automobile, truck, heavy-duty truck, and motorcycle dealerships. It also does this for related leasing companies.

M&T’s competitive advantage is rooted in its management and the associated culture. As Buffett noted in his 1990 letter, “the banking business is no favorite of ours. . . . Because leverage of 20:1 magnifies the effects of managerial strengths and weaknesses, we have no interest in purchasing shares of a poorly-managed bank at a ‘cheap’ price. Instead, our only interest is in buying into well-managed banks at fair prices.”

The success of a banking operation derives from several sources, which converge into what analysts call core earnings. MTB’s lower cost of funds and efficient operating expense structure generate a strong core earnings stream. As a result, the company has generated relatively more capital than its peers. Recently, M&T Bank’s 5Yr Net Profit Margin (5Year Avg.) is approximately 21.1%, while the industry Net Profit Margin (5-Year Avg.) is 16.6%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

The significant noninterest bearing and core deposit base give it a funding advantage. Noninterest bearing deposits are 31% of total deposits as of

year end 2010. Brokered deposits comprise less than 1.5% of total deposits. Funding provided by core deposits represented 73% of average earning assets in 2010, compared with 66% and 55% in 2009 and 2008, respectively.

In addition, M&T's cost structure allows it to maintain a superior efficiency ratio in comparison to its similarly sized peers and historically, compared to its national peers. MTB was one of the very few banks that remained profitable throughout the recession and did not impair its earnings power. Additionally, it was one of only seven US commercial banks with assets greater than \$10 billion (49 total) that did not cut its quarterly dividend during the cycle.

M&T has taken advantage of general weakness in the banking industry to expand its footprint and enter some attractive fee-generating businesses such as Wilmington Trust's well-regarded wealth management business. The Wilmington Trust acquisition may prove timely as the company has doubled its fee income from trust and investment management services at the very time that regulatory reforms are beginning to burden traditional banking businesses.

The bank demonstrated a return on tangible equity of 18.95% in 2010, a year when the industry average was -0.3%. Credit quality disciplines manifested themselves during the recession as well. Non-performing assets as a percentage of loans peaked at 2.78% (1Q10) vs. 4.88% (1Q10) for its regional bank peers.

M&T experienced the lowest level of net charge-offs as a percentage of loans during this severe credit cycle compared to its regional bank peers at an average of 0.81% over the last five quarters (the peak was 1.07% in 4Q09) compared to 2.95% for the regional banks (the peak was 3.47% in 4Q09).

Banking is in many ways a leveraged commodity business, so the importance of management is paramount. Wilmers and the conservative management team of M&T therefore constitute its competitive advantage. Through disciplined adherence to its focus on quality lending and cost control M&T is able to consistently generate returns on assets of over 1% and returns on equity of 20%. The distinguishing characteristic of M&T is

its discipline and undivided attention on community-banking even as the enterprise has grown outside its original home territory.

M&T is a conservative lender focused on relationship based lending. The company benefited from not straying too far from its core markets, which were less affected by the economic downturn. Over two-thirds of MTB's loans are in New York, Pennsylvania, and Maryland, where home values held up better than most of the nation.

Is M&T's competitive advantage sustainable? M&T is one of very few banks that have come out of the recession with its earnings power intact. The bank has growth opportunities in contiguous geographies in the mid-Atlantic region. Management appears very strong, deep, and committed to maintaining its independence. M&T has demonstrated an ability to operate at lower capital levels than its peers; this is due to its lower risk balance sheet and strong underwriting discipline.

Charlie Munger said, "Because he talked about morality and business, Bob Wilmer sounds like an Old Testament prophet. He doesn't like that banks make so much money in trading. He thinks these banks are just trying to outsmart their own clients. It is one of the best annual reports ever."

While M&T certainly has the ability to maintain its disciplined approach to banking, the danger with a moat premised upon outstanding leadership is that once Wilmer no longer leads the company M&T may trend toward its banking peers. In this sense, M&T's competitive advantage is not as inherently enduring as businesses protected by brands, low-cost positions, or scale. However, a culture can be set in place to promote able and trustworthy managers who can grow wellmanaged banks like M&T Bank. We believe that the deep cultural roots of excellence at M&T will continue to sustain the disciplines that have created this success.

MARMON HOLDINGS, INC. COMPETITIVE ADVANTAGES

BUD LABITAN WITH DAVID LAU AND THEODOR TONCA

The Marmon Group is a customer focused profit generating holding company composed of over 140 smaller companies. It headquartered in Chicago, Illinois. The multi-billion dollar complex of businesses known today as The Marmon Group began in 1953 when brothers Jay and Robert Pritzker acquired The Colson Corporation, then an ailing manufacturer. Once Colson was restored to profitability, other small businesses were subsequently acquired or created. By the early 1960s, a dozen companies had joined informally to benefit from shared consulting and administrative services. In 2007, the Pritzker family sold a 60 percent interest in Marmon Group to Berkshire Hathaway.

Marmon's main competitive advantages are customer focus, experience, and first-rate managers in each area of its product lineup. Since this company is composed of over 140 smaller companies, the durability of each competitive advantage will not be discussed in this book. Instead, this chapter is an overview.

The Colson company name was changed to Marmon Group in 1964 after the acquisition of Marmon-Herrington. Marmon-Herrington Company was the successor to the Marmon Motor Car Company. Marmon was an early 20th century producer of automobiles. It entered the auto business in 1902, won the first Indianapolis 500 race of 1911 with the "Wasp", and exited the auto business in 1933.

In this tradition, the deal in which Berkshire Hathaway acquired a controlling 60% equity stake in the company with the remaining 40% to be acquired in separate tranches was labeled "Indy 500."

Warren Buffett has said, "When Charlie and I read reports, we have no interest in pictures of personnel, plants or products." In the 2008 purchase of 60%, Berkshire's initial outlay was \$4.5 billion; Marmon had

\$7 billion in sales. In 2010, an additional \$1.5 billion was paid for 17% more stock that brings ownership up to 80%. So, thus far, Berkshire has paid \$ 6 billion for 80% of Marmon. Berkshire will then purchase the remaining

Pritzker holdings in 2013 or 2014, whichever date is selected by the family, using a formula based on earnings.

Today, the Marmon Group stands as an international association of about 140 business units that operate independently within diverse business sectors. Its companies produce electrical components, industrial components and transportation equipment, and provide services including construction and retail solutions. Each member business operates under its own management within a sector structure that provides access to the experience and expertise of other members in related businesses and markets.

The company is split into eleven sectors: Building Wire, Construction Services, Distribution Services, Engineered Wire & Cable, Flow Products, Food Service Equipment, Highway Technologies, Industrial Products, Retail Store Fixtures, Transportation Services & Engineered Products, and Water Treatment.

With the 1976 acquisition of Cerro Corporation, combined revenues for Marmon Group member businesses doubled to nearly \$1 billion and the organization grew more diverse.

In 1981 the acquisition of Trans Union Corporation added businesses that manufacture and lease railroad tank cars, provide consumer credit information, and produce water purification systems, fasteners and other products. Combined revenues that year approached \$3 billion.

Throughout the 1980s and 1990s, The Marmon Group of companies expanded via internal investment and multiple smaller acquisitions in industries where member businesses already had a presence, including information management, retail store equipment, wire and cable and others.

In January 2002, Robert Pritzker concluded his five decade tenure at Marmon. Thomas Pritzker became Chairman and John Nichols was named Chief Executive Officer. The Marmon Group subsequently organized into the eleven core business sectors outline above which are dedicated to supporting growth within their respective business units. At the start of 2005, Trans Union, an information-based business that was unique within

the largely manufacturing based Marmon organization, was spun out as a stand-alone operation.

In March 2008, Berkshire Hathaway Inc. acquired majority interest in The Marmon Group of companies. It was then the largest cash purchase in Berkshire's history.

Buffett met Jay Pritzker in 1954 around the time Pritzker had initiated a one-of-a-kind tender, offering 80 pounds of cocoa beans for each share of Rockwood stock. Buffett described this particular transaction in a section of Berkshire's 1988 annual report that explained arbitrage indepth. There he explained that Jay Pritzker was the business genius behind this tax-efficient idea. Jay Pritzker was friendly and gave Buffett an impressive education on the 1954 tax code. Thereafter, Buffett avidly followed Jay's business dealings. Jay Pritzker's valued partner was his brother Bob. Bob Pritzker ran the Marmon Group for nearly 50 years.

Jay died in 1999. Bob retired in 2002. Around then, the Pritzker family decided to gradually sell or re-organize certain of its holdings, including Marmon.

This is when Berkshire came in and purchased 60% of Marmon and agreed to acquire all of the remaining balance within seven years. Their initial outlay was \$4.5 billion, and the price of their later purchases will be based on a formula tied to earnings. The deal was done in the way Jay would have liked. They arrived at a price using only Marmon's financial statements, employing no advisors and engaging in no nit-picking.

Marmon has approximately \$7 billion in sales and over 20,000 employees as of the end of 2010. It is composed of over 140 smaller companies; and this chapter provides an overview of Marmon and its competitive advantages as an industrial group.

One such advantage, which should not come as a surprise, is management. Since more than half of all of Marmon's revenue is derived from manufacturing and industrial related companies and these are heavily homogeneous, commoditized businesses, management plays a crucial role in providing these subsidiaries with any form of competitive advantage.

Marmon's CEO, Frank Ptak, works closely with a long-time associate, John Nichols. John was formerly the highly successful CEO of Illinois Tool Works (ITW), where he teamed with Frank Ptak and ran a mix of industrial businesses. In January 2006, Mr. Nichols became Vice Chairman of Marmon and was succeeded as CEO by Frank Ptak.

John Nichols summarized their philosophy in an interview for MSCI, Metals Service Center Institute, this way: "Our competitive advantage is our focus on the customer. We look for opportunities to be involved in decisions for procurement, operations management and to solve problems and create advantages for them. Partnership assumes something more formal, but we try to be involved with our customers to our mutual advantage. We always talk about value-added processes, not just selling a bar or tube or any of our other products."

Marmon's current VP of Transportation Services & Engineered Products and the former CEO of Union Tank Car Co. Kenneth P. Fischl is one such example as Mr. Fischl brings over 30 years of specialized experience and knowledge in the transportation and energy industry to Marmon.

Another aspect that is unique to Marmon is its centralized business processes (accounting, legal, personnel) which are performed out of Marmon's Chicago headquarters by a relatively small staff of just over 70. This helps bring down costs at many of Marmon's businesses and enables them to focus solely on what they do best (running respective operations) which in turn has provided these businesses with otherwise un-realizable efficiencies and a low cost base of operations which is vital to keeping such diversified manufacturing operations profitable over the long-term.

How will Marmon Group compete going forward? The John Nichols interview from 2005 is quite informative. He knows that competing with China or India is tough. He said, "but we went through it before—the Japanese and Maquiladora threats, among others. China has changed its political structure and manufacturing base to become more efficient and productive. They've subsidized their basic materials and set up infrastructure that was not there before. They're now a very strong competitor as well as a proficient supplier. U.S. manufacturers need to work on technologies and processes... Now you may cut the number of jobs required, but you've saved the remaining jobs and maintained control of

your innovation. If you lose that control, then you lose a vital link to future competitiveness... There are certain business components that aren't core competencies with a heavy labor content that make sense to outsource. As part of our Pareto analysis, we identify our core competencies, and anything not a core competency is open to being outsourced. But, keep in mind, there can also be a domestic supplier... Don't miss the fundamental issue: When we as manufacturers sell to our customers, we want to make sure that they look at the installed cost, rather than just focusing on piece-part cost."

The Marmon Group is a customer focused profit generating holding company composed of over 140 smaller companies that have experience competing.

McLANE COMPANY COMPETITIVE ADVANTAGES

BUD LABITAN WITH DR. MAULIK SUTHAR, GUJARAT, INDIA

McLane is a \$34 billion supply chain services company, providing grocery and foodservice supply chain solutions for thousands of convenience stores, mass merchants, drug stores, military locations, and thousands of chain restaurants throughout the United States.

In 1894 Robert McLane opened a small retail grocery store in downtown Cameron, Texas. In 1903, he expanded into wholesale trade, supplying grocery stores in neighboring towns via rail and horse-drawn wagons. During the 1920s through the 1940s, with the advent of the automobile and a robust highway system, his business grew rapidly to encompass much of the Central Texas region.

Headquartered in Temple, Texas, It operates 38 semi-automated grocery and foodservice distribution centers across the country. From these centers the company services every state and county in the United States. McLane has grown into an international distribution and logistics leader.

To make the McLane purchase from Wal-Mart, Warren Buffett had a meeting with Tom Schoewe, Wal-Mart's CFO. Buffett called McLane "a good business, but one not in the mainstream of Wal-Mart's future." McLane has sales of about \$23 billion, but operates on paper-thin margins – about 1% pre-tax. Buffett said that it will swell Berkshire's sales figures far more than its income.

From the beginning, McLane has been about innovation, integrity and leadership. It evolved into a leading grocery wholesaler and distributor in the '60s and '70s; then to a worldwide logistics powerhouse in the 1990s. Today, McLane is a supply chain services leader, delivering more than 10 billion pounds of merchandise every year.

Charlie Munger has said, "The interesting thing to me is the mindset... We talk about welcoming partners. The guy doing deals, he wants to do a deal and then unwind it in the near future. It's totally opposite for us. We like

to build lasting relationships. I think our system will work better in the long term than flipping deals.”

In 1966, convenience stores were popping up on many street corners and gasoline stations. McLane Company moved to Temple, Texas, and adapted its warehouse operations and distribution methods to serve the unique needs of this new retail segment. In 1976, Drayton McLane, Jr., a third generation of family member led McLane’s rapid expansion beyond Texas. By 1990, the company was servicing customers nationwide.

In December 1990, Drayton McLane sold McLane Company to WalMart Stores, Inc. for 10.4 million shares of Wal-Mart stock and an undisclosed amount of cash.

McLane Company entered the foodservice business in December 2000, when it acquired some assets from AmeriServe Food Distribution to create McLane Foodservice.

In May 2003, Berkshire Hathaway acquired McLane Company from Wal-Mart for \$1.45 billion.

Some prominent retail chain customers that receive one or more product categories from McLane are Wal-Mart, Sam's Club, Circle K, WaWa, 7Eleven, ExxonMobil, and Target Stores. Among the national restaurant chains supplied by McLane Foodservice are the Yum! Brands family of restaurants: Taco Bell, KFC, Pizza Hut, Long John Silvers, and A&W Restaurants.

The McLane Company owns the following specialty divisions and subsidiary companies: McLane Foodservice, Inc. is a leading supplier of food and foodservice items to restaurants throughout the US, serving more than 20,000 customers. Salado Sales develops and markets private label products to McLane’s convenience store customers. Its lines include various health and beauty care items, film and flash products, light bulbs, motor oil and work gloves. Professional Datasolutions, Inc. is a leading provider of software and services to the convenience and petroleum industries.

McLane Company acquired C.D. Hartnett in 2004. Hartnett is a full-line grocery wholesaler based in Weatherford, Texas. C.D. Hartnett supplies

food service accounts, convenience stores, and independent grocers in Texas, Kansas, Oklahoma, and Louisiana. McLane acquired McCartyHull a full-line grocery wholesaler in 2006. And, McLane Company purchased Empire Distributors in 2010. Empire is a wholesale alcoholic beverage distributor in the Southeast US.

With approximately 15000 employees and 54,000 as service point locations, McLane's competitive advantage strength arises from its formidable large scale and logistics expertise. McLane runs a successful integrated business model for express package distribution. It provides grocery and foodservice supply chain solutions for thousands of convenience stores, mass merchants, drug stores and military locations, as well as thousands of chain restaurants throughout the United States. McLane also provides logistics services in Brazil and export to 34 countries.

Substantial investments on shipment tracking technology have served to erect entry barriers for competitors. These initiatives provide McLane's competitive advantage as it evolves into a purveyor of total logistics solutions. McLane's expanding fleet, new material handling equipment, and technology is ramping up ground handling facilities. McLane has made huge investments in building an infrastructure that is unparalleled. It has more than \$1 billion invested in its nationwide supply chain infrastructure.

McLane has amassed whopping over 8 million square feet of warehouse space. This has more than 2.5 million combined square feet of refrigerated and frozen space. McLane's modern fleet includes over 2,000 multi-temperature trailers to maintain proper temperatures while in transit.

McLane is a debt-free company and all the investment related finance comes from internal accruals. Its brand is well recognized that has offered superior realizations per unit of good transported vis-à-vis its peers. This helped the company offset higher input costs like freight, handling and service costs.

With an extensive network and a strong clientele, the company is set to consolidate its position in the domestic market. McLane also has Subsidiaries like Empire Distributors, Inc. engaged in wholesale alcoholic

beverage distribution, Professional Data solutions, Inc. is engaged in provision of enterprise-wide software and services to meet convenience store and wholesale petroleum marketers; Salado Sales is engaged in development and distribution of high-quality control label products and Vantix Logistics is engaged in third-party supply chain management solutions for logistics, inventory management and procurement. No other competitor operates in such wide range of the services in the logistics sector nor has capability to scale up in short time.

McLane's unique combination of highly trained manpower and worldclass procurement, logistics, merchandising and technology services will survive better in the today's and tomorrows' highly uncertain economy.

All customers are affected by tighter margins, gasoline price uncertainty, food safety concerns, and employee turnover. New customers initially have bargaining power and can either shop around for low prices or demand a higher level of service. However, existing customers have decreased power because of higher switching costs which makes them unwilling to change.

The capital intensive nature of McLane's business restricts new entrants. Customers are difficult to attract because of high switching costs and conveniences offered by the efficient McLane logistics system.

Added business opportunities such as supply chain management, product distribution management and logistics solutions could continue to pep up McLane's margins in a difficult environment. The best business returns are usually achieved by companies that are doing something quite similar today to what they were doing five or ten years ago and continue to do the same things ten, twenty or fifty years from now. McLane is critical to the transport of products and it is uniquely positioned not just to survive, but to thrive.

MEDICAL PROTECTIVE COMPETITIVE ADVANTAGES

BUD LABITAN WITH RESEARCH ASSISTED BY MICHAEL MURILLO,
KANSAS CITY UNIVERSITY OF MEDICINE AND BIOSCIENCES

Medical Protective is the leading American liability insurance company for physicians and dentists. In 2005, Warren Buffett's Berkshire Hathaway purchased the company for \$825 million from General Electric, GE.

In 1899, Alpheus P. Buchman, MD of Fort Wayne, Indiana and a group of physicians formed the Physicians' Guarantee Company in order to provide pre-paid legal defense services for medical malpractice lawsuits. In 1902, Physicians' Guarantee Company changed its name to the Physicians' Defense Company.

In 1907, Byron H. Somers and Charles M. Niezer founded The Medical Protective Company and in 1913, Medical Protective acquired Physicians Defense Company. Byron Somers and by his descendants ran Medical Protective until 1998 when General Electric purchased the company. In June of 2005, Berkshire Hathaway bought Medical Protective Company ("MedPro"), a 106-year-old medical malpractice insurer based in Fort Wayne.

Buffett said that malpractice insurance is tough to underwrite and has proved to be a graveyard for many insurers.

In his view, MedPro should do well because it has the attitudinal advantage that all Berkshire insurers share: "underwriting discipline trumps all other goals." As part of Berkshire, MedPro has financial strength far exceeding that of its competitors. This quality assures doctors and dentists that their insurer will not fail.

Buffett also praised CEO, Tim Kenesey as a smart and energetic manager who thinks like a Berkshire manager.

The Medical Protective Company insurance products are distributed through a network of employee market managers and appointed agents. Company headquarters is located in Fort Wayne, Indiana.

In the 1930s, Medical Protective introduced a much broader coverage policy that helped shape the defense of medical practitioners. It designed the first "medmal bible" book for this industry, called "Brief on Malpractice Law."

During the 1940s, Medical Protective defended over 50,000 claims and provided physicians and dentists with continued coverage during their WWII military service. Medical Protective began insuring residents and interns during their training in the 1950s.

During the 1970s, Medical Protective was one of the few carriers to survive the increasing number of medical malpractice suits that resulted in the industry's first financial crisis. Many carriers exited the market during the industry's "second crisis" of the 1980s. And, Medical Protective continued to offer occurrence coverage. It also awarded claim-free credits for policyholders without losses.

In the 1990s, Medical Protective began to insure small and communitybased hospitals. The 1998 purchase by General Electric allowed Medical Protective the resources to expand coverage countrywide.

In 2001, Medical Protective started offering online risk management CME courses, and online coverage application. The next year, St. Paul Travelers and other competitors exited the market during the industry's "third crisis." Medical Protective stood strong and added policyholders.

In 2005, GE management elected to exit this business and GE used the funds to refocus its mission on its core competencies. So, Medical Protective was purchased by Berkshire Hathaway because it met Buffett and Munger's criteria of an understandable high quality business.

In 2006, the S&P and A.M. Best rating agencies assigned the highest financial strength ratings to Medical Protective, "AAA" and "A++" respectively.

Medical Protective started insuring stand-alone surgery centers, cancer treatment centers, dialysis centers and imaging centers in 2007. It also forged partnerships with specialty organizations and associations to offer new insurance solutions to their members.

The competitive advantages of Medical Protective include its superior financial strength, its positive brand identity, and its historical ties to the original pre-paid malpractice insurer. Consumers seem to be drawn more towards companies that have traditionally performed well. And, Medical Protective has survived three "crises" over the past 100+ years, and it continues to prosper. This achievement demonstrates durability and effective management.

Charlie Munger has said, "I'm glad we have insurance, though it's not a no-brainer, I'm warning you. We have to be smart to make this work."

As long as there is a market for medical and dental malpractice insurance, and managers are careful, Medical Protective will be ready and able to compete for clients. MedPro has demonstrated durability over the last 100 years. Its professional customers have shows a hesitancy to switch. Its history suggests that the company will be sustainable for many years to come as long as management avoids poor decisions and makes good underwriting decisions.

MIDAMERICAN ENERGY HOLDINGS COMPETITIVE ADVANTAGES

BUD LABITAN WITH DR. MAULIK SUTHAR, GUJARAT, INDIA AND
BRIAN BERNARDINO, JD

MidAmerican Energy Company ("MidAmerican Energy") is an industry leading public utility with electric and natural gas operations. It is also leading the industry in energy sources diversification.

It is the principal subsidiary of MHC Inc. ("MHC"). MHC is the wholly owned subsidiary of MidAmerican Funding, LLC ("MidAmerican Funding"), which is an Iowa limited liability company with MidAmerican Energy Holdings Company ("MEHC") as its sole member. MEHC is a consolidated subsidiary of Berkshire Hathaway Inc.

MidAmerican Energy Holdings Company is a holding company that owns and operates a diverse portfolio of assets in order to meet its customers' energy needs. In 1999, Buffett and Munger acquired a major portion of MidAmerican Energy for cash, issuing no Berkshire shares. Said Munger, "The interesting thing is the field is so big - It's enormous. One thing a modern civilization needs is energy."

MidAmerican holds the following companies: MidAmerican Energy Company, PacifiCorp, CE Electric UK, Integrated Utility Services UK, CalEnergy Generation, Kern River Gas Transmission Company, Kern River Pipeline, Northern Natural Gas Company, HomeServices of America and 10% of outstanding shares of the BYD. BYD is an auto, battery, and solar products company.

MidAmerican Energy Company engages in the regulated and non regulated retail sale of electricity and natural gas. It serves residential, agricultural, and various commercial and industrial customer groups, as well as other utilities, municipalities, and energy marketing companies. MidAmerican operates in the business sector where barriers to entry are very high. Entry in power generation, transmission and distribution

business segments requires heavy capital investment. The other barriers are fuel linkages, backward integration with suppliers, and payment guarantees from clients that buy power. In addition, the bargaining power of retail customers is low. Government regulation of electricity tariffs affects the profit margins and ROE significantly.

Its six core business principles are: customer service, employee commitment, environmental respect, operational excellence, regulatory integrity and financial strength. Chairman Greg Abel said: “These business principles are the bedrock of our organization, the cornerstones of our decision-making processes and the measures by which we determine success.”

MidAmerican Energy is a composite power public utility company that generates a capacity of 18,722 megawatts of electricity. This is the 2nd highest in the USA. It is Iowa’s largest energy company and it is strategically located in the middle of several major markets in the Midwest. Headquartered in Des Moines, Iowa, the company provides service to customers in a 10,600-square mile area in Iowa, Illinois, South Dakota and Nebraska. It transmits, distributes and sells approximately \$11.1 billion dollars of electricity. It also distributes, sells, and transports natural gas. It has 729,000 regulated retail electric customers, and 710,000 regulated retail and transportation natural gas customers. MidAmerican employs 17,800 highly trained professionals. Its total assets are worth about \$ 46 billion, which are highly depreciated. This gives MidAmerican Energy a cost of replacement advantage against potential competitors.

Are its competitive advantages sustainable for the next 10 years? At the end of 2010, MidAmerican Energy had 7,048 megawatts of owned and contracted generating capacity. Approximately 52 percent was fueled by coal; 21 percent by natural gas and oil; 20 percent by wind, hydroelectric and biomass; and 7 percent by nuclear.

MidAmerican Energy also delivers Hydroelectric and Wind energy. This gives it a leg up or added advantage for future expansion in both sectors. MidAmerican Energy’s experience is in energy production and energy

project financing. Hydroelectric, Wind, and Solar electricity are renewable energy sources and that has support from the regulatory and environmental forces. MidAmerican has not invested heavily in the Nuclear power. And, after the Fukushima, Japan incident, this may be one advantage in its favor. With the public's rejection of nuclear powered energy, coal prices may rise with increasing world demand. Globally, MidAmerican Energy continues to monitor this basic fuel supply, in addition to alternative sources such as wind, geothermal, and solar.

MidAmerican has a well diversified portfolio. Its operational experience in serving clients and dealing with government regulation, keeps it managing and decreasing environmental risks. It has investments in subsidiaries like PacifiCorp, CE Electric UK, Integrated Utility Services UK, CalEnergy Generation, Kern River Gas Transmission Company, Kern River Pipeline, Northern Natural Gas Company, Home Services of America and BYD Company (10% of outstanding shares).

MidAmerican Energy has benefitted from the Public Utilities Regulatory Policy Act of 1978 because that act started the industry on the road to competition. The act ended promotional rate structures, established unconventional qualifying facilities and encouraged conservation. It also intended that non-conventional sources of power from renewable sources such as geothermal come on line. Known as PURPA, the act started the competitive process because it enabled non-utility generators to produce power for use by customers attached to a utility's grid. Any efficient energy producer could sell electricity into the power grid. Because of the huge capital investment required in operating expensive generating facilities, if one company could produce power more economically than competitive firms, efficiency would be rewarded. So, PURPA rewarded innovation. Competition in this industry does not force monopolistic utilities to lose market share. It encourages the introduction of new efficiencies and lower prices for customers.

In 1992, the Energy Policy Act's tax credits helped increase production of domestic energy resources from renewable resources. A new class of producers was created, Exempt Wholesale Generators. The EP Act

increased competitive pressure on existing generating companies and forced them to become more efficient and cost-conscious. Utilities like MidAmerican Energy won some new rights under The EP Act allowing them to own some Exempt Wholesale Generators, even outside their franchise area if the unit made good financial sense. Also, utilities did not even have to keep all their business in the United States. As long as customers of domestic operations were not disadvantaged, if companies saw profit opportunities abroad, utilities could purchase companies overseas.

Utilities also won a major concession when the law required utilities to open their transmission systems (only wholesale transactions) to other companies. This added some competitive pressure to upgrade efficiency.

Although the federal law limited sales to wholesale customers, it left the door open for competition on the retail level by allowing state legislatures and regulatory commissions to allow suppliers to sell electricity to all customers.

MidAmerican has new projects in development. If necessary, big expansions such as mega power units can be financed by capital support from Berkshire Hathaway. The lack of a dividend requirement provides it an important competitive advantage in MidAmerican's ability to invest in capital growth. This addresses debt obligations and funds capital requirements of its subsidiaries.

MidAmerican will spend approximately \$9.6 billion over the next three years for development and maintenance capital expenditures for projects that include 593 MW of wind and 637 MW of gas plant electricity power production. Future growth drivers for MidAmerican will be additional generation and transmission investment in its subsidiary PacifiCorp, Wind power expansion, Natural Gas storage & transportation, and for its joint venture with AEP, the Electric Transmission Texas, LLC.

In addition to the difficulty of setting up a hydro unit or a thermal unit this process calls for considerable skills in planning, getting clearances, and building new units. The ability to generate funds for capital expenditures

is a competitive advantage for MidAmerican under the Berkshire Hathaway umbrella.

MidAmerican Energy's plans are subject to risks and uncertainties stated recently in their Financial Reports. These risks and uncertainties can be categorized into five groups: economic, social, business, market and political. Economic risks and uncertainties include changes in economic industry, the financial condition and creditworthiness of significant customers and suppliers, and the impact of inflation on costs and the ability to recover such costs in regulated rates. Social risks and uncertainties include demographic changes that could affect customer usage of electricity and natural gas, the effects of war, and the effects of terrorism. Examples of business risks and uncertainties are risks relating to nuclear generation, increases in employee healthcare costs, and unanticipated factors that could affect future generating facilities and infrastructure additions. Market risks and uncertainties can consist of changes in prices, credit, availability and demand for purchases and sales of wholesale electricity, coal, natural gas, and other fuel sources that could have an impact on generating capacity and energy costs, and the impact of investment performance and changes in interest rates. Political risks and uncertainties include changes in energy laws or regulations, and receipt of required permits and authorizations from government entities.

In 2010, MidAmerican businesses took a disciplined approach to managing costs and expand alternative sources of production. CalEnergy is adding three new geothermal power facilities in California's Imperial Valley that can produce 195 megawatts of renewable energy.

Recently, MidAmerican Energy Holdings agreed to buy the \$2 billion Topaz Solar Farm project from First Solar. While financial terms of the deal were not disclosed, MidAmerican likely scored the project at a discount. The solar power sector has begun to decline sharply due to a combination of slack demand and oversupply. The Topaz plant in California is one of the two largest solar projects in the world. It's slated to be done by 2015, and is expected to generate enough renewable energy for

about 160,000 homes. Pacific Gas & Electric Co. agreed to buy the electricity under a 25-year power purchase agreement.

Achieving excellence with customer satisfaction is a major focus of the organization. PacifiCorp and MidAmerican Energy Company continue to lead in rankings for industrial customer satisfaction. MidAmerican was ranked 1st in the U.S. in overall customer satisfaction, according to TQS Research. The Pacific Power division received the highest score among all operating utilities in the U.S. It had 97.5 percent of customers polled were very satisfied. In the customer satisfaction survey done by Mastio & Company, Kern River Gas Transmission Company and Northern Natural Gas Company ranked first and second, among interstate natural gas pipelines. MidAmerican also performs continuous improvement in safety performance by sharing best practices among its businesses.

MidAmerican works to balance the needs of its customers while minimizing the impact of its operations on the environment. Renewable and noncarbon fuel sources comprise 25 percent of MidAmerican's generation capacity. Together, the regulated U.S. utilities, MidAmerican Energy and PacifiCorp, own 2,316 megawatts of wind-powered generation, ranking them No. 1 in the U.S. among rate-regulated utilities. In 2010, PacifiCorp's 111-megawatt Dunlap Ranch wind project was placed in-service, and MidAmerican Energy announced plans to add 593 megawatts of wind generation in Iowa by year-end.

MidAmerican Energy's and PacifiCorp's comprehensive air initiative projects – two power plant scrubber and baghouse projects achieved substantial completion and six continued on schedule – further demonstrate its focus on solutions that protect customers and the environment.

PacifiCorp's Energy Gateway transmission expansion program is building 2,000 miles of high-voltage transmission lines to provide access to conventional energy sources. It will also connect to areas where renewable energy development possibilities are strong. In 2010, a segment that extends from southern Idaho into northern Utah was placed in service.

When Kern River's Apex Expansion Project expansion is complete, the Kern River system will be able to transport more than 2.16 billion cubic feet of natural gas per day.

A new strategic market for the natural gas business was identified. Plans were announced to develop an underground natural gas storage facility in the Cook Inlet region of Alaska. The storage facility, with an initial capacity of 11 billion cubic feet, is needed to meet the area's peak demand for energy by winter 2012-2013.

MidAmerican Energy has demonstrated competitive advantages in management, operations, alternative energy sourcing, and capital generation. While there have been periods of slow pace in energy sector product innovation, MidAmerican has demonstrated that it looks around the globe and partners with the best.

With the heavy capital intensive nature of this business, the biggest competitive advantage of MidAmerican Energy may be its incorporation into the group of Berkshire Hathaway companies. Managers are pleased with the benefits this relationship brings to customers. MidAmerican Energy now delivers electricity from Coal-Fueled, Combustion-Fueled, Hydroelectric, Wind, and Solar power plants.

MidAmerican managers are preparing today to meet customers' energy needs of the future. They will meet those needs in an environmentally responsible manner that focuses on the long-term interests of the customers. With smart and trustworthy managers, MidAmerican Energy Holdings Company's competitive advantages are sustainable for decades to come.

MITEK INC. COMPETITIVE ADVANTAGES

BUD LABITAN WITH MR. JACK WANG CPA, LEXICO ADVISORY

MiTek's steel connector plates are the best in the industry. MiTek strives to combine consistent nail values, high-quality test-substantiated steel values, and packaging options to produce the best connector plate package in the industry. Acquired by Berkshire Hathaway in 2001, along with Shaw, Johns Manville, and XTRA, Buffett said that all of these businesses are led by smart, seasoned and trustworthy CEOs.

Warren Buffett received a package from St. Louis, containing a chunk of metal whose function he could not imagine. The package and letter was from Gene Toombs, CEO of MiTek. Toombs explained that MiTek is the world's leading producer of a connector plate which is used in making roofing trusses. Toombs also said that the U.K. parent of MiTek wished to sell the company. "Liking the sound of his letter," Buffett gave Gene Toombs a call. The deal was made for cash.

In building its moat, MiTek ensures that clients receive the best service in the industry. MiTek engineering services leads the industry in credibility, speed, accuracy and efficiency. MiTek engineering offices provide expertise in reviewing the designs of component manufacturers around the world.

Utilizing the speed of the Internet and state-of-the-art workflow, it has created instant linkage with MiTek customers' engineering and design departments. Builders, building inspectors, and designers all over the globe benefit from the responsible and efficient review services MiTek provides.

Gene Toombs' managerial crew was enthusiastic about the business and wanted to participate in the purchase. So, Berkshire Hathaway arranged for 55 members of the MiTek team to buy 10% of the company, with each putting up a minimum of \$100,000 in cash. This makes all of these managers true *owners*. They face their business decisions carefully and they incur a true cost of capital. Charlie and Warren "love the highgrade,

truly entrepreneurial attitude that exists at MiTek, and we predict it will be a winner for all involved.”

The MiTek team knows that resolving technical and software issues are crucial to a client’s business’s performance. MiTek’s goal is to help the customer enhance the performance of the customer’s business. With MiTek’s unmatched technical support team, they deliver on that commitment daily.

MiTek is the world’s leading provider of steel connector products. It is also a leader in designing engineering software and ancillary services for the global building components market. As such, it helps make construction safer around the globe.

MiTek’s software has become the industry standard. It provides the component manufacturer with the ability to control the crucial parts of the business and to consistently improve performance. MiTek’s software enhances each engineering step from the framing and design process, through cost control and pricing, into the production and throughput of the shop floor. Therefore, it brings time-savings and dollar savings to the customer.

The competitive edges of MiTek lies in its unrivalled expertise in terms of professional structural engineering service and its extensive Research and Development on construction engineering solutions.

Are the advantages sustainable for the next 10 years? MiTek should be able to sustain its competitive advantages by relying on its expertise in providing the most sophisticated and customized engineering solutions.

Mitek has extensive operations on five continents with local partners to assist its effort to develop innovative construction products and systems. It has formed strong strategic alliance with other industry leaders with complementary products.

In March, 2011, MiTek built up its moat by purchasing USP Structural Connectors from Gibraltar Industries, Inc. USP designs, engineers and is a leading manufacturer of structural framing and bracing connectors sold

into the residential and light commercial industry. When we read about this acquisition, we thought of this bit from one of Charlie Munger's talks: "We try more to profit by always remembering the obvious than from grasping the esoteric. It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent."

MiTek's circle of competence is in structural connectors. It has also developed the most advanced suite of design software to complement and document this expertise. With its more than 100 engineers worldwide, MiTek has the depth in expertise to provide the best technical solution and on-site supports.

In order to build its economic moat, MiTek must continue its focus to deepen its engineering expertise, technical services, and work closely with its local partners to prevent erosion of market shares to niche domestic competitors with better connection to local clients on each individual region. MiTek must continue to lead in connectors, component manufacturing equipment, construction engineering software, and customer-focused technical services.

If MiTek continues to lead in this mix of products and services, it can widen its moat and provide greater value to its customers.

MOODY'S (MCO) COMPETITIVE ADVANTAGES

BUD LABITAN WITH RAGHU DASARI, UNO-CBA

Moody's and its largest competitors, McGraw-Hill's S&P, and Fitch, enjoy competitive advantages and distinguished brand names in what may be considered an oligopoly. There are large barriers to entry for potential competitors. And, there are high switching costs for customers. Such advantages have conferred tremendous pricing power and profitability on Moody's and S&P.

Warren Buffett and Charlie Munger had read the Moody's Banks & Finance Manual for years. They purchased a stake in Moody's for Berkshire Hathaway in 2001.

Moody's started in the early 1900s as a provider of financial data on a variety of stocks in its published manual. After the 1907 stock market crash forced the company out of business, founder John Moody reentered the business by providing a simple, standard, and elegant analysis and opinion on a number of companies. He also issued securities. Within 15 years, the company covered substantially the entire bond market. Its ratings had become an influential factor in the markets.

Moody's persevered through the Great Depression, eventually expanded into covering more areas of the financial world. Moody's was purchased in the 1970s by Dun & Bradstreet Corporation. It was eventually spun off in 2000 in a public stock offering.

Moody's Corporation (NYSE:MCO) is a provider of credit rating services to the capital markets. In virtually all global markets, Moody's provides risk assessment and research on debt and its issuer. Moody's was one of four other companies which were Nationally Recognized Statistical Rating Organizations prior to a 2006 law abolishing that SEC-designated title. S&P, Fitch's, A.M. Best, and Dominion Bond Rating Service were the others.

Moody's is still heavily entrenched in the financial world as a trusted provider of independent, objective ratings on creditworthiness, especially within the US domestic capital markets. It maintains ingrained services and brand recognition. This helps insulate the company from heavy competitive entry into this field.

Moody's offers standard ratings of a company's creditworthiness. This signals the likelihood that a loan extended will be repaid. It also states opinions on both long-term and short-term obligations. Most of Moody's revenue comes from charging fees to companies seeking its objective rating. The company generates about 80% of its revenue from ratings, with the remainder from research and software.

Corporate and public finance issuers typically pay Moody's an ongoing fee to publish credit ratings on their entities. This allows them to signal their own creditworthiness, and thus, lowers their own cost of capital. The ratings are disseminated by means of press releases to the public via electronic and print media.

For ratings, long-term obligations may be considered either "investment grade" (Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3) or "speculative grade" (Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca, C).

Short-term obligations may be either Prime 1, 2, or 3 or else Not Prime (NP), representing a decreasing ability of issuer to repay such obligations. Historically, these ratings have correlated with a company's likelihood of defaulting on its obligations to pay back debt.

The company's services and ratings are considered indispensable for a company trying to raise money. A positive rating from Moody's allows a company to borrow money at much lower interest rates, lowering that company's cost of capital. Moody's ratings often play an important role in increasing market liquidity, as bond holders are more willing to lend money to a company that has Moody's rating.

In 2009, Moody's earned \$407.1 million in net income on \$1.80 billion in total revenues. This represents an 11.8% decrease in net income and a 2.4% gain in total revenues from 2008. While the company spent \$17.5 million on restructuring expenses throughout 2009, what really drove down net

income was a 10.0% increase in operating expenses throughout the year. Approximately 1/3 of revenue comes from its subsidiary Moody's Analytics.

Moody's operates through three segments: A. Research, Data, and Analytics (71.3% of total revenue) B. Risk Management Software (25.0% of total revenue) and C. Professional Services (3.6% of total revenue).

Research, Data, and Analytics (71.3% of total revenue): The RD&A segment is Moody's primary revenue generator. This is the segment that assigns credit ratings to various securities. RD&A charges fees to the issuers of every security it rates. In 2009, RD&A generated \$413.6 million in revenue.

Risk Management Software (25.0% of total revenue): The RMS segment provides economic and risk management software for its client companies.

Professional Services (3.6% of total revenue): This segment offers advising and training for better risk management to its customers. Packages and contracts are usually created on a case-by-case basis. In 2009, the Professional Services segment generated \$20.8 million in revenue.

Recently, MCO's 5Yr Gross Margin (5-Year Avg.) is approximately 100% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 28.7%, while the industry Net Profit Margin (5-Year Avg.) is 0.3%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

At the start of the Great Recession of 2007-2009, Moody's and other ratings agencies were found grossly incompetent in their rating of collateralized debt obligations, structured investment vehicles, and mortgage backed securities.

Moody's and other ratings agencies' inability to correctly identify the inherent risks in these securitized debt instruments led to many investors believing they had purchased risk free cash flows. A majority of these securities were rated AAA, the same debt rating as a treasury bond. The lack of faith in Moody's and its peers was apparent when certain CDO's were trading at 10 cents on the dollar despite having an AAA rating.

To better understand why Moody's went along with its peer rating agencies, take a look at this passage from one of Charlie Munger's talks on one of the misjudgments called the incentive caused bias: (#3 from The 24 Standard Causes of Human Misjudgment.) “#3. Incentive-cause bias, both in one's own mind and that of ones trusted advisor, where it creates what economists call ‘agency costs.’ Here, my early experience was a doctor who sent bushel baskets full of normal gall bladders down to the pathology lab in the leading hospital in Lincoln, Nebraska. And with that quality control for which community hospitals are famous, about five years after he should've been removed from the staff, he was. And one of the old doctors who participated in the removal was also a family friend, and I asked him: I said, “Tell me, did he think, ‘Here's a way for me to exercise my talents’” -- this guy was very skilled technically-- “and make a high living by doing a few maimings and murders every year, along with some frauds?”” And he said, “Hell no, Charlie. He thought that the gallbladder was the source of all medical evil, and if you really love your patients, you couldn't get that organ out rapidly enough... Now that's an extreme case, but in lesser strength, it's present in every profession and in every human being. And it causes perfectly terrible behavior.” Moody's and its peers did not exercise alternative views because the incentives were heavily weighted towards maintaining its institutional imperative. Buffett described the institutional imperative as that need for managers to do like their peers no matter how irrational it may be.

In the face of recent ratings failures, should there be greater regulation of this industry? There is a legitimate counter-argument that these rating agencies were fooled by the complexity and lack of transparency built into these bundled complex mortgage backed securities.

Are the competitive advantages sustainable for the next ten years? Moody's has a significant 40% of market share in the ratings industry. Moody's credit ratings business has significant barriers to entry as investors seek an experienced and reputable firm for their source of information. The client companies who want to be rated also seek a reputable firm that will provide confidence in the marketplace. Then client firms can get credit at lower rates. This provides a significant competitive advantage from any new entrants.

Moody's is also spread out internationally in over 110 countries. This provides it the competitive advantage of network scale worldwide.

Moody's has a sustainable moat because it has the experience and brand recognition in financial markets that are becoming increasingly complex. However, it must get better at analyzing and rating complex securities. Investors need information analyzed, simplified and rated objectively so that it is easier for them to comprehend. And, the growing strength of financial markets in Asia and Africa will need these services from a reputable ratings agency.

Even though a law was passed in 2006 to increase the competition in credit rating agencies with provisions to make the entry of new Raters easier, we did not see any new major players. Also, the recent financial crisis did not decrease the market share of Moody's. We believe that Moody's competitive advantages are sustainable. However, it must improve and evolve its methods of analyzing and rating complex securities.

NATIONAL INDEMNITY COMPANY COMPETITIVE ADVANTAGES

BUD LABITAN WITH JEN IWANSKI, UNO-CBA AND RICK MAYHEW

Over the years, National Indemnity's underwriting profitability has provided large sums available for Warren Buffett and his partner Charlie Munger to invest for Berkshire Hathaway's shareholders.

National Indemnity Company is the lead member of the National Indemnity group of insurance companies. The National Indemnity group of insurance companies is composed of: National Indemnity Company, National Liability & Fire Insurance Company, National Fire & Marine Insurance Company, National Indemnity Company of the South, National Indemnity Company of Mid-America, and the Columbia Insurance Company.

Warren Buffett wrote, "Had we not made this acquisition, Berkshire would be lucky to be worth half of what it is today... National Indemnity has been the most important operation in Berkshire's growth."

In 1940, two entrepreneurial brothers in Omaha, Nebraska, Arthur and Jack Ringwalt founded National Indemnity Company as a specialty insurance firm. It was a four employee operation that wrote liability insurance on taxis. Ringwalts' founding principles were based on the idea that "there is a proper rate for every legitimate risk"; and, that such "risky" classes as long-haul trucks, taxis, rental cars, and public buses should not be arbitrarily rejected.

Jack Ringwalt instilled the underwriting discipline at the inception of the company, and Phil Liesche maintained it after him. Today, the National Indemnity Company is one of the leading property/casualty/reinsurance members of the Berkshire Hathaway group of insurance companies. Stock control changed from founder Jack Ringwalt to Berkshire Hathaway Inc. in March of 1967. That year, Berkshire Hathaway acquired the Associated Cotton Shops, National Indemnity and National Fire & Marine. Insurance Underwriting Discipline has been the core of this success.

Exceptional underwriting profits during 1972 in the insurance business at National Indemnity presented a paradox. Profits swelled their corporate profits, but the factors which produced such profits induced large amounts of new competition. The experienced management, headed by Jack Ringwalt and Phil Liesche underwrote and produced a profit. Their approach based their rates on long-term expectations rather than short-term hopes. While this approach has meant dips in volume from time to time, it has produced excellent longer-term results.

Their traditional insurance business, specialized auto and general liability lines conducted through National Indemnity Company and National Fire and Marine Insurance Company, had an exceptionally fine underwriting year during 1973; but, it had an extraordinarily bad underwriting year in 1975. However, volume at the National Indemnity Company grew rapidly during 1976 as competitors finally reacted to the inadequacy of past rates.

Buffett made it a point to give credit to: “Phil Liesche, greatly assisted by Roland Miller in Underwriting and Bill Lyons in Claims, for an extraordinary underwriting achievement in National Indemnity’s traditional auto and general liability business during 1977.”

Buffett’s 1985 Letter illustrates how he and his managers were learning more about the reinsurance business. They followed Jack Byrne’s moves at Fireman’s Fund (“FFIC”) where he was Chairman and CEO of that holding company. On September 1, 1985 Berkshire became a 7% participant in all of the business in force of the FFIC group of affiliated companies.

Buffett wrote: “Our (insurance) contract runs for four years, and provides that our losses and costs will be proportionate to theirs throughout the contract period. If there is no extension, we will thereafter have no participation in any ongoing business. However, for a great many years in the future, we will be reimbursing FFIC for our 7% of the losses that occurred in the September 1, 1985 - August 31, 1989 period. Under the contract FFIC remits premiums to us promptly and we reimburse FFIC promptly for expenses and losses it has paid. Thus, funds generated by our share of the business are held by us for investment. As part of the deal, I’m available to FFIC for consultation about general investment strategy. I’m not involved, however, in specific investment decisions of FFIC, nor is

Berkshire involved in any aspect of the company's underwriting activities. FFIC was doing about \$3 billion of business... The company's September 1, 1985 unearned premium reserve was \$1.324 billion and it therefore transferred 7% of this, or \$92.7 million, to us at initiation of the contract. We concurrently paid them \$29.4 million representing the underwriting expenses that they had incurred on the transferred premium. All of the FFIC business was written by National Indemnity Company, but two-sevenths of it is passed along to Wesco-Financial Insurance Company ("Wes- FIC"), a company organized by our 80%-owned subsidiary, Wesco Financial Corporation."

When Warren Buffett wanted to venture into reinsurance, he asked George Young to help him with this operation. According to Mrs. Young, Warren and George checked out every book at the local libraries on the subject of insurance and reinsurance. George Young built a substantial and profitable reinsurance operation in just a few years. The reinsurance division experienced many competitive factors in 1972 as many new organizations entered what had historically been a small field. The reinsurance area was built up by managers such as Mike Goldberg, Rod Eldred, Dinos Iordanou, Ajit Jain, Phil Urban, and Don Wurster.

Rational and skeptical, Ajit Jain rose up to head the reinsurance division as its CEO and achieve great underwriting returns for the business. Early on, Buffett stated this goal: "In the longer term we plan to be a very major factor in the reinsurance field, but an immediate expansion of volume is not sensible against a background of deteriorating rates." When the losses for competitors arrived, Berkshire Hathaway and National Indemnity's Insurance and Reinsurance operations were able to expand significantly.

In 1985, National Indemnity Company evolved by launching its Specialty Risks Division. This is now known as Professional Liability & Specialty Risks Division. An ad, placed in the Wall Street Journal, featured the headline, "Berkshire Hathaway wants to see property/casualty risks where the premium is \$1,000,000 or more." This operation began in the Omaha office and eventually moved to Connecticut with the company's reinsurance division.

When the reinsurance business grew large, Warren Buffett said this: "Our ability to choose between good and bad proposals reflects a management

strength that matches our financial strength: Ajit Jain, who runs our reinsurance operation, is simply the best in this business... Here Berkshire has a major advantage: Ajit Jain, our super-cat manager, whose underwriting skills are the finest... Ajit Jain is the guiding genius of our super-cat business and writes important non-cat business as well.”

The National Indemnity group of insurance companies has traditionally conducted its non-reinsurance business nationwide relying on a network of more than 100 contracted general agents.

Independent “producing” agents strive to understand and address their customers’ needs. They often relying on the markets provided by general agents to place such business. National Indemnity contracts with the general agents to manage business relationships with those local producing agents. This wholesale distribution arrangement allows Berkshire Hathaway’s commercial insurance products to be effectively available across the country.

The National Indemnity group has a rich history and a promising future. The group is committed to protecting customers with strength, stability and integrity. It has developed an economic moat or competitive advantages based on underwriting expertise. This managerial expertise has contributed strong profits from having a sound franchise in such a volatile industry. The company has taken advantage of selected underwriting opportunities as they have presented themselves. For example, National Indemnity's traditional business had a combined ratio of 84.2 in 1995 and a combined ratio of 74.2 in 1996.

Many of the company’s competitors suffered credit downgrades last year, leaving Gen Re, and its sister operation at National Indemnity, as the only AAA rated companies among the world’s major reinsurers.

Buffett said, “When insurers purchase reinsurance, they buy only a promise – one whose validity may not be tested for decades – and there are no promises in the reinsurance world equaling those offered by Gen Re and National Indemnity.”

In the face of the recent financial crisis, the National Indemnity Company has continued to lead property/casualty and reinsurance members of insurance companies. National Indemnity Company also has a strong

ability to recover and maintain financial stability even after a catastrophic event like 9/11. National Indemnity management embraces a conservative risk management strategy which decreases the affect and significance of terrible losses.

National Indemnity Company can sustain their underwriting expertise over the next ten years by means of attracting, developing and retaining highly qualified underwriters.

Here is how Warren Buffett said it: “At some point - we don’t know when - we will be deluged with insurance business. The cause will probably be some major physical or financial catastrophe. But we could also experience an explosion in business, as we did in 1985, because large and increasing underwriting losses at other companies coincide with their recognition that they are far under reserved. In the meantime, we will retain our talented professionals, protect our capital, and try not to make major mistakes.”

As operating costs increase, it may be tempting to reduce the company headcount and outsource some underwriting activities. It is crucial that the company maintains its underwriting activities in-house. This way, the risks are closely monitored by management to ensure safety.

Charlie Munger said, “Reinsurance is not as much of a commodity business as it might appear. There’s such a huge time lag between when the policy is written and when it is paid that the customer has to evaluate the insurer’s future willingness and ability to pay.” Buffett and Munger have said that at the reinsurance operation, Ajit Jain continues to add enormous value to Berkshire. Since joining Berkshire in 1986, Ajit Jain has built a great specialty reinsurance operation, super-catastrophe reinsurance business, from scratch.

The retroactive business is almost single-handedly the work of Ajit Jain, whose praises Buffett sings annually. Ajit Jain and his associates are able to offer both no-commission annuities and a liability policy with jumbo limits of a size rarely available elsewhere.

Berkshire Hathaway has major reinsurance operations at General Re and National Indemnity. GEICO and National Indemnity are working together in the commercial field, and results are very encouraging.

National Indemnity Company may be faced with challenges that will alter its financial position in some calamitous years, but it will sustain its market position over the coming years.

The company will need to pay close attention to each underwriting risk as well as market conditions. It must always try to evaluate new ways to minimize its risk exposure and protect its shareholders. The company's motto, "strength, stability and integrity since 1940" reinforces its rational philosophy and its competitive advantages in the minds of customers.

NEBRASKA FURNITURE MART COMPETITIVE ADVANTAGES

BUD LABITAN WITH JULIE ROSENBAUGH, UNO-CBA, THEODOR
TONCA, AND SHOURYAMOY DAS

They buy brilliantly; they operate at superior expense ratios competitors don't even dream about. Then, they pass on to their customers much of the savings. In 1983, Warren Buffett and Berkshire Hathaway acquired a majority interest (90%) in Nebraska Furniture Mart for approx. \$60 million from its founder Rose Blumkin and her family.

The Blumkins at Nebraska Furniture Mart (NFM) have produced high returns on invested capital, despite being in an industry with traditionally poor underlying economics. They have built a unique profitable regional economic moat based on honesty and value.

In 1917 Mrs. Rose Blumkin, then 23, talked her way past a border guard to leave Russia for America. She had no formal education and she knew no English. After years of selling used clothing, Mrs. Blumkin had saved \$500 with which to realize her dream of opening a furniture store in 1937. She began by selling used furniture out of the basement of her husband's pawn shop. After seeing the American Furniture Mart in Chicago she decided to name her dream Nebraska Furniture Mart. With only \$500 and no locational or product advantage, she entered competition against well-capitalized, long entrenched competition. Her competitive advantage was her drive and vision.

When her tiny resources ran out, “Mrs. B” coped in a way not taught at business schools. She sold all the furniture and appliances in her own home in order to pay creditors as promised.

Eventually Omaha furniture retailers began to recognize that Mrs. B would offer customers better deals or more value per transaction. They pressured furniture and carpet manufacturers not to sell to her. But by various methods, Mrs. B obtained merchandise and cut prices sharply.

Mrs. B was then sued for violation of Fair Trade laws. She won the case and received invaluable publicity. At the end of one case, after demonstrating to the court that she could profitably sell carpet at a discount, the presiding judge purchased \$1,400 worth of carpet.

Today Nebraska Furniture Mart generates over \$100 million in sales annually from its original 200,000 square foot store in Omaha. NFM has also added two additional locations; first a 24,000 sq. foot outlet in Des Moines, Iowa opened in 2000, and a 420,000 sq. foot store in Kansas City. These stores sell more furniture, carpets, and appliances than all other furniture stores in the country combined.

In early 1989, Berkshire took its lessons learned from NFM and applied them to its acquisition of Borsheim’s, a family-owned and operated jewelry store in Omaha which was owned by a cousin of Mrs. B’s through marriage Louis Friedman and his son Ike. In complimenting both operations Buffett noted that they offer: *“(1) single store operations featuring huge inventories that provide customers with an enormous selection across all price ranges, (2) daily attention to detail by top management, (3) rapid turnover, (4) shrewd buying, and (5) incredibly low expenses. The combination of the last three factors lets both stores offer everyday prices that no one in the country comes close to matching.”*

Buffett has also famously been quoted for saying that he’d *“rather wrestle grizzlies than compete with Mrs. B and her progeny.”* Because they buy brilliantly, they operate at expense ratios competitors don’t even dream about, and they then pass on to their customers much of the savings. Essentially this is a business built upon exceptional value to the customer. An example of the marketing mix in practice, taking care of the customer is what translates into exceptional returns.

At a UCSB lecture in 2003, Charlie Munger talked about Nebraska Furniture Mart like this: “There’s too much emphasis on macroeconomics and not enough on microeconomics...”

Case study: Nebraska Furniture Mart’s new store in Kansas City. Let me demonstrate the power of microeconomics by solving two microeconomic problems. One simple and one a little harder. The first problem is this: Berkshire Hathaway just opened a furniture and appliance store in Kansas City. At the time Berkshire opened it, the largest selling furniture and appliance store in the world was another Berkshire Hathaway store, selling \$350 million worth of goods per year. The new store in a strange city opened up selling at the rate of more than \$500 million a year...

Well, I’ve given you the problem. Now, tell me what explains the runaway success of this new furniture and appliance store, which is outselling everything else in the world? (Pause). Well, let me do it for you. Is this a low-priced store or a high-priced store? (Laughter). It’s not going to have a runaway success in a strange city as a high-priced store. That would take time. Number two, if it’s moving \$500 million worth of furniture through it, it’s one hell of a big store, furniture being as bulky as it is. And what does a big store do? It provides a big selection. So what could this possibly be except a low-priced store with a big selection?

But, you may wonder, why wasn’t it done before, preventing its being done first now? Again, the answer just pops into your head: it costs a fortune to open a store this big. So, nobody’s done it before. So, you quickly know the answer. With a few basic concepts, these microeconomic problems that seem hard can be solved much as you put a hot knife through butter. I like such easy ways of thought that are very remunerative. And I suggest that you people should also learn to do microeconomics better.”

NFM obtains furniture from suppliers for low prices because they acquire their inventory in great quantities. This is an “economy of scale.” This scale coupled with good cost controls (low operating expenses) has enabled NFM to pass these savings directly on to customers. The result is a higher turnover and a higher than average margin retail business that generates consistently nice profits.

NFM has also created a tremendous franchise or regional brand. This respected regional brand was built with customer goodwill since its

inception. This positive “mind share” protects NFM’s leading market position today while creating almost impossibly high barriers to entry for potential competitors.

NFM’s managers have been able to buy furniture better than competitors. They acquire their products cheaply and in great quantities. Together with their incredibly low expenses, they then pass the savings onto customers. They use a high turnover and low margin business model that generates incredible profits. Their giant warehouses and sales floor are unmatched to offer an enormous and diverse product selection. They continue to attract customers with their large selection, low cost, honest business, and long financing terms.

NFM has created a regional monopoly of sorts in the low cost furniture business. A competitor would need impeccable resources to compete at the level NFM does in their target markets. NFM has positioned itself defensively to deter market infiltration. If a competitor tried to enter NFM’s market, NFM would have the ability to just “go lower” and drive the competitor back out.

Warren Buffett recognized great managers. He has said that he prefers to leave management in place when they are experts at what they are doing. And the Blumkins continue to build NFM’s economic moat daily.

It often takes great people to create durable competitive advantages. It started with Mrs. Blumkin, and this driving force continued with Mrs. B’s son Louie Blumkin and three grand-sons managing the day-to-day operations. This economic moat is sustainable because they practice Mrs. B’s famous motto: *“Sell cheap and tell the truth.”*

NETJETS® COMPETITIVE ADVANTAGES

BUD LABITAN WITH CHRISTIAN LABITAN

NetJets is now the largest operator in its industry and safety is their most important mission. NetJets pilots receive extensive training at least twice a year from FlightSafety International, another Berkshire subsidiary.

Berkshire Hathaway first bought a corporate jet in 1986. In 1989, they sold that corporate jet for \$850,000 and bought another used jet for \$6.7 million. Warren Buffett said, “Planes not only cost a lot to operate, they cost a lot just to look at.”

Later, Buffett heard about the NetJets® program from Frank Rooney of H.H. Brown. Rooney was delighted with the service and suggested that Buffett meet Rich Santulli and sign up his family. Buffett said “It took Rich about 15 minutes to sell me a quarter (200 hours annually) of a Hawker 1000. Buffett asked Rich to call if he ever got interested in selling.

In 1998, General Re and Executive Jet were acquired and described as “first-class in every way.” In May of 1998 they made a \$725 million deal, paying equal amounts of cash and stock.

Later renamed NetJets, the business was selling fractional shares of jets and operating the fleet for its many owners. Rich Santulli, former CEO, created the fractional ownership industry in 1986, a new way of using planes.

You purchase a portion of flying time annually and “Dead-head” hours don’t count against your allotment. You pay both a monthly management fee and a fee for hours actually flown. Then, on a few hours notice, NetJets makes your plane, or another at least as good, available to you at your choice of the 5500 airports in the U.S. So, calling up a plane is like phoning for a taxi.

NetJets customers gain because of the fleet of planes positioned throughout the country at all times. NetJets gains from this blanketing because it reduces dead-head costs. NetJets also offers products from Boeing, Gulfstream, Falcon, Cessna, and Raytheon.

In many cases, clients own fractions of several different planes and can match specific planes to specific missions. This can give them a virtual fleet of aircraft for a small fraction of the cost of a single plane. Some of America’s largest companies use NetJets as a supplement to their own fleet. This saves them big money in both meeting peak requirements and in having to maintain a larger fleet of wholly-owned planes.

Without Berkshire's backing during the recession, NetJets would have likely been "out of business" according to Warren Buffett. Mr. David Sokol was brought in to restructure the business in August 2009. In an interview with Aviation Week, NetJets former Chairman and CEO Sokol predicted that NetJets would post pre-tax profits of \$200 million for 2010. Sokol indicated that NetJets is likely to evolve into a fundamentally lower margin business that may deliver 4 to 5 percent net profit margins in a "steady state, long term" environment.

Berkshire doesn't walk away from commitments. Starting in late 2006, the capital being expended by NetJets was exceeding the returns coming in. There were commitments to acquire too many airplanes.

When the recession of '08 started, there was a general impression within management that there wasn't enough of a structural response. So, David Sokol's job was to restructure NetJets and explain to the employees, the business' condition.

Now, NetJets is profitable. But, 4% and 5% return on investment is not a huge return. They must run the business efficiently. NetJets must buy airplanes and fuel at the right price, and do everything to run the business so that the owner is getting everything he paid for and high quality professional service.

Netjets' competitive advantages are its safety, scale, high quality services, and the strength of financial backing from Berkshire Hathaway. The NetJets brand is growing from a network of past and current customers who experience this high quality service.

NetJets Europe has a fleet of 150 aircraft and 900 pilots trained by Berkshire Hathaway's FlightSafety International Inc. Its operations centre is in Lisbon, Portugal. Its customer teams are arranged by language to ensure convenience and speed with bookings 24 hours a day. Pilots have additional simulator training for flying into mountainous airports like Sion, Chambery, and Innsbruck.

The cabin crew take notes regarding customer preferences. If a customer has left their car at an airport in the middle of winter, NetJets staff will make sure their heater is on when their plane taxis over.

The customer gets their preferred newspaper each time they fly. A consumables corporation customer who is entertaining clients will see only their brand on board.

Corporations are important customers. Ten corporations account for 10% of NetJets Europe's profits. One even uses NetJets as a back-up, to follow their own jets around in case there is a problem.

The last few years have been tough for NetJets Europe and NetJets Inc., the US sister company. Together the two companies lost \$711 million in 2009.

In 2010 NetJets Europe managed to cut Eu 100 million (\$135 million) from its costs. However, it did this without having to cut customer service. NetJets Europe was profitable in 2010. Sales of fractional shares have been increasing over the last year, and the next fleet renewal will include marketing planes from Bombardier and Embraer.

Are NetJets competitive advantages sustainable for the next 10 years? Netjets' economic moat comes from years of focus on safety, fleet positioning scale, and excellent services. Furthermore, it has a timetested management and operations system that is unmatched in the private aircraft industry.

NetJets pilots train on FlightSafety simulators. Charlie Munger has explained it best this way: "The use of simulators in pilot training. Here, again, abilities attenuate with disuse. Well the simulator is God's gift because you can keep them fresh."

In addition to the continuous cycle of safety training, Netjets has restructured itself and it is building up its economic moat. It has placed new orders for jets to be delivered in the coming years as a way to secure its growing market share.

In the 2001 Letter to Shareholders, there is an excerpt about NetJets scale advantage where Warren Buffett said: "Both we and our customers derive significant operational benefits from our being the runaway leader in the fractional ownership business... The ubiquity of our fleet also reduces our "positioning" costs below those incurred by operators with smaller fleets."

These advantages of safety, scale, and service give NetJets a significant economic edge over its competition.

PACIFICORP COMPETITIVE ADVANTAGES

BUD LABITAN WITH TIM BISHOP

PacifiCorp is a major electric utility serving six Western states. At the time of the acquisition, PacifiCorp added 1.6 million electric customers in six Western states. Oregon and Utah provided most of that new business.

In 2005, MidAmerican Energy, Berkshire Hathaway's 80.5% owned subsidiary, bought PacifiCorp. Warren Buffett said, "You can't expect to earn outsized profits in regulated utilities, but the industry offers owners the opportunity to deploy large sums at fair returns – and therefore, it makes good sense for Berkshire." Charlie Munger said, "One thing a modern civilization needs is energy."

PacifiCorp was formed in 1984 from the growth of an electric utility, natural resource development business, and a telecommunications business. Then, in 1989, it merged with Utah Power & Light. It continued doing business as Pacific Power and Utah Power. In 2006, PacifiCorp was acquired by Berkshire Hathaway's MidAmerican Energy Holdings Company.

PacifiCorp is headquartered in Portland, Oregon. Today, it has three main business units: PacifiCorp Energy, Pacific Power, and Rocky Mountain Power. PacifiCorp Energy contains electric generation, commercial, energy trading and coal mining operations. It is headquartered in Salt Lake City, Utah. Pacific Power delivers electricity to customers in Oregon, Washington and California. It is headquartered in Portland, Oregon. Rocky Mountain Power delivers electricity to customers in Utah, Wyoming and Idaho. It is headquartered in Salt Lake City, Utah.

Pacific Power

Just 30 years after Thomas Edison invented the light bulb, Pacific Power & Light Company (PP&L) was born in the Pacific Northwest. Formed in 1910, PP&L started from several small electric companies and served just

7,000 customers in Astoria and Pendleton in Oregon, and Yakima and Walla Walla in Washington. Once established, PP&L acquired other companies and service areas, building new generation and an extensive transmission and distribution system to serve electric customers in Oregon and Washington, and later in Idaho, Wyoming, Montana and Northern California.

Rocky Mountain Power

Before the company's name was changed in 2006, Rocky Mountain Power served customers in Utah and Idaho as Utah Power. Wyoming customers were served by Pacific Power, though some had been served earlier under the Utah Power name.

Utah Power dates back to 1881, when Salt Lake City became the fifth city in the world to have central station electricity. It was organized from dozens of smaller power companies that served 130 small towns and cities. Known then as Utah Power & Light (UP&L), the company itself was formed in 1912 from several small electric companies in Utah, Idaho and western Colorado.

PacifiCorp has owned several hydroelectric power dams on the Klamath River, and these have provided lower cost electricity and profits. However, they have also been controversial because of local and environmentally degrading issues.

In 2004, PacifiCorp's 50-year operating license on the Klamath dams expired. They filed for a new license, but it had no provisions for fish passage. Tribes, fishermen and others traveled to Scotland to demand dam removal from Scottish Power, the owner of PacifiCorp. Then, in 2006, Scottish Power sold PacifiCorp to Berkshire Hathaway's MidAmerican Energy Holdings.

In 2006, Federal agencies file terms for relicensing the dams including \$400 million in fish passage upgrades. Low salmon returns closed the commercial salmon season from Monterey, California to Newport, Oregon. Then, in 2007, the California Energy Commission uses PacifiCorp's data to show that dam removal would be cheaper than mandatory upgrades associated with relicensing. A Klamath delegation

traveled to Omaha to ask Warren Buffett to discuss dam removal options. He refused, and the delegation returned to Omaha the next 2 years.

In 2008, after years of negotiations, stakeholders release a Klamath Basin Restoration Agreement supported by over 20 agencies and organizations. After a successful lawsuit from KRK, the US EPA lists PacifiCorp's reservoirs as impaired by dam-caused algal toxins.

PacifiCorp decided to work with the federal government, Oregon, and California on the hydropower agreement. With relicensing becoming too costly, PacifiCorp announced that dam removal is in the best interest of its customers. An Agreement in Principle (AIP) to remove the dams was released.

In 2009, after years of negotiations, most stakeholders, Klamath Basin Tribes, counties, conservation groups, fishing groups, and farming and ranching organizations as well as the state and federal government, reached an agreement called the KHSA, The Klamath Hydroelectric Settlement Agreement (KHSA).

On November 10, 2011, The Klamath Economic Restoration Act was introduced in the US Senate by Oregon Senator Jeff Merkley and in the House by California Congressman Mike Thompson. Klamath Economic Recovery Act supporters claim that now is the time to settle water rights disputes, and help workers of the salmon fishing industry. The bipartisan recommendations are based on the Klamath Basin Restoration Agreement and Klamath Hydroelectric Agreements. Companion documents were developed by farming, fishing, tribal and environmental groups with support from both the Bush and Obama administrations as well as Governors Brown, Schwarzenegger, Kitzhaber, and Kulongoski. The legislation authorizes the Secretary of the Interior to determine whether four aging dams should be removed. The Agreements are designed to provide security to fishing and agricultural jobs in the region; these are estimated to have an economic value exceeding \$750 million a year.

The KHSA focuses on the fate of PacifiCorp's lower four Klamath River Dams. It will significantly increase water flows for fish, provide greater reliability of irrigation water delivery, undertake Basin-scale habitat restoration, and make critical economic investments. The Agreement

represents a major step toward restoring the health of the Klamath River, and the KHSa provides a pathway that would lead to dam removal in 2020 following an analysis by the Secretary of the Interior. Planners must make sure that dam removal is as safe as preliminary assessments suggest and that it can be done cost effectively.

The KHSa is based on the Agreement in Principle reached between PacifiCorp, Oregon, California, and the federal government in 2008. It provides for funding up to \$200 million in dam removal costs by collecting a surcharge from PacifiCorp's Oregon and California customers over the next 10 years. The Oregon legislature authorized the customer surcharge. If necessary, the State of California would provide up to \$250 million more towards the cost with the total project costs not to exceed \$450 million.

PacifiCorp supports the approach in the Agreement. PacifiCorp Chairman & CEO, Greg Abel describes the agreement as a "balanced and reasonable outcome that best protects the interests of our customers, while achieving the policy objectives of the states and federal government, as well as helping to peacefully resolve numerous conflicts in the Klamath basin." The Klamath settlement process is an effort to create a viable and durable solution to this long standing environmental controversy.

What are the competitive advantages of PacifiCorp? Like most regulated utilities, they control an area customer base. This allows PacifiCorp to earn a fair return on investment if managers maintain safe operations and manage operational costs diligently.

Its thoughtful cost conscious managers are a competitive advantage. PacifiCorp has found ways to negotiate with its neighbors, and the benefits of recent agreements include an end to decades of ongoing and costly litigation. The California Public Utilities Commission determined that dam removal will cost at least half of associated relicensing costs and is in the best interest of ratepayers. PacifiCorp now supports removal rather than relicensing because removal will save their Oregon and California customers money.

Buffett and Berkshire Hathaway and MidAmerican Energy do not expect to earn huge profits, but the the union with MidAmerican can make PacifiCorp more effective in cost containment and energy trading

distribution. Furthermore, as the industry consolidates and moves towards a more modern energy trading grid, this combination will be a stronger and more formidable competitor.

PRECISION STEEL WAREHOUSE, INC. COMPETITIVE ADVANTAGES

BUD LABITAN WITH ADAM D. STUDTS, PE, UNO-CBA AND J.T.
LOUDERMILK, MBA

Precision Steel Warehouse is a leader in the specialty steel service center business. In 1979, Precision Steel and its subsidiaries were sold to Wesco Financial Corporation of Pasadena, California. At that time, Wesco was an 80% owned subsidiary of Berkshire Hathaway Inc.

During the late 1930s, Mr. George Tinsley, worked in the Chicago area as a sales representative for a major steel mill. Tinsley became aware of the need for a metal service center that would be able to supply customers who were unable to buy metal in mill quantities. So, in July 1940, at the age of fifty, Mr. Tinsley founded Precision Steel Warehouse, Inc. The business was started on a small scale in rented quarters of approximately 3,500 square feet. The name adopted for the company, Precision Steel Warehouse, Inc., is a misnomer. Precision is in the service center business and it is much more than just a warehouse. During his 34 years at Precision Steel, Mr. Tinsley dedicated himself to operating the Precision companies based on sound business practices and high ethical standards.

This service center business consists principally of purchasing large coils which are manufactured to high quality standards. This material is then processed to exacting tolerances for industries which either cannot buy in economical quantities from the producing mills or do not have the technical ability or equipment to process the material. Precision's modern equipment, extensive inventories, and sophisticated production controls allows it to meet the needs of customers. These top quality products are delivered on time. Precision is known for its high quality standards throughout the United States, Canada and in many foreign countries.

Despite the scarcity of metals during the war years, the company quickly grew. In 1946 the company organized a division known as the Package Goods Division. This was later called the Manufacturing Division and it is today known as Precision Brand Products, Inc. As a division, Precision

Brand Products, Inc. is involved in the manufacturing and packaging of various tool room specialty items.

In 1949, Precision further expanded and formed a company known as DuPage Manufacturing Company to be a thin gage metal stamping operation. However, DuPage also developed a line of worm gear hose clamps. Eventually, the metal stamping portion of the business was phased out and DuPage became solely a manufacturer of worm gear hose clamps.

Throughout the fifties and sixties the volume of business continued to grow and necessitated the physical expansion in Franklin Park, Illinois, which is currently the site of the Franklin Park Service Center and the Corporate Offices.

In 1976 the service center operation opened a branch operation in Charlotte, North Carolina. This service center was started on a small scale similar to the early beginning of Precision Steel.

In 1978, Precision Brand Products was incorporated as a separate entity owned by Precision Steel. This change was made in order to increase Precision Brand's autonomy so it could respond faster to the changing needs of the industrial distribution market.

During 1979, Precision Steel and its subsidiaries were sold to Wesco Financial Corporation of Pasadena, California. Two significant events have taken place during the beginning of the eighties. First, the manufacturing assets of Dupage Manufacturing were sold and that company was dissolved. The legal name, DuPage, was maintained and its product line continues to be distributed by Precision Brand Products, Inc. under the DuPage trade name.

The second event was the building of a new 40,000 square foot facility in Charlotte, North Carolina to house the expanded service center operation. The service centers have the ability to process the metal to very exacting specifications. The modern slitting lines can slit from .001 thickness through .187 thickness with modern x-ray gage systems accurately measuring and recording metal tolerances in order to insure compliance with customer requirements.

In addition, Precision has the ability to flatten and cut material to length, and provide specialty edges with deburring, edge rolling and skiving equipment.

Precision's commitment to excellence extends throughout the organization and is enhanced by the controls established using sophisticated data processing equipment and systems. Another accomplishment is Precision's technical handbook, The Precision Steel Catalog. It has become legend and is used extensively in the industry to develop standards and requirements.

Over the years Precision Brand has developed a line of specialty tool room and maintenance supply items which it sells through industrial distributors and mill supply houses. Its industrial product line is the most complete available and well known for excellence. Precision Brand, under the DuPage Products Group trade name, also markets hose clamps and threaded rod in the automotive, hardware, plumbing, marine and electrical markets.

Like the service centers, Precision Brand stresses quality and customer service. These products are produced to exacting standards and they maintain inventory sufficient to ship most orders within two working days.

In 1988, Warren Buffett wrote: "take special note of Dave Hillstrom's performance at Precision Steel Warehouse, a Wesco subsidiary. Precision operates in an extremely competitive industry, yet Dave consistently achieves good returns on invested capital. Though data is lacking to prove the point, I think it is likely that his performance, both in 1988 and years past, would rank him number one among his peers."

An additional competitive advantage for PSW is a patent (intellectual property) it holds relating to a process whereby metal coils are supplied to a processing station for processing. This patent translates into efficiency, allowing PSW to process orders much more quickly, removes human-factor error, and allows the end-product to be offered to the consumer at a lower price.

One main value-added service PSW provides as a wholesaler is purchasing materials in bulk quantities, breaking that bulk into smaller quantities and processing the material into products to be used by PSW's customers. This

provides form utility to PSW's customers, allowing these customers to only order quantities needed but still get the "discount" commonly associated with larger orders.

Precision Steel Warehouse's (PSW) main competitive advantages include economies of scale purchasing, which allows small-order customers the cost advantage of large-order customers. Another advantage includes ISO-9001 certification, which provides the quality assurance to customers requiring exacting precision. Additional advantages include a wide range of materials and capabilities, providing diversification into several markets and shielding the company from heavy risk during swings in the manufacturing and industrial construction industries. A wise competitor could attack this company's moat by offering the same full range of material types that PSW does. For example, Ken-Mac Metals (a Thyssen-Krupp company) provides similar services in the aluminum and stainless strip steel markets, but does not provide copper and brass alloy products.

At first glance, PSW's competitive advantages don't seem sustainable over the course of the next decade. Barriers to entry into this market are relatively low, and a new company could enter this market and compete directly with PSW. The competitive advantages outlined above are general and do not represent distinct internal advantages that an existing competitor or new competitor could not duplicate.

In Wesco's 2008 annual report, Charlie Munger wrote, "We do not consider Precision Steel's recent after-tax operating earnings of approximately \$1 million annually to be a satisfactory investment outcome, particularly when compared with its after-tax operating earnings which averaged \$2.3 million for the years 1998 through 2000. And, because of the intensifying recession, more difficulty for Precision Steel will surely lie ahead."

Precision Steel revenues declined from \$60.9 million for 2008 to \$38.4 million for 2009. It sold about half the annual volume compared to the number of pounds shipped thirty years ago when the company was acquired by Wesco. Some of Precision Steel's customers have been moving production outside the United States. And, these losses are due to both offshore competition and the general business impact of the great recession.

For the second quarter of 2010, Wesco reported improved results with net income rising when compared with 2009's. The Precision Steel subsidiary posted a 43 percent improvement in sales which generated an \$183,000 net profit for the quarter compared to a \$285,000 loss a year earlier. First half net income was \$237,000 compared to a net loss of \$673,000 for the first half of 2009. Sales were up 31.3 percent for the first half of 2010 compared to the first half of 2009.

While PSW's business has significant fixed operating costs, sales, in terms of pounds sold, have posted nice increases over the past few quarters. Volumes are still significantly lower than the levels posted in the first half of 2008 prior to the onset of the Great Recession. Management did not know whether the sales improvement is due to sustainable growth in industrial activity or inventory restocking.

In Wesco's 2009 annual report, Charlie Munger wrote, "Terry Piper, who became Precision Steel's President and Chief Executive Officer in 1999, has done an outstanding job in leading Precision Steel through very difficult years. But he has no magic wand with which to compensate for competitive losses among his best customers or from the weak economic conditions. He is redoubling his efforts to pare costs, which must be his response to conditions faced."

While this is a tough economic period for Precision Steel, its competitive advantages are sustainable if it continues to provide excellent service combined with high quality products from business managers with high ethical standards. Customers know who they are dealing with. Therefore, if Precision delivers high quality steel products and services at a fair value price, why would customers want to switch to a less reliable source?

PROCTER & GAMBLE (PG) COMPETITIVE ADVANTAGES

BUD LABITAN WITH BERYL CHAVEZ LI, UNIVERSITY OF MANCHESTER

Gillette's business is the kind that Buffett and Munger like. Charlie and Warren think they understand the company's economics and believe they can make a reasonably intelligent guess about its future. Procter & Gamble later bought Gillette.

Buffett and Munger bought convertible preferred stocks in 1989. They purchased \$600 million of The Gillette Co. preferred with an 8 3/4% dividend, a mandatory redemption in ten years, and the right to convert into common at \$50 per share. Unlike standard convertible preferred stocks, their issues were non-salable or nonconvertible for considerable periods of time so that they would not gain from short-term price blips in the common stock. Buffett also went on the board of Gillette.

Liking and loving are two different things however. So, notice what Buffett said: "Our lack of strong convictions about these businesses, however, means that we must structure our investments in them differently from what we do when we invest in a business appearing to have splendid economic characteristics." Also, they only want to link up with people who they like, admire, and trust. And, Colman Mockler, Jr. at Gillette met this test.

In 2005 Gillette was merged into Procter & Gamble. In that year, Berkshire substantially increased holdings in Wells Fargo, and established positions in Anheuser-Busch and Wal-Mart. Charlie Munger has said, "We don't give a damn about lumpy results. Everyone else is trying to please Wall Street. This is not a small advantage."

Procter & Gamble Co. (P&G, NYSE: PG) is a Fortune 500 American multinational corporation headquartered in Cincinnati, Ohio. It manufactures a wide range of consumer goods and it is credited with many business innovations including brand management and the soap opera.

In 1837, William Procter, a candlemaker, and James Gamble, a soapmaker, immigrants from England and Ireland, formed the company. P&G has built a rich heritage of touching consumers' lives with brands that make life a

little better every day. This simple purpose has enabled P&G to become one of the world's leading consumer products companies.

During the American Civil War, the company won contracts to supply the Union Army with soap and candles. In the 1880s, Procter & Gamble began to market a new product, an inexpensive soap that floats in water. The company called the soap Ivory. William Arnett Procter, William Procter's grandson, began a profit-sharing program for the company's workforce in 1887. By giving the workers a stake in the company, he correctly assumed that they would be less likely to go on strike.

The company began to build factories in other locations in the United States and diversify its products. In 1911, it began producing Crisco, a shortening made of vegetable oils rather than animal fats. As radio became more popular in the 1920s and 1930s, the company sponsored a number of radio programs that became commonly known as "soap operas".

The company becoming an international corporation with its 1930 acquisition of the Thomas Hedley Co., based in Newcastle upon Tyne, England.

The company introduced "Tide" laundry detergent in 1946 and "Prell" shampoo in 1947. In 1955, Procter & Gamble began selling the first toothpaste to contain fluoride, known as "Crest".

Branching out once again in 1957, the company purchased Charmin Paper Mills and began manufacturing toilet paper and other paper products. Procter & Gamble began making "Downy" fabric softener in 1960 and "Bounce" fabric softener sheets in 1972.

One of the most revolutionary products to come out on the market was the company's "Pampers", first test-marketed in 1961. Prior to this point, disposable diapers were not popular, although Johnson & Johnson had developed a product called "Chux".

Procter & Gamble acquired a number of other companies that diversified its product line and significantly increased profits. These acquisitions included Folgers Coffee, Norwich Eaton Pharmaceuticals (the makers of Pepto-Bismol), Richardson-Vicks, Noxell (Noxzema), Shulton's Old Spice, Max Factor, and the Iams Company.

In 1994, the company made headlines for big losses resulting from leveraged positions in interest rate derivatives, and subsequently sued Bankers Trust for fraud. This forced P&G management in to testifying in court that they had entered into transactions that they were not capable of understanding.

In January 2005 P&G announced an acquisition of Gillette, forming the largest consumer goods company and placing Unilever into second place. This added brands such as Gillette razors, Duracell, Braun, and Oral-B to their stable. The acquisition was approved by the European Union and the Federal Trade Commission, with conditions to a spinoff of certain overlapping brands.

The P&G-Gillette merger closed in the fourth quarter of 2005. It required Berkshire to record a \$5.0 billion pre-tax capital gain as dictated by GAAP. Buffett did not intend to sell Berkshire's Gillette shares before or after the merger. So, Berkshire Hathaway incurred no tax when the merger took place.

Buffett liked Jim Kilts. When Kilts arrived at Gillette in 2001, the company was struggling, having suffered from capital-allocation blunders like Gillette's acquisition of Duracell. Buffett believed that Gillette overpaid for Duracell, and this cost Gillette shareholders billions of dollars.

Buffett said, "Upon taking office at Gillette, Jim Kilts quickly instilled fiscal discipline, tightened operations and energized marketing, moves that dramatically increased the intrinsic value of the company. Gillette's merger with P&G then expanded the potential of both companies."

In 2008, P&G sponsored Tag Records as an endorsement for TAG Body Spray. P&G's dominance in many categories of consumer products can sometimes make one brand cannibalize the sales of another.

Since 1837, Proctor and Gamble has developed a portfolio of 50 leadership brands. They include Beauty and Grooming, and Household Care products. Some of which are the world's most well-known household names like Crest, Charmin, Pampers, Tide and Downy. They account for 90% of sales with 23 brands generating more than 1 billion dollars in annual sales. P&G invests 350 million dollars understanding consumers annually. It has operations in 80 countries, products sold in 180 countries

and billions of consumers around the world. It is ranked in the top 5 supply chains in terms of financial performance, peer review rating, and analyst rating of companies.

Recently, PG's 5Yr Gross Margin (5-Year Avg.) is approximately 50.8% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 13.9%, while the industry Net Profit Margin (5-Year Avg.) is 12.0%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

P&G's main advantages are its brand reputation, customer loyalty and its unparalleled research. Through globalization and increased use of technology, it increased its brand recognition world-wide. Moreover, there is a growing population particularly the middle class that serves as a spiraling increase in demand for P&G products.

Are these competitive advantages sustainable for the next 10 years? Yes. Procter and Gamble uses a Connect and Develop innovation model by learning and abandoning what doesn't work. This strategy is applied in R&D, manufacturing, marketing and purchasing capabilities to create better and cheaper products, faster.

It invests scientifically in areas including biotechnology, imaging, nutrition, veterinary medicine and even robotics. Innovation success rate doubled and cost of innovation fallen from percentage of sales from 4.8% in 2000 to 3.4% today. In the last 2 years, it launched 100 new products. In 2005 onwards, its stock price doubled and has a portfolio worth of 22 billion dollar brands. It uses outsourcing to transfer work to lower-cost providers. It searches for technologies, packages, and products that can be improved, scaled-up. Some of these are Olay Regenerist, Swiffer Dusters, and the Crest SpinBrush.

P&G has strong consumer brands. It also has an increasingly collaborative relationship with buyers and suppliers. It has an ability to innovate and it has an extensive global marketing network. With able and trustworthy managers, Procter and Gamble can continue to build up its competitive economic moats and add more to its lineup of 22 "billion dollar brands."

RC WILLEY HOME FURNISHINGS COMPETITIVE ADVANTAGES

BUD LABITAN WITH AZALIA KHOUSNOUTDINOVA, UNO-CBA

RC Willey Home Furnishings (often called just RC Willey) is a profitable home furnishings company with stores in Utah, Idaho, Nevada and California. It is a business that developed a respected regional brand image of honesty and value. Like the Nebraska Furniture Mart, this is its economic moat.

The business was founded by Rufus Call Willey in 1932 when he started selling Hotpoint Brand appliances door-to-door in Syracuse, Utah. Today, RC Willey is a retail store that sells merchandise in the following categories: furniture, electronics, home appliances, mattresses, flooring, and seasonal merchandise. What started out as a small family business has evolved over the years into the largest furniture dealer west of the Mississippi.

Warren Buffett said, "Of all our activities at Berkshire, the most exhilarating for Charlie and me is the acquisition of a business with excellent economic characteristics and a management that we like, trust and admire." Charlie Munger, Berkshire's Vice Chairman and Warren Buffett wanted to build a collection of companies, both wholly- and partly-owned, that have excellent economic characteristics and that are run by outstanding managers.

Their favorite acquisition is the negotiated transaction that allows them to purchase 100% of such a business at a fair price. However, they are almost as happy when the stock market offers them the chance to buy a modest percentage of an outstanding business.

Warren Buffett said, "This double-barreled approach - purchases of entire businesses through negotiation or purchases of part-interests through the stock market - gives us an important advantage over capitalallocators who stick to a single course."

The RC Willey Home Furnishings investment is a wonderful business that fit their acquisition criteria. Rufus Call (RC) Willey started selling Hotpoint Brand appliances door-to-door in 1932. Employed by the local electric company, RC conducted his small appliance business from the back of his red pick-up truck on the side. To guarantee customer satisfaction while electricity was still so new, RC Willey would lend out appliances for a week so that people could try them out. He also let them finance the purchases in installments over a three-year period, payable at harvest time. His business continued to grow, and in 1950 he built his first store next door to his home in Syracuse.

In 1954, Willey left the company due to terminal cancer. William H. Child, who had married Willey's daughter Darlene three years earlier, took over the business. Bill and his brother Sheldon Child grew the business over 40 years. Bill Child is credited with adding furniture to the company's appliance offerings. Multiple stores were built along the Wasatch Front. The Wasatch Front is now a metropolitan region in the north-central part of Utah. It is a chain of cities and towns along the Wasatch mountain range. Roughly 80% of Utah's population resides in this region. The area includes the major cities of Salt Lake City, Provo, and Ogden. RC Willey became the most well-known Home Furnishings retailer in the state of Utah.

RC Willey began an important marketing tactic in the early 1980s: giving out free hot dogs to increase traffic. Company executives credited the chain's success to three factors: an eye for expansion, focus on the middle segment of the market, and dedication to customer satisfaction.

Berkshire Hathaway, Inc. acquired RC Willey on May 24, 1995. The price was a reported \$150 million in stock. Bill Child remains as chairman. Chief financial officer Scott L. Hymas, who had been with the company since 1987, succeeded Bill Child as CEO in February 2001. At the same time, Bill Child's nephew, Jeffrey S. Child, became the company's president.

Today, RC Willey is still family operated, and has 13 stores located in Utah, Nevada, California, and Idaho. The chain continues to be known for its variety of products, delivery, and in store credit, as well as being closed on Sundays. The company runs frequent promotions and contests, one of

the most famous being their free hot dogs on some Saturdays which they call "Free Lunch".

Key Dates:

1932: Rufus Call Willey begins selling appliances door-to-door.

1950: RC Willey opens its first store in Syracuse, Utah.

1954: William H. Child takes over the business.

1969: A second store opens in Murray, Utah.

1990: Six stores have sales of \$100 million.

1995: Berkshire Hathaway, Inc. acquires the company.

1999: RC Willey expands outside Utah with Meridian, Idaho, store.

2001: RC Willey's first Las Vegas store opens.

2005: RC Willey continues expansion in Nevada and into California.

RC Willey is a large furnishing retailer with multiple locations in Utah, Nevada, Idaho, and California. Its biggest competitive advantage is its regional brand identity and size. With a valuable brand, or marketing mix, plus its 13 stores in four states it can leverage its position with suppliers; creating a moat that is difficult for competitors to cross.

Furniture and home appliances are typically bulky in size. Since this type of purchase is not a daily occurrence, customers want to buy from a business they know and trust. Thus, it would require a significant investment by new competitors getting started.

With RC Willey dominates the market in four states. Its ability to offer merchandise at reasonable prices makes it difficult for competitors to price competitively and take away the market share.

Another competitive advantage is RC Willey's commitment to customer satisfaction. Not only they carry most home furnishings, they also make sure that customer's needs like financing and delivery. Competitors would have to provide the same type of service in order to compete. So, a decision to buy comes that much easier.

RC Willey's competitive advantages can be reasonably sustained for a long time, unless a company with unlimited resources decided to take over the home furnishings market in this region no matter what the cost. This seems seems unlikely, especially in today's sluggish economy.

RICHLINE GROUP COMPETITIVE ADVANTAGES

BUD LABITAN WITH DANIEL DOYON, PURDUE UNIVERSITY

The Richline Group is an inventive worldwide jewelry manufacturer that uses its leadership position to advance the relevance of the jewelry industry. Innovation, technology and creativity are at the forefront of its focused efforts.

The Richline Group was formed in 2007 and includes a diverse group of jewelry brands specializing in metals, gemstones and design. These include Andin, Aurafin, AuraGem, Bel-Oro, Michael Anthony and TruKay.

In May 2006, Warren Buffett spoke at a lunch at Ben Bridge, the Seattle-based jewelry chain. In the audience was Dennis Ulrich, owner of a company that manufactured gold jewelry, Richline. In January 2007, Dennis Ulrich called Warren Buffett, suggesting that with Berkshire's support, he could build a larger jewelry supplier.

Buffett made a deal for Richline, while simultaneously purchasing a supplier of about equal size. The new company, Richline Group, has since made smaller tuck-in acquisitions.

The Richline Group has also been growing by strategic acquisitions of competitive brands. For example, it purchased the jewelry manufacturer Alarama in 2007. "Alarama is our first diversification into the gemstone and wedding band category," said Dennis Ulrich, CEO of Richline Group. "It brings us into a new field with a good company with good management."

The Richline Group combines precious metals and gems with artistry, science, innovation, technology, fashion, and marketing throughout the world. Constant discovery affords Richline the capacity to learn new cultures, create new directions, and deliver exceptional products that are valuable, symbolic and timeless to its customers.

Richline's mission of "One Vision, One Goal, One Team" is an objective involving all of its employees, customers, suppliers, and supporters. It is

dedicated to investments that bring a positive, collaborative result to the entire jewelry industry.

Charlie Munger has said, “We want very good leaders who have a lot of power, he said, and we want to delegate a lot of power to those leaders. It’s crazy not to distribute power to people with the most capacity and diligence.” Buffett and Munger believe that Dennis Ulrich and his partner Dave Meleski will build a large operation, earning good returns on capital employed. The Richline Group aims to be tireless in its pursuit of innovation and value for the worldwide jewelry consumer.

Competitive Advantages

- Quality—maintained through innovation and technological advancements.
- Collaboration – strong relationships between firm and retailers.
- Eco-Friendliness – economic, social, environmental.
- Empowerment – employees blend experience with passion, and employees are inspired to grow.
- Strong International Presence – located worldwide.

The Richline Group’s current success is largely due to its aggressive growth strategy coupled with its conservative business practices and strategic acquisitions. Richline’s products are high quality jewelry with creative designs sold only to selected retailers. As such, it has some degree of pricing power.

Richline promotes empowerment in its employees and this creates a more efficient positive work atmosphere. It also takes proactive steps to stay ahead of the green sustainable movement.

The Richline Group builds its economic moat by tirelessly pursuing innovation and value for the worldwide jewelry consumer of higher quality jewelry. Their growing business model is sustainable if the business continues to be run by able and trustworthy managers who focus on providing high quality brands.

SCOTT FETZER COMPANIES COMPETITIVE ADVANTAGES

BUD LABITAN WITH CLIFF ORR, KELLOGG-NORTHWESTERN UNIVERSITY
AND HOANG QUOC ANH, VIETNAM

In 1986, Berkshire acquired the profitable Scott Fetzer Company. It was a holding company comprised of 17 businesses, most notably World Book encyclopedias and Kirby vacuum cleaners.

When CEO Ralph Shey took charge, the company had 31 businesses, the result of an acquisition spree in the 1960s. He disposed of many that did not fit or had limited profit potential. Buffett noted that Scott Fetzer is a prototype of the kind of business Berkshire seeks to acquire – “understandable, large, well-managed, a good earner.”

Warren Buffett said, “Charlie and I look for companies that have a) a business we understand; b) favorable long-term economics; c) able and trustworthy management; and d) a sensible price tag.”

The Scott Fetzer Company had sales of about \$700 million derived from 17 businesses. Many are still leaders in their fields. Their return on invested capital is good to excellent for most of these businesses. Some well-known products are Kirby home-care systems, Campbell Hausfeld air compressors, and Wayne burners and water pumps.

The Scott Fetzer Company had been a candidate for purchase since early 1984. In the takeover craze of the 1980s, Scott Fetzer could not go unnoticed. Financier Ivan Boesky began accumulating shares of the company before the spring of 1984, when Shey announced a plan by a group he led to take the company private in a leveraged buyout. Kelso & Company, a New York investment firm, entered the fray with a \$61-a-share bid. Kelso's specialty was corporate buyouts through employee stock ownership plans (ESOP). After the ESOP deal fell through, Buffett wrote a letter to Ralph Shey and said that he admired the company's record. Warren Buffett and Charlie Munger met Ralph Shey for dinner in Chicago and the sale was made to Berkshire Hathaway for roughly \$320 million in early 1986.

At that price, Buffett and Munger had paid \$142 million more than the net assets of Scott Fetzer. This valued the business at around 1.8 times the book value. Warren Buffett explained that his valuation was based on the “owner earnings” of the business. He explained this in his 1986 letter to shareholders. The owner earnings represents *“the (a) reported earnings + (b) depreciation, amortization, depletion and certain other non-cash charges – (c) average annual amount of capitalized expenditures for plant and equipment, etc that the business required to fully maintain its long-term competitive position and its unit volume. (if the business requires additional working capital to maintain its competitive position and unit volume, the increment also should be included in (c). However, businesses following the LIFO inventory method usually do not require additional working capital if unit volume does not change.)”*

Buffett considered the “owner earnings” figure to be more relevant for valuation purposes in both stock and business buying. A lot of other businesses need to spend more on capital improvements in order to maintain their competitive advantage. When (c, capitalized expenditures) exceed (b), GAAP earnings overstate owner earnings. In identifying great businesses with “great moats”, Buffett and Munger prefer businesses like See’s Candies and Scott Fetzer, that do not require much extra capital expenditures. (or “that only require little extra capital expenditure”) Such businesses have strong “owner earnings.”

Looking back, it is not difficult to see why purchasing Scott Fetzer was a great move. Eight years after making the purchase, the earnings of Scott Fetzer kept increasing over time, from \$40 million to \$70 million. This made for a consistent growth of 7.2% per year. The Scott Fetzer business kept generating a lot of free cash flow for Berkshire Hathaway that Buffett and Munger were able to deploy elsewhere. In those eight years within the Berkshire Hathaway family, the dividends which had been paid out by Scott Fetzer totaled a figure of \$634 million.

Founded in 1914, Scott Fetzer manufactured flare pistols through World War I. During the 1920s, it entered the vacuum cleaner business; and selling these for 40 years. It began diversifying between 1964 and 1973, broadening its manufacturing range to include chain saws and trailer hitches.

Ralph E. Schey became president in 1974. Schey was a noted venture capitalist who quickly applied himself to trimming and restructuring the company. Within four years, Schey reduced Scott Fetzer from 31 to 20 divisions. He concentrated the remaining divisions in brand name goods for consumer markets, based upon his belief that such goods were more recession-proof.

Scott Fetzer Company's new direction was the home improvement market. Schey's first large acquisition was Wayne Home Equipment, a maker of oil and gas burners and pumps. As a subsidiary, Wayne went from supplying manufacturers to becoming a retail competitor, issuing branded products into mass merchandise stores. By the mid-1980s, Wayne formed a new group known as Environmental Products & Services. It sells a broad line of air- and water-treatment products, as well as heating, cooling, and home-security products.

In 1978, Schey purchased World Book from Field Enterprises for \$50 million. At the time, World Book was the market leader in direct sales. The company came with a profitable mail-order business in books and various consumer goods. Its encyclopedia buyers proved to be ideal mail-order customers because they had already been found credit worthy. World Book's only big competitor was Encyclopedia Britannica.

After the purchase, Schey spent two years revising World Book by selling off the Japanese division and trimming domestic operations. Preschool and elementary school lines were expanded so that customers could start buying sooner and trade up into other sets of encyclopedias as their children grew older. By 1984, World Book had more than 30,000 sales representatives.

Scott Fetzer's Kirby vacuum cleaners were also sold door-to-door by dealers who bought the machines for cash. As these sales representatives worked strictly on commission, Scott Fetzer's profit margins grew plump enough to attract investor attention.

As the sales force of World Book was reorganized in 1981, Scott Fetzer also revised its selling strategies. Instead of attaching salaries only to sales, sales managers were given greater responsibility for expenses and profits. Recruiting, training, motivational, and compensation strategies were all

updated, and the sales force was increased by 50 percent in 1984. Other direct-selling giants, like Avon and Mary Kay, were unable to get the number of sales representatives they needed. Direct selling was developed into a science by Scott Fetzer during the early 1980s. Sales representatives now contacted potential buyers first by phone, at fairs, or in shopping malls, and set up appointments.

Just as World Book had undergone reconstruction, Kirby too was overhauled. In 1980, Kirby eliminated half of its independent contractor distributors. At the time, a practice called bojacking was prevalent. Bojacking by distributors was the practice of buying vacuums from Kirby and jacking up the price; then reselling them with a price tag that undercut Kirby salesmen. This prompted Scott Fetzer to write a new dealer agreement that mandated that Kirby vacuum cleaners be sold in the home. The roughly 700 distributors who disagreed with this new policy were eventually dismissed.

Between 1971 and 1981, unit sales plunged by one-third. The company concentrated on training its key salespeople to run their own dealerships. This strategy inspired other direct sellers to turn their attention to training as a way to increase productivity.

Direct sales traditionally pepped up when the economy dragged, with revenues reflecting the number of available representatives rather than market size. A slowed economy meant cutbacks, which translated to more people looking for work such as direct selling. However, during the down-cycle of the late 1970s and early 1980s, those who usually entered direct sales went looking for part-time work instead.

At the time of the sale, Scott Fetzer was considered well-managed and a good earner. Scott Fetzer, with 17 businesses at the time, had sales of about \$700 million. World Book accounted for about 40 percent of Scott Fetzer's sales. World Book was then selling more encyclopedias in the United States than its four largest competitors combined. Other businesses included Kirby, Campbell Hausfeld air compressors, and Wayne burners and water pumps.

In 1986, World Book's unit volume increased for the fourth consecutive year. The Childcraft unit sales were also growing significantly. Success

was in part attributed to good prices and editing and a sales force of teachers and librarians.

Kirby sales were also strong. In Kirby's case, the product was more expensive than most competing cleaners, but it was known for its longevity. Some homes boasted 35-year-old Kirbys still on duty. Campbell Hausfeld, Scott Fetzer's largest unit, was the nation's leading producer of small and medium-sized air compressors.

If Scott Fetzer had been an independent company, it would have ranked close to the top of the Fortune 500 in 1990 in terms of return on equity. A new Kirby vacuum cleaner did very well. However, earnings overall for Kirby did not grow as quickly as sales. The new product had start-up and learning curve costs.

The encyclopedia market was a profitable duopoly with World Book and Encyclopedia Britannica garnering over 50% of industry sales. Scott Fetzer's World Book, represented the precise type of company Berkshire covets – a company offering a quality product with dominant market share and lower cost positioning than its competition. This quality-value combination served to form the backbone of Scott Fetzer's competitive advantage, which was augmented by outstanding management and capital allocation under CEO Ralph Schey.

As Benjamin Graham taught that in investing, it was not necessary to do extraordinary things to get extraordinary results. And Buffett had found that idea held true in management as well. What a manager should do is handle the basics well and not get diverted. That was exactly Ralph Shey's formula.

In 1986, Scott Fetzer's moat appeared sustainable and defensible. In Buffett's words, World Book is "something special . . . I've been a fan and user for 25 years, and now have grandchildren consulting the sets just as my grandchildren did." This inter-generational relevance combined with an edge in distribution indicated all the hallmarks of long-term competitive advantage. However, the emergence of softwarebased encyclopedias, Google web searches and Wikipedia has created new methods to search for information and these sources are much more easily updated than traditional printed encyclopedias, while also obviating the need for

physical product delivery. Although World Book has adapted to these changes with online offerings and some brand value remains in the product name, it is clear that competitive dynamics have emptied the moat World Book once enjoyed.

The good news is that Scott Fetzer is now a successful conglomerate of 22 competitive businesses that include products from the Environmental Products & Services group. These businesses are: Adalet, Altaquip, Arbortech, Campbell Hausfeld, Carefree of Colorado, CWP Technologies, Douglas/Quikut, France, Halex, Kingston, Kirby, Meriam Instrument, Northland, Powerex, Scot Laboratories, Scottcare, Stahl, UCFS, Wayne Combustion Systems, Wayne Water Systems, Western Enterprises, and World Book.

SEE'S CANDIES COMPETITIVE ADVANTAGES

BUD LABITAN WITH JEN IWANSKI, UNO-CBA

See's Candies is "The Wonderful Business." It is the prototype of Buffett and Munger's dream business. While the boxed-chocolates industry in which it operates is unexciting, See's has excelled. Per-capita chocolate consumption in the U.S. is low and doesn't grow. Many other brands have disappeared.

At See's, annual sales were 16 million pounds of candy when Blue Chip Stamps purchased the company in 1972. Charlie Munger and Warren Buffett controlled the Blue Chip Company and later merged it into Berkshire.

In 2007, See's sold 31 million pounds, a growth rate of only 2% annually. Yet its durable competitive advantage, built by the See's family over a 50-year period, and strengthened by Chuck Huggins and Brad Kinstler, produced extraordinary results for Berkshire.

Buffett and Munger bought See's for \$25 million when its sales were \$30 million and pre-tax earnings were less than \$5 million. The capital then required to conduct the business was \$8 million. Modest seasonal debt was needed for a few months each year. Consequently, the company was earning 60% pre-tax on invested capital.

Two factors helped to minimize the funds required for operations. First, the product was sold for cash, and that eliminated accounts receivable. Second, the production and distribution cycle was short, which minimized inventories.

Charlie Munger said, "If See's Candy had asked \$100,000 more, in the purchase price, Warren and I would have walked - That's how dumb we were. Ira Marshall said you guys are crazy - there are some things you should pay up for, like quality businesses and people. You are underestimating quality. We listened to the criticism and changed our mind. This is a good lesson for anyone: the ability to take criticism constructively and learn from it. If you take the indirect lessons we learned from See's, you could say Berkshire was built on constructive criticism."

Since See's was purchased by their Blue Chip Stamps Company at the beginning of 1972, pre-tax operating earnings have grown with little need for additional capital investment. See's achieved this record while operating in an industry experiencing practically no unit growth. By 2007, See's sales were \$383 million, and pre-tax profits were \$82 million. The capital, in 2007, required to run the business is \$40 million. This means they have had to reinvest only \$32 million since 1972 to handle the modest physical growth of the business.

Interestingly, pre-tax earnings have totaled \$1.35 billion. All of that except for the \$32 million has been sent to Berkshire. After paying corporate taxes on the profits, Buffett and Munger have used the rest to buy other attractive businesses. Therefore, See's has given birth to multiple new streams of cash.

See's Famous Old Time Candies® are well known and loved throughout the West. See's is headquartered in South San Francisco, California with kitchens located in both Los Angeles and South San Francisco delivering fresh chocolates and candies to over 200 See's shops in the West. To produce the best possible boxed chocolates, See's acquires the finest grade raw ingredients from all over the world. Making over 100 varieties of candies, See's has maintained its reputation for excellence by strict adherence to See's "Quality Without Compromise®" motto.

When Charles See arrived in Los Angeles from Canada in 1921, he decided that no image would better reflect the personality of his fledgling venture than that of his mother. Apart from using her recipes as a foundation, See knew that keeping things in the family was the only way to bring about the kind of lovingly crafted product he desired.

See along with his mother and his wife, Florence, opened the first See's Candies shop and kitchen in Los Angeles in November of 1921. The sparkling clean, black and white shop was designed to resemble Mary See's home kitchen.

Mary See has symbolized the old-fashioned virtues of homemade quality and friendly service. The spectacled, silver haired woman still smiles with pride from candy boxes shipped throughout the world, and her original recipes are savored by millions to this day.

Mary See died in 1939 at the age of 85, but the company's ability to adjust to changing times kept it going strong throughout the decades to come. In the 50s, See's established itself with the new phenomenon of shopping malls. See's customers continued to recognize the See's Candies product for its quality and taste, and continued to visit See's oldfashioned black and white shops, enjoying a visit to a time past where service was paramount.

In 1972, the See's family sold the company to Berkshire Hathaway Inc. Warren Buffett installed Charles N. Huggins as President and CEO. Charles Huggins dedicated himself to the continuance of the company he joined in 1951, guiding it with the old-fashioned values set by Charles See until his retirement at the end of 2005. He was succeeded by current See's President and CEO, Brad Kinstler.

Today See's Candies are sold in over two hundred shops throughout the West, a true sign of their enduring popularity. And, to this day, Charles See's living motto, "Quality Without Compromise®" continues to guide the company.

In recent years See's has encountered two important problems. The problem concerned costs. Raw material costs are largely beyond control since See's will buy the finest ingredients, regardless of changes in their price levels. They regard product quality as sacred. Other kinds of costs

are more controllable, and Chuck Huggins record as manager and cost controller has been extraordinary.

There have been times when sales volume was flat. Despite the volume problem, See's strengths are many and important. In the primary marketing area, the West, See's candy is preferred by an enormous margin to that of any competitor.

See's Candies differentiate themselves by providing old-fashioned candy accompanied by friendly service. Cheerful, helpful personnel are as much a trademark of See's as is the logo on the box. This is no small achievement in a business that requires See's to hire about 2000 seasonal workers.

See's Candies is now headquartered in South San Francisco. Customers can expect a wide variety of old-fashioned candies for every occasion. The company has stayed true to the old-fashioned experience through their product offerings and their store design.

Customers of See's Candies can expect unique, high quality products. See's candies are backed by a satisfaction guarantee and the motto at See's Candies is "Quality Without Compromise". The customers of See's Candies have the ability to choose from a variety of best-selling candies in addition to seasonal items. The product line remains dynamic by designing products and gift packages for every occasion. The company has brand and differentiation advantages. The See's Candies brand has been built over the years on quality old-fashioned candy that grandma used to make. Customers can be confident enough in the product to send See's products to friends and family all around the country.

See's Candies can sustain its reputation for old-fashioned, high quality products for the next 10 years. The old-fashioned product line offered by See's Candies cannot be easily duplicated. The company has built their reputation on their distinctive products and continues to stay true to their position in the market. The competitive advantages can be sustained by continuing to provide customers with old-fashioned candy with a friendly experience.

See's Candies brand is known for nostalgic and innovative products. This advantage has enabled See's to have substantial pricing power. See's can

charge higher prices for their candy because customers expect a unique high quality candy and a pleasant experience.

Although the candy industry may remain unchanged, the needs and preferences of customers may fluctuate. To ensure that See's Candies maintains its profitable place in the market, See's should continue to listen to its customers and adapt to their changing needs.

SHAW INDUSTRIES COMPETITIVE ADVANTAGES

BUD LABITAN WITH DANIEL DOYON AND RICHARD KONRAD, CFA,
VALUE ARCHITECTS ASSET MANAGEMENT

Shaw Industries is the world's largest carpet manufacturer and it became a part of Berkshire since January of 2001. Shaw began in 1946 as Star Dye Company, a small business that dyed scatter rugs. The philosophy guiding its growth has been customer and cost focused.

Bob Shaw, CEO of Shaw Industries, and his partner Julian Saul, met with Warren Buffett and worked out a purchase by Berkshire. Upon its sale to Berkshire Hathaway Inc. in 2002, Shaw ended its status as a public company. After the deal, Bob and Julian were to continue owning at least 5% of Shaw. At the time of the deal, Shaw had annual sales of about \$4 billion, and Berkshire bought 87.3% of the company.

In 1958, the company started finishing carpet as Star Finishing Company. In 1967, a holding company was formed to acquire Philadelphia Carpet Company. The holding company added Star Finishing to this fold one year later. This marked the company's first move into carpet manufacturing.

In 1971, the holding company went public as Shaw Industries, Inc. with approximately \$43 million in sales and 900 employees. In 1985, Shaw made its first appearance on the list of America's largest corporations-the Fortune 500.

Shaw has a reputation of being a quick responder to competitive threats and style changes. Continually differentiating its service and adding value for customers motivated major moves in the company's development. It focused on improving its manufacturing technology. And, it has reduced production costs over the last three decades. Modernizing plants and equipment in the early 1980s allowed it to respond quickly to such breakthroughs as stain resistant carpet.

Shaw started generating its own yarn supply with the 1972 purchase of its first yarn plant. Seeing the potential, it acquired its first continuous dye

plant in 1973. It created its own trucking subsidiary and it dramatically improved shipments nationwide. It expanded direct sales to retailers beginning in 1982. It also established regional distribution centers across the United States.

Shaw decreased the consumption of fuel, water, and electricity in the manufacturing process. It also found innovative recycling solutions for its manufacturing waste. It acquired Amoco's polypropylene fiber production facilities in 1992 to provide consumers popular Berber styles. It started the rug division in 1993 and the hard surfaces (ceramics) division in 1998.

The desire to be the industry's low-cost provider was also a determining factor when it brought respected names such as Cabin Crafts and Sutton. The merger of Shaw and Queen Carpets was one of the largest moves in the industry's history.

Today, with the leadership of Vance Bell, CEO, and Randy Merritt, President, Shaw is a full-service flooring company with more than \$4 billion in annual sales and approximately 25,000 employees. Employees' are determined to stay on top of this ever-changing and highly competitive marketplace.

Shaw's competitive advantages include a large selection of carpets and flooring products, affordability, ease and convenience, transportation/delivery, eco-friendliness and sustainability, creative designs, strong international presence, and brand Image. Shaw's brands include Philadelphia, Cabin Crafts, Queen, Sutton, Kathy Ireland, Shawmark, Tuflex, and Couture.

As a public company, Shaw managed rapid growth through a combination of acquisitions and internal growth. The company had a wonderful history of capital management and was an active repurchaser of stock when the market presented a value opportunity.

Shaw's mission has been vertical integration and consolidation. It became 100% integrated in spinning its own yarn and built a nationwide distribution and trucking system in the early 1980s. The company operates 29 distribution centers, the most in the industry. Consolidation followed later that decade with the acquisition of WestPoint-Pepperell's carpet division adding 40% to Shaw's capacity and some valuable brand names.

Subsequent acquisitions of Armstrong's carpet division, Salem, and Queen Carpets built revenues and cash flows.

Since the Berkshire purchase, the company has become increasingly international with showrooms in Singapore, China, Latin America, Australia, and Europe. In addition, Shaw has diversified into hard surface and resilient flooring.

The U.S. floor covering industry has declined from \$18.8 billion in sales in 1999 to \$17.1 billion in 2009. Sales have been declining since 2006 coinciding with the weakness in housing markets. In 2009, the primary categories of the U.S. floor covering industry, based on sales dollars, were carpet and rug (55%), resilient and rubber (12%), ceramic tile (11%), hardwood (11%), stone (6%) and laminate (5%). Domestic carpet and rug sales were \$9.6 billion, with the split between residential and commercial sales of 69% and 31% respectively. The market has become less reliant on new home sales as 73% of the dollar values of shipments are made in response to residential replacement demand.

Shaw's competitive advantages stem from scale and cost efficiencies. It has the largest collection of brands and is completely vertically integrated including the extrusion of resin and post-consumer plastics into polypropylene, polyester, and nylon fiber, yarn processing, backing manufacturing, tufting, weaving, dyeing, coating and finishing. Only Mohawk, the second largest manufacturer in the industry comes close.

The carpet and rug industry in the US is developing into a duopoly. In residential carpeting, the industry is even more concentrated with the top three companies constituting 90% of sales so most of the fracturing is on the commercial side. Here's a look at the overall industry structure in 2009:

	\$ in millions	% of Total
Shaw	3,025	31.4%
Mohawk	2,479	25.8
Beaulieu (private)	857	8.9
Interface	423	4.4
Dixie Group	199	2.1

Though Shaw is the largest carpet manufacturer in the world, there are significant opportunities for growth in flooring. For example, the Chinese market for ceramic floors is about 25 times the size of Shaw's domestic market in this segment. The consolidation opportunities for the world market are enormous. The top four participants in the global market for flooring have only an 8.4% share. Therefore, this is a much fractured market that should present great opportunities for Shaw's skill sets.

Charlie Munger has said, "It would help current (Berkshire Hathaway) shareholders to hear our CEOs, of the Berkshire operating subsidiaries, we promised them they could spend 100% of their time on their business. We place no impediments on them running their businesses. Many have expressed to me how happy they are that they don't have to spend 25% of time on activities they didn't like." Buffett and Munger know that the managers of well run businesses have an expertise in their field. Vance Bell and Randy Merritt know how to build Shaw's economic moat even stronger.

Shaw Industry's competitive advantages are indeed sustainable for the next 10 years. They possess important competitive traits that all companies should strive for to satisfy the customer – affordability and selection. They capitalize on their ability to satisfy the customer by being able to supply in mass and globally. Finally, they take proactive steps to stay ahead of the green sustainable movement.

Worldwide, carpets and rugs represent only about 29% of the flooring market versus 55% in the US. In Asia, carpets and rugs constituted only 17% of the flooring market. Shaw will be an important competitor in most areas of the flooring market over the years ahead.

STAR FURNITURE COMPETITIVE ADVANTAGES

BUD LABITAN WITH PAMELA A. QUINTERO, MBA

Star Furniture is a profitable regional leader. It is a Houston-based furniture retailer that was acquired by Berkshire Hathaway in 1998. It fully met Warren Buffett and Charlie Munger's criteria: Understandable business; possessing excellent economics; and are run by outstanding people.

Buffett wrote this about the deal: "The Star transaction has an interesting history. Whenever we buy into an industry whose leading participants aren't known to me, I always ask our new partners, Are there any more at home like you? Upon our purchase of Nebraska Furniture Mart in 1983, therefore, the Blumkin family told me about three outstanding furniture retailers in other parts of the country. At the time, however, none was for sale. Many years later, Irv Blumkin learned that Bill Child, CEO of R.C. Willey -- one of the recommended three -- might be interested in merging, and we promptly made the deal described in the 1995 report. We have been delighted with that association... Furthermore, when we asked Bill about industry standouts, he came up with the remaining two names given me by the Blumkins, one of these being Star Furniture of Houston."

Bob Denham of Salomon told Warren Buffett that Melvyn Wolff, the long-time controlling shareholder and CEO of Star, wanted to talk. Wolff came to the meeting in Omaha, and Buffett looked at Star's financials, and liked what he saw. A few days later, they met in New York and made the deal in a single, two-hour session.

Said Buffett, "As was the case with the Blumkins and Bill Child, I had no need to check leases, work out employment contracts, etc. I knew I was dealing with a man of integrity and that's what counted."

Star Furniture's business struggled until Melvyn Wolff and his sister Shirley Toomin took over in 1962. Today Star operates 12 stores in Texas. After the sale, Melvyn and Shirley made large payments to everyone in the business.

Star Furniture is a regional chain whose 11 Texas stores sell brands including Broyhill, Howard Miller, Natuzzi and Thomasville. Bill Kimbrell, Star Furniture's chief executive officer, said the new location "has better visibility, accessibility and enables us to build a custom, freestanding showroom."

Star Furniture will help anchor the second phase of the \$150 million Lakes@TechRidge project, which ultimately is expected to have 1.1 million square feet of commercial space and up to 1,000 apartments, 350 of which are already built in an existing complex within the project. "We've been successful in the Austin market and believe there's more growth potential with a new showroom at this new location," Kimbrell said.

Kimbrell, a former Rhodes Furniture executive, took the helm at Star Furniture in 2004, replacing Chairman Melvyn "Mel" Lee Wolff, who headed the company for 42 years.

The new showroom will be on five acres of the Lakes@TechRidge, which TechRidge Spectrum purchased in 2006. TechRidge Spectrum is a partnership of Kelly Capital Group Inc. and Ledcor Properties, based in Vancouver, British Columbia.

Ken Satterlee, general partner of TechRidge Spectrum, said Star Furniture "is one of the few retailers in an expansion mode right now, which speaks very well of their business operations." Ian Asselstine, vice president of Ledcor Properties, said Star Furniture is a "highquality, well-respected" operation that will "serve as a magnet for other retailers."

One of Buffett's apparent discoveries is that certain companies can maintain a competitive advantage through a regional monopoly. This has been especially true for some privately-owned furniture retailers in select markets. Star Furniture, the Houston-based retailer, exemplifies one of these companies.

This mid to upper priced tier Furniture Company maintains its foundation as a regional monopoly by building strong customer relationships. However, one critical aspect of the business that sets Star furniture apart from its competition is that they run their own credit operations and therefore are able to control consumer financing availability in their stores.

This continues to be a profit center for Star Furniture by allowing them to be more flexible than third party creditors available through other competing furniture outlets. The ability to control the availability of consumer credit not only allows them to be more flexible, but gives them the ability to set their own credit standards.

Are these competitive advantages sustainable for the next 10 years? The ability of Star Furniture to exploit its credit operations and maintain strong consumer relationships sets it apart from a field of competitors.

Charlie Munger has said, "Retail is a very tough business." However, Star Furniture's competitive advantages coupled with a stronger than average housing market in Texas, and a projected double-digit growth in furniture sales in the southern region over the next 5 years; support the notion that regionally based Star Furniture can flourish.

Meanwhile other competing furniture retailers in Texas must absorb not only the higher costs of offering consumer credit but also the stagnated housing recovery being experienced in other areas of the country where they operate retail outlets. Additionally, the furniture sector represents a group of products that consumers will continue to buy at multiple points within their lifetime. As the economy begins to rebound over the next decade, consumers will again focus on value, as it relates to product quality and the buying experience.

What is its unique economic moat? As a respected regional brand, Star Furniture is a recognized leader for its finer furniture, its ability to provide internal credit services, and its ability to develop strong relationships with its customers, and its ability to maintain those relationships over a lifetime.

THE PAMPERED CHEF® COMPETITIVE ADVANTAGES

BUD LABITAN WITH JULIE ROSENBAUGH, UNO-CBA

The Pampered Chef story is a dream in optimizing capital expenditure. Doris Christopher borrowed \$3,000 against her life insurance policy and went to the Merchandise Mart on a buying expedition. This was all the money ever injected into the company. It is also a good example of how products and service can come together to form something special, a trusted brand.

The Pampered Chef history began in 1980 when Doris Christopher was a 34-year-old suburban Chicago home economics teacher with a husband, two little girls, and absolutely no business background. Wanting, to supplement her family's modest income, she turned to thinking about what she knew best – food preparation.

Why not, she wondered, make a business out of marketing kitchenware, focusing on the items she found most useful? There, she picked up a dozen pieces of items she liked, and went home to set up operations in her basement. Her plan was to conduct in-home presentations to small groups of women, gathered at the homes of their friends. The women she faced on her first presentation loved her and her products. So, they purchased \$175 of goods. Doris and her husband Jay did \$50,000 of business in the first year.

When the Pampered Chef acquisition by Buffett and Berkshire started in 2002, it was doing more than \$700 million of business annually, working through 67,000 kitchen consultants.

Buffett and his daughter have been to a TPC party, and he said that it is easy to see why the business is a success. "The company's products, in large part proprietary, are well-styled and highly useful, and the consultants are knowledgeable and enthusiastic. Everyone has a good time."

Doris brought in Sheila O'Connell Cooper, now CEO, to share the management load. They met with Buffett in Omaha. He quickly decided that they were able and trustworthy managers and he promptly made a deal.

Warren Buffett said, “Charlie and I have seen so much of the ordinary in business that we can truly appreciate a virtuoso performance.”

What is a unique competitive advantage? It is an asset or benefit that a particular business, product or service holds that gives it an edge in any particular market. The Pampered Chef products and service began to gain popularity in the 1990s and the company grew. With growth in popularity, a brand identity was established in the minds of satisfied customers.

Pampered Chef showed expansion potential in 1996 by developing sales growth in Canada. Then it grew in the U.K. and Germany. The Pampered Chef Company now sells special kitchen tools and related food products. And, with an annual revenue of over \$118 Billion, Pampered Chef continues to hold a unique competitive advantage among its competitors (Wal-Mart, Costco, etc).

Warren Buffett has an impeccable ability to recognize companies with that something special – a unique competitive advantage. Pampered Chef has just that. They have created a unique competitive advantage by building an enterprise around directly selling quality cooking products through in-person demonstrations.

It all started with a dedicated and motivated mother of two that found a target market for those that wanted to learn her kitchen techniques and for others that wanted to earn a stay-at-home income. Again Warren Buffett recognized the excellent management and entrepreneurial sense that Doris Christopher used to build and grow this profitable company. Customers are able to see the products work first hand while picking up new cooking techniques and recipes. Pampered Chef found a way to connect with and inspire families and individuals on a personal level by tapping into their emotions. They have successfully positioned themselves with products that make cooking easier, more interactive, and more fun. The direct selling concept allows Pampered Chef and the independent representatives to profit without any debt.

Pampered Chef’s simple business concept makes it easy to sustain. They have successfully created a recognizable brand name and image. But the continuation depends largely on the independent sales reps. Keeping them going and keeping them selling is key.

Pampered Chef currently has around 60,000 sales reps while Mary Kay (with a similar selling concept) has over two million so there is still a lot of market potential out there for Pampered Chef. But at the same time, there is a lot of market potential for any competitor. The minimal amount of start-up capital needed and the simple direct selling concept allows for easier entry into the market. The ability to earn extra income, stay at home with children, or work on your own schedule will continue to attract sales representatives. But there is vast potential for increased competition.

In his 1992 Letter to shareholders, Warren Buffett wrote: “An economic franchise arises from a product or service that: (1) is needed or desired; (2) is thought by its customers to have no close substitute and; (3) is not subject to price regulation. The existence of all three conditions will be demonstrated by a company's ability to regularly price its product or service aggressively and thereby to earn high rates of return on capital.”

The Pampered Chef franchise should continue to offer selected products that are needed or desired; ones thought by its customers to have no close substitute and; ones that have pricing power.

Buffett knew this when he said, “The company’s products, in large part proprietary, are well-styled and highly useful, and the consultants are knowledgeable and enthusiastic. Everyone has a good time.” So, Pampered Chef managers should always think about building their economic moat by building on their positive brand image in both specially selected product offerings and superior service.

TTI, INC. COMPETITIVE ADVANTAGES

BUD LABITAN WITH PETER CHEN, SINGAPORE

"The Best Little Warehouse in Texas" grew big and profitable. In 2011, TTI, Inc. proudly celebrated its 40th anniversary. In 1971, Paul Andrews founded the business in Fort Worth, Texas. Andrews, a former components buyer at General Dynamics, had a vision to offer superior customer service, exceptional product knowledge, and extensive inventories of electronic components to his customers. His business was started as a small entrepreneurial business called Tex-Tronics, Inc. In 1973, Andrews changed the name to TTI, Inc. to avoid a legal dispute with another company with a similar name.

With an eye towards controlling costs and facilitating efficient distribution, TTI was known as "The Best Little Warehouse in Texas." Paul Andrews had combined a specialized inventory with supply chain management systems to develop a special business. Over a 35-year period, Andrews built TTI from \$112,000 of sales to \$1.3 billion. TTI employs more than 1,500 people at more than 50 locations throughout North America, Europe and Asia.

TTI grew from a small lower-cost warehouse distributor of electronic components into a special seller that is ranked among the world's top 10 electronic component distributors. Today TTI sells passive, connector, electromechanical and discrete components world-wide to more than 25,000 electronics manufacturers.

TTI strives to be the most preferred "on time" electronics distributor for customers and suppliers. It sells from a broad line of manufacturers. TTI's extensive product line includes: resistors, capacitors, connectors, discretes, potentiometers, trimmers, magnetic and circuit protection components, wire and cable, wire management, identification products, application tools, and electromechanical devices. TTI has become the distributor of choice for industrial, military, aerospace and consumer electronic manufacturers worldwide.

John Roach introduced Warren Buffett to Paul Andrews, Jr., owner of about 80% of TTI. Andrews is an owner who did not want his carefully built company dismantled after it was sold. So, Buffett and Berkshire was his best choice.

In 2007, Paul Andrews sold his majority ownership of TTI to Warren Buffett's Berkshire Hathaway. Buffett called Andrews "is a remarkable entrepreneur and operator."

TTI COMPETITIVE ADVANTAGES:

- Paul Andrews is a remarkable manager and entrepreneur who built an outstanding business with more than \$1 billion in sales.
- TTI's products, personalized service and custom supply chain solutions have transformed it into an industry respected brand. It was grown into a distributor of choice for industrial, military, aerospace and consumer electronics manufacturers worldwide who are the bigger buyers for electronic components.
- TTI broadened its reach into the catalog business by purchasing Mouser Electronics in 2000. TTI acquired Mouser Electronics, one of the industry's fastest-growing catalog distributors. Mouser was one of the fastest growing global catalog distributors in the electronics industry. Together, the two offer the ideal distribution solution for design and production buyers in the electronics manufacturing industry. Mouser has many advantages over the industry players, including 1) rapid product introduction, 2) extensively using e-commerce, 3) State-of-the-Art Warehouse Operations, 4) Special personalized service.
- TTI affiliate Mouser Electronics signed new deals or expanded existing contracts with various companies, including Actel, Amphenol, Avago Technologies, On Semiconductor, Sharp Microelectronics and Tyco.
- TTI strives to be the industry's preferred information source by offering the latest IP&E technology and market information through the online MarketEye Research Center.

- TTI's facilities include the 270,000-square-foot corporate headquarters and passives operation, a 200,000-square-foot connector warehouse, assembly and modification center.
- TTI has operations in Europe, including a new 165,000-squarefoot multi-level distribution center in Maisach-Gernlinden near Munich, Germany, which opened in mid-2005.
- TTI expanded its Asia facilities in Singapore, Hong Kong, Taiwan and China.

Are TTI's competitive advantages sustainable for the next 10 years? TTI values the online sales model, which it is utilizing. TTI has constructive plans to continue its international expansion, new product expansion, and the addition of several key franchises.

TTI's original customer base consisted primarily of companies that manufactured military/aerospace electronic products. Now TTI's distribution network of products and services has expanded toward covering portions of the commercial and automotive markets as well. Typical customers include component manufacturers, cable assembly houses and small to medium-sized electronics manufacturers.

Charlie Munger has said, "We've really made the money out of high quality businesses. In some cases, we bought the whole business. And in some cases, we just bought a big block of stock. But when you analyze what happened, the big money has been made in the high quality businesses. And most of the other people who've made a lot of money have done so in high quality businesses."

Today, TTI is a high quality business growing globally with sales locations in locations throughout North America, Europe, and Asia. Now with over 2,000 employees in locations around the globe, the mission of offering superior service and product knowledge continues as the company looks forward to charting the next 40 years. The business philosophy established by Andrews in the early years remains; focus on being the best, not the biggest.

U.S. LIABILITY INSURANCE GROUP COMPETITIVE ADVANTAGES

BUD LABITAN WITH STEPHEN CHAN, UNIVERSITY OF MANCHESTER AND
COLIN FARRIER AND RICHARD KONRAD, CFA

USLI aspires to be the best insurance company for underwriting insurance for small businesses. It specializes in underwriting low premium, low hazard specialty insurance products. The average annual premium is only about \$1,500.

USLI's Business is written by 'professional wholesale brokers' in two main components professional liability and commercial liability. Professional liability is focused on the errors and omissions coverage for insurance agents, real estate agents and consultants, while the commercial liability covers a range including child care, artisan contractors, vacant buildings, bars and taverns and liquor liability.

The Berry family acquired the charter for the dormant company United States Liability Company of Philadelphia in 1950. This family started the Mount Vernon Fire Insurance Company in 1958. The two companies were consolidated under the holding company US Investment Corporation in 1971. US Underwriters Insurance Company was started in 1972. The holding company was acquired by Berkshire Hathaway in 2000.

As member of the Berkshire Hathaway family of companies, USLI is an A++ rated company that supports its products with financial strength and stability.

This financial strength and underwriting conservatism is demonstrated in its most recently reported results for 2010 where the company had net earned premiums of about \$80 million relative to its very strong capital and surplus positions of about \$357 million. Total loss reserves were \$127 million. The company has demonstrated a net underwriting gain every year for the last five years.

USLI makes a difference to customers through well-designed products that are delivered with unparalleled speed, service and support. In addition to innovative insurance products, USLI provides a broad range of marketing assistance to customers to help ensure their long-term success. Its president

Thomas P. Nerney said, "Our aim is to make a difference to our customers and our people - through our service, our products and our support - every day."

In 2000, Ron Ferguson of General Re put Buffett in contact with Bob Berry, whose family had owned U.S. Liability for 49 years. After Bob Berry and Warren Buffett talked, they agreed by phone on a half-stock, half-cash deal. Charlie Munger has said, "If you can buy the best companies, over time the pricing takes care of itself." This insurer, along with two sister companies, is a medium sized, highly-respected writer of unusual risks. These unusual risks are called "excess and surplus lines" in the insurance industry.

Tom Nerney has managed USLI for the Berry family and has achieved an uncommon combination of excellent growth and high profitability.

Warren Buffett said, "Few property-casualty companies are outstanding businesses. We have far more than our share, and U.S. Liability adds luster to the collection."

United States Liability Insurance Group aspires to be the very best insurance company specializing in underwriting low premium, low hazard specialty insurance products and it is focused on being the go-to company for small businesses.

Strengths: The strengths are strong capitalization and excellent operating profit derived from conservative underwriting and management over the long cycle. The group now also benefits from the umbrella of Berkshire Hathaway Group through a 50% loss portfolio transfer agreement and a 50% quota share reinsurance agreement with National Indemnity, another subsidiary of Berkshire. These transactions have led to a substantial reduction in USLI's underwriting leverage. Further, the group maintains a careful watch over expected catastrophe losses over the very long term.

Weaknesses: The considerable growth in premium has been offset by the organic growth in premiums in this field and a general rise in premiums.

Opportunities: Berkshire Hathaway purchased this specialist insurer and integrated it with its existing insurance operations in 2000, when the economic and insurance cycle was down and the price was favorable.

Based upon the supply of capital available at low rates to Berkshire Hathaway, a profitable USLI has grown. It appears to have been very effective in selling low premium liability insurance in the small business market.

Threats: The ‘under review with negative implications’ Financial Rating of A++ Superior by A. M. Best was removed temporarily in 2009. This was a ramification of the acquisition by Berkshire Hathaway of Burlington Santa Fe railroad. A.M. Best affirmed the financial strength rating of A++ (Superior) again in 2011.

USLI creates a moat to keep its competitors out by designing products that are delivered with unparalleled speed, service and support for their customers. Therefore, its competitive advantage is superior customer service from a lower-cost provider.

As a member of the Berkshire Hathaway family of companies, USLI is an A++ rated company that supports its products with financial strength and stability. Aside from its good reputation and innovative products, it provides a broad range of marketing assistance to its customers to help ensure their long-term success. The firm is committed to developing new products and constantly enhancing its existing products in order to have a competitive advantage in both product and service.

Competitors: The main competitors identified by Hoovers are Markel Corporation, RLI Corporation and The Travelers Companies, Inc. Are USLI’s competitive advantages sustainable for the next 10 years?

Having the experience of tremendous depth of underwriter knowledge, innovation, customer loyalty, and flexibility, USLI maintains its competitive edge.

It has been assigned at Best’s Rating of A++ (Superior), reflecting the company’s superior level of capitalization, strong operating results and solid market position within the specialty admitted and surplus lines markets.

USLI’s competitive advantage can be sustainable because the management of USLI appears to have the same the conservative attitude and husbandry of its owners. The results of relatively high operating profits and a low cost

base indicate that the efficient investment of capital has been growing the returns to the owners. There is a focus on underwriting discipline. This may be compared with a similar situation at GEICO at the same earlier stage of GEICO's development.

Given its comparative advantages such as able and honest managers, firm values, innovation, and experience, we believe that USLI can sustain its competitive position and grow in this industry.

US BANCORP (USB) COMPETITIVE ADVANTAGES

BUD LABITAN WITH RICHARD KONRAD, CFA, VALUE ARCHITECTS
ASSET MANAGEMENT

USB has been profitable in every quarter through this financial crisis. Minneapolis-based U.S. Bancorp (NYSE: USB), with \$330 billion in assets, is the parent company of U.S. Bank National Association, the 5th largest commercial bank in the United States.

The company operates 3,089 banking offices, 5,092 ATMs in 25 states across the Midwest and the West Coast. USB provides a comprehensive line of banking, brokerage, insurance, investment, mortgage, trust and payment services products to consumers, businesses and institutions.

In its most recent quarter, the firm reported total assets of \$321 billion including loans of \$200 billion. The company, as a corollary of its perceived high quality has been successful in attracting corporate and trust deposits which total \$215 billion.

USB first appeared in Berkshire Hathaway's portfolio in the 2006 annual report, at the time representing an initial stake of 1.8% of the company. This position grew in 2007 to represent a stake of 4.4%. As of the end of the second quarter of 2011, Berkshire's ownership was 3.6%.

Charlie Munger said, "No one can 100% stay away from trouble. However, companies like US Bank and Wells Fargo are better at avoiding the common stupidities of banking than most."

Historically, many banks including USB achieved high profitability as measured by return on equity that almost routinely exceeded 20%. The

financial crisis battered profitability for all banks, largely due to credit losses. In this distressing time, the banking industry has been volatile. Unlike any other large bank, USB has been profitable in every quarter through this financial crisis.

USB has demonstrated far better stability in these exceedingly difficult times for financial companies. The average return on equity for the last five years for USB was 17.1% compared to the industry average of 7.3 %. For perspective, the much admired JP Morgan achieved a comparable ROE of 8.1% and Wells Fargo (6.7% held by Berkshire) returned 13.1 % on its equity. BankAmerica, Buffett's most recent "private" deal has returned merely 5.5% on equity over this chilling period.

Also, USB's 5Yr Net Profit Margin (5-Year Avg.) is approximately 23.1%, while the industry Net Profit Margin (5-Year Avg.) is 15.8%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

How has US Bancorp achieved these superior results? Success has been achieved through superior execution. USB managers avoided the pratfalls that trapped other banks. Their ability to moderate growth in the loan book over the past several years resulted in USB having better profitability than its competitors. USB has been a company that has zigged while most other banks zagged over the last several years.

Superior, thoughtful underwriting standards have been a mainstay. Subprime loans represented, at peak, less than 2.5% of the total loan portfolio. Construction loans represented no more than 2% of the portfolio during the crisis years. Both of these metrics were well below industry averages.

Is there exposure to commercial real estate (CRE) and its problems? Absolutely, but about 35% of the commercial real estate mortgage business for USB is owner-occupied rather than dependent on attracting tenants. In 2008, USB had a \$31 billion CRE portfolio with just over \$1 billion of that in California. This was a lower participation rate in what has been a problematic weakness for competitors. Credit quality diversification of USB's portfolio was extremely helpful with diversification by industry, by geography and by customer as well as a limited exposure to leveraged lending.

What ultimately has been the biggest differentiator of USB's business from other banks is its very significant revenue streams from "fee" business rather than "interest spread" business.

USB management has demonstrated better underwriting and decisionmaking in its traditional lending businesses. However, traditional banking revenues represent about 55% of total revenues. The largest of USB's fee businesses is its payment processing business which represents about 25% of revenues. Its wholly owned Elavon subsidiary provides merchant processing services in more than 30 countries and supports the payment needs of more than 1,000,000 merchant locations across the globe. It is the fourth largest US credit card processor. USB also has a significant wealth management business that requires little capital and achieves high returns on the capital employed. Hence, the overall profitability of the bank has proven more resilient than more traditional banks.

Expense management has always been a strong suit for USB. Its efficiency ratio (which measures expenses as a percentage of revenues and hence, so the lower the number, the better) is the best in the industry for large banks at 51.6%. This is a full two percentage points better than its next best competitor.

In general, bank investors have had a lot to worry about in the last few years. Questions about credit quality remain on the front burner. Balance sheets were shrinking and depositors were nervous. Regulatory questions remain as Dodd-Frank regulation takes hold. Hence, excess leverage that so many banks deployed to maximize their return on equity will be part of a shady past for this industry. Questionable underwriting, especially in residential mortgages, will be a political and a legal football that will continue to plague much of the industry as foreclosed property holders and politicians seek revenge and retribution.

Are USB's competitive advantages sustainable? USB should continue to attract low cost core deposits as depositors engage in a flight to quality.

Whether it's individuals, corporate CFOs, or municipal treasurers that are making these decisions, depositors are willing to place their money under

the safety and soundness of USB at levels above FDIC insured levels. This is a very strong endorsement of this bank's quality.

Given the depth and duration of the recession, demand for loans has been modest. As confidence builds, USB should continue to be able to garner its share of loans in its disciplined fashion. Already, it is benefitting from the reluctance, or the inability of some of its competitors to lend.

Ultimately, when the economy does come back, it is likely to be corporate-led, not consumer-led which is highly unusual. US Bancorp diversified mix of businesses should benefit from this recovery. USB's cost-control culture, its historical shareholder focused orientation (where 80% of earnings were ear-marked for return of capital through dividends and share buybacks) and its strong ability to generate capital should keep USB's profitability among the best in the industry.

USG CORP (USG) COMPETITIVE ADVANTAGES

BUD LABITAN WITH RICHARD KONRAD, CFA, VALUE ARCHITECTS
ASSET MANAGEMENT

USG is a leading manufacturer and distributor of building materials such as gypsum wallboard and ceiling tile for use in both residential and nonresidential construction and renovation. Its gypsum-based products account for about 48% of business net revenue. The rest comes from product distribution and other construction materials.

USG is a 110 year-old corporation that has seen many business cycles. Recently, the pace of new U.S. home construction has been declining since its peak in 2007. The surplus of unsold homes and foreclosures as well as tight mortgage lending, continues to impair economic recovery. These factors have also led to a very slow recovery in repair and remodeling for both residential and non-residential sectors.

Home Depot is USG's largest customer, accounting for roughly 11% of the company's sales. USG is domestically focused with 77% of its revenues generated in the US, about 12% in Canada, and the remaining 11% in other countries. The company does command strong market shares with a 28%

share in gypsum wallboard (#1) in North America, a 32% share (#2) in US ceiling systems, and 11% (#1) in gypsum wallboard distribution.

Gypsum wallboard manufacturing is USG's largest business segment representing about 50% of revenues. USG's Sheetrock brand is a very strong brand in construction. A majority of its gypsum wallboard products are sold as the SHEETROCK brand while its major cement board product is the DUROCK brand. In 2010, U.S. Gypsum introduced SHEETROCK® Brand UltraLight Panels. This new lightweight gypsum wallboard is up to 30% lighter than competing brands.

USG emerged from bankruptcy in 2006 following a surge of asbestos-related lawsuits. Warren Buffett said, "It's the most successful managerial performance in bankruptcy that I've ever seen."

Before USG set up a trust fund to pay all current and future asbestos claimants and, Charlie Munger said, "'Asbestos had many wonderful qualities. But when the health risks became clear, the companies that were major users of asbestos such as Johns Manville covered it up and were rightly hit with damages through the tort system. But other companies only used small amounts -- for example, in brake pads or a bit in USG's paste... There are judges in Texas who are in the pockets of the plaintiff's bar, and there are compliant juries. It's turning the courts into an extortion system... Isn't it interesting that the only brand names that plaintiffs can remember are the brands of the only two solvent companies? Is it good for society that lawyers, workmen, etc. are lying, that junk science is accepted? It's a national disgrace... I regard what's happening to USG as a dishonorable mugging of an honorable place. I don't think they should be driven out of business."

Buffett and Munger originally bought 15% of the company for Berkshire Hathaway, and later raised the stake to about 20%. With financial help from Berkshire Hathaway, USG hedged future risks by allocating a \$4 billion fund to resolve further asbestos claims. USG has since replaced old gypsum factories with higher-quality, lower-cost plants. This has increased efficiency and countered increasing prices of key raw materials.

Given the highly cyclical nature of this business, the tentative nature of this economic recovery and the weak pricing conditions for gypsum wallboard,

USG has scaled back its operations, closing 3.8 billion square feet of its highest cost manufacturing capacity.

Net sales for USG Corporation and its subsidiaries were \$3.2 billion in 2009. This was a sharp decline from the previous year's sales of \$4.6 billion. With the collapse of the housing market, USG has faced declining revenues since 2006. As a result, its net income for 2009 was a loss of \$787 million. USG's 5Yr Gross Margin (5-Year Avg.) is approximately 11.4% and its 5Yr Net Profit Margin (5-Year Avg.) is a (negative 5.9%), while the industry Net Profit Margin (5-Year Avg.) is 6.4%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

Pricing remains challenging with USG's capacity utilization at about 43% as compared to the industry's 52%. USG views itself as the lowcost deliverer in wallboard and ceilings. However, this is a highly capital intensive business in both wallboard and ceiling tile production. If wallboard prices remain at depressed levels, it would not be surprising to see more capacity leave the industry or consolidation to occur.

The industry structure for wallboard is fragmented with geographically scattered competitors with disparate market shares. Producers have widely varying facilities and operating costs. Hence, statesman-like pricing will be difficult to achieve in this industry.

USG's Worldwide Ceilings is a worldwide platform where USG leads in ceiling grid, and is second in ceiling tile. Ceiling grid is the framework that is used to install suspended ceiling tiles. USG's margins in this business have been more stable than in the gypsum wallboard business. USG's Worldwide Ceilings include USG Interiors, USG International and CGC. This segment handles USG business with Europe, Latin America and the Asia-Pacific. CDG is the largest manufacturer in Canada, while USG Mexico is the largest in that country. USG is not fully developed in the international markets because of the higher costs of shipping and handling overseas.

The third part of USG's business is a specialty distribution business called L&W Supply. Its acquisition by USG is an example of Moat building for competitive advantage. L&W Supply has over 220 distribution centers offering on-site delivery to contractors nationwide. This business sells to

strategic customers such as the big-box retailers, Home Depot and Lowes. It also sells to other specialty dealers, professional dealers, and paint, hardware, and tile chains. This business was launched in 1971 and has over 30,000 contractor relationships. USG wallboard accounted for 47% of L&W sales.

USG is one of Buffett's most cyclical businesses. The recovery in housing is viewed by most as being slow and protracted. New commercial construction is showing some positive signs with double digit increases in this sector for three years in a row. There is a lag of some 12-18 months on new commercial construction before demand for wallboard and ceilings steps up.

There has been a near stop in terms of new home constructions since the housing bust. In response, USG reported lowering its selling price and lowering its revenue. USG faced declining revenues since 2006, mostly as a result of the collapse of the housing market. For the year 2009, net sales were \$3.2 billion, the operating loss was \$185 million and net loss was \$787 million. In February of 2009, Warren Buffett lent USG \$300 million and Prem Watsa lent USG \$100 million in the form of a convertible bond yielding 10%. This shows their confidence in USG's long term prospects.

Repair and remodeling is the brightest part of the business currently and represents about 50% of revenues. Recent results from the big box retailers are showing the best seasonal strength in four years.

Manufacturing costs for USG increases mainly because of the increasing costs of raw materials such as natural gas and wastepaper. In addition, the company acquires materials from a limited number of suppliers; this can increase the risk of unavailability. For natural gas, USG enters into fixed-price supply agreements and hedging transactions for 12 months.

USG Competition comes from the National Gypsum Company (or NSG). NSG is a privately-owned, fully-integrated construction company and is the second ranking manufacturer of gypsum wallboard in the US. USG operates on a wider scale than National Gypsum, owning 22 gypsum wallboard plants and 8 paper mills, compared to National Gypsum's 19 plants and 4 mills.

Eagle Materials (EXP) manufactures construction materials including gypsum wallboard, cement and recycled paperboard. Its products are distributed throughout the US, but are more concentrated in regions close to EXP wallboard plants. In contrast, USG supplies materials more evenly distributed through its own L&W Supply network.

CertainTeed is a subsidiary of the French industrial company Compagnie de Saint-Gobain, has 13 gypsum plants. It sells construction materials to residential and commercial contractors in the US.

Lafarge North America is a supplier of construction materials in the US and Canada. Unlike USG, Lafarge isn't focused on the production of gypsum materials. Its gypsum segment accounts for 10% of its sales.

USG has tried to strengthen the core businesses by consolidating capacity in North American manufacturing and distribution. This has lowered the breakeven point to position the business for an eventual recovery. USG has reduced employee count by 5,000 employees and reduced costs by over \$450 million.

There are product line extensions and adjacencies. Securock® sheathing goes on the exterior skin of buildings. This is a high margin product and brings USG to the exterior of the building. Continuing innovation, USG recently introduced Sheetrock Ultralight wallboard, a product that is 30% lighter than its standard product. This product has rigidity and strength but it allows contractors to be more productive and efficient in installing wallboard. With construction labor in North America earning more than \$50 an hour, a product that is easier to carry and install adds some real efficiencies.

Currently, USG's plant utilization is close to 46%. USG's pricing philosophy has not changed despite the recessionary pressure to maintain sales and market share. With the value proposition they provide, USG will continue to market as a premium product brand. It is doing things to trim back costs with a workforce reduction. SG&A expenses are now at 9% of revenue. USG has curtailed operations at older less efficient wallboard lines, optimized their L&W supply network, and reduced plant operations.

Buffett's investment here is focused on long term demographics. Notwithstanding the current excess inventory levels in housing, new home

demand of about 16 million units is estimated for the next decade. The median age of US housing stock is about 37 years, with nearly one third over 50 years old. During the credit crisis, high unemployment and record foreclosures discouraged many homeowners from making improvements to their properties.

With competitive advantages in superior quality products, an efficient network of distribution and service, disciplined cost management, constant innovation of industry leading products, and a local presence, USG is poised to resume a competitive and profitable leadership position when demand resumes.

WAL-MART (WMT) COMPETITIVE ADVANTAGES

BUD LABITAN WITH ASSISTANCE FROM FLORIAN BEIL, UNO COLLEGE
OF BUSINESS

Wal-Mart Stores, Inc. (NYSE: WMT) is the world's largest seller of a wide array of merchandise including groceries, apparel, electronics, household goods, and small appliances. Now, over half of the company's sales come from grocery items. Wal-Mart is larger than Target (TGT) and Sears Holdings (SHLD) combined. Wal-Mart has more than 9000 stores under 60 different banners in 15 countries. In the U.S., more than 100 million customers visit a Wal-Mart store each week.

In 2010, Wal-Mart sales of \$405 billion made it the world's largest public corporation by revenue. Costco Wholesale had revenues of about \$78 billion and Target had revenues of about \$67 billion. Business growth as of January 31, 2011, showed that net sales increased 3.4% to \$419 billion. Net income increased 14% to \$16.4 billion.

Because of its size and buying power, Wal-Mart can buy its products at lower prices. It can sell high volumes at lower prices and pass some savings onto its customers. Wal-Mart can exert pressure on its suppliers because they depend on this discount retailer for a majority of their sales.

While the industry average is 20.7 percent, Wal-Mart only spends 16.6 percent of sales revenue on overhead. However, its reliance on Chinesemade imports makes the company vulnerable to a weakening

dollar or strengthening of the Yuan. A stronger Yuan means that Wal-Mart will have to pay more for its merchandise from China. Additionally, the company is vulnerable to adverse legislation, such as higher tariffs, that would raise the cost of its Chinese imports.

Charlie Munger talked about Wal-Mart in 1994 at USC's business school this way: "It's quite interesting to think about Wal-Mart starting from a single store in Bentonville, Arkansas against Sears, Roebuck with its name, reputation and all of its billions. How does a guy in Bentonville, Arkansas with no money blow right by Sears, Roebuck? And he does it in his own lifetime—in fact, during his own late lifetime because he was already pretty old by the time he started out with one little store.... He played the chain store game harder and better than anyone else. Walton invented practically nothing. But he copied everything anybody else ever did that was smart—and he did it with more fanaticism and better employee manipulation. So he just blew right by them all... He also had a very interesting competitive strategy in the early days. He was like a prizefighter who wanted a great record so he could be in the finals and make a big TV hit. So what did he do? He went out and fought 42 palookas. Right? And the result was knockout, knockout, knockout—42 times... Walton, being as shrewd as he was, basically broke other small town merchants in the early days. With his more efficient system, he might not have been able to tackle some titan head-on at the time. But with his better system, he could destroy those small town merchants. And he went around doing it time after time after time. Then, as he got bigger, he started destroying the big boys. Well, that was a very, very shrewd strategy... You can say, "Is this a nice way to behave?" Well, capitalism is a pretty brutal place. But I personally think that the world is better for having Wal-Mart."

Wal-Mart operates across three business segments of retail stores worldwide. About half of the company's stores are located in the United States, with the majority of international stores located in Central and South America and China.

Wal-Mart stores account for 63.8% of Revenue. Wal-Mart stores come in one of three traditional formats: Supercenters average about 185,000 square feet in size and include a supermarket. Discount Stores average approximately 108,000 square feet in size and carry a wide assortment of

general merchandise, but a limited assortment of food products. Neighborhood Stores are usually about 42,000 square feet in size and carry a limited assortment of general merchandise, but have a full supermarket.

Sam's Club accounts for 11.5% of Revenue. It provides goods for stores, restaurants, offices, daycares and schools, and motels. Sam's Club also offers office furniture and restaurant supplies. It also has services geared towards small business, such as prescription drug plans and worker's compensation claims billing.

Wal-Mart International accounts for about 24.7% of Revenue. Wal-Mart operates international locations of its Wal-Mart and Sam's Club stores as well as other retail and supermarkets in Central and South America, Mexico, Canada, Japan, China, and the United Kingdom. The company also has a global e-commerce unit called Global.com to drive online growth in new and existing markets.

Wal-Mart uses its large size to maintain its low cost leadership. For example, to fight rising commodity prices, Wal-Mart pressured companies like General Mills to shave its costs by implementing redesigns of its products and packaging.

Target (TGT) is Wal-Mart's most direct domestic competitor with a similar store format. Target's major competitive advantage over WalMart lies in its customer base: the average household income for Target customers is about \$50,000 a year, whereas the average yearly income for a Wal-Mart customer is only \$35,000.

Because of its focus on low prices, Wal-Mart has found it difficult to promote higher-quality items or private labels that come in at a higher price point. Target has had some success with its quality-at-value-prices strategy among higher-income demographics. Kmart (SHLD), the third discount retailer, has been losing market share to both Wal-Mart and Target since 2000.

Wal-Mart competes with a wide variety of other, specialized retailers, such as Safeway in groceries, Best Buy (BBY) in consumer electronics, and department stores such as Macy's in apparel and home decor. Its focus on price differentiation means that these companies are not necessarily competing for the same type of customer. However, in more volatile or

price-sensitive markets, such as consumer electronics, discounters like Wal-Mart are able to leverage their pricing advantage.

Sam's Club directly competes with Costco Wholesale (COST) and BJ's Wholesale Club (BJ) in the warehouse club sector, where Costco has the advantage in total sales.

The major international competitors are Britain's Tesco, France's Carrefour, and Germany's Metro. Each has a competing presence in China, the UK, and Japan.

Wal-Mart's greatest competitive advantage is in lower costs and lower prices. From 1962 until 2006, Wal-Mart's slogan was 'Low prices, always.' In 2006 its slogan was changed to 'Save money. Live better.' Low prices are the most important reason of the customers to shop at Wal-Mart. Its size combined with its ability to provide low prices are two factors that are interdependent. While low prices helped Wal-Mart grow, their bigger size then allowed them to offer even lower prices. This "economy of scale" gives Wal-Mart tremendous bargaining power.

Securing or losing a contract with Wal-Mart can have critical consequences for its suppliers. Wal-Mart can raise a supplier into new dimensions or lead it into bankruptcy.

Another key factor for their competitive advantage of low-cost leadership is Wal-Mart's legendary technology driven logistics system. Wal-Mart's replenishment system allows it to achieve lower operational costs and higher inventory turnover. The store shelves are well stocked at all times.

As soon as consumers pay for their purchases at the cash register, this continuous replenishment system sends orders to suppliers, and transaction information to Wal-Mart headquarters. As the system replenishes inventory immediately, Wal-Mart does not need to spend as much money on maintaining large inventories of goods in its own warehouses. Moreover, the system enables Wal-Mart to adjust inventory to changing customer demands quickly.

Are Wal-Mart's scale and cost competitive advantages sustainable? Yes. In the U.S. supermarket industry it holds a market share of more than 25%. Moreover, Wal-Mart's product line mainly comprises items that are

seldom cut from consumer's budgets, such as food, household, and home health care products. These advantages combined with Wal-Mart's low-cost leadership provide a strong foundation for sustainability.

The Great Recession, from December 2007 to about July 2009, caused a severe economic problem for many. It took a particularly sharp downward turn in September 2008 and this affected the entire world economy. While other retailers had severe problems, Wal-Mart stayed remarkably strong because consumers turned to more careful "lower cost" purchasing.

When analyzing Wal-Mart with Michael Porter's Competitive Forces Model, its sustainability does not seem to be in question. New market entrants find a wide moat. Entry into this industry is extremely difficult. Entering the retailing industry is possible, but only on a much smaller level.

Wal-Mart, the world's largest retailer, sets its own demands. Suppliers are highly dependent on being on Wal-Mart's shelves. Being excluded from Wal-Mart's shelves is likely to decrease the supplier's revenue tremendously.

Substitute products are lesser threats to Wal-Mart, because they can adapt their product line quickly at all times. It has so much purchasing power that no supplier can deny their bids. Customers may be able to switch easily to another competitor, but Wal-Mart's low-cost leadership suppresses this movement. Suppliers have almost no market power over Wal-Mart.

Wal-Mart can still grow. In 2006 Wal-Mart entered the health care sector and recently formed a partnership in the pharmacy sector with Caterpillar Inc. Their next goal is to grow in the consumer electronics area, a viable and popular sector.

Recently, WMT's 5Yr Gross Margin (5-Year Avg.) is approximately 24.9% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 3.6%, while the industry Net Profit Margin (5-Year Avg.) is 3.4%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

Internationally, there is room for Wal-Mart to grow. They have more than 3,600 stores internationally, in 15 markets, a number that doubled during

the Great Recession. However, not all markets are viable for Wal-Mart. One example is Wal-Mart's failure in entering the German market. Nevertheless, Wal-Mart has proven to be successful in parts of Europe like the UK. The emerging markets will provide another opportunity for Wal-Mart.

Wal-Mart's revenue for FY07 was \$345 billion. It grew to \$374 billion in FY08, \$401 billion in FY09 and \$405 billion in 2010. Given the economic consequences of the Great Recession, these numbers are a remarkable proof of Wal-Mart's sustainability.

WASHINGTON POST (WPO) COMPETITIVE ADVANTAGES

BUD LABITAN WITH ANDREA TAGART, UNO-CBA AND RICHARD KONRAD, CFA, VALUE ARCHITECTS ASSET MANAGEMENT

Washington Post Company (NYSE: WPO) is a profitable education and media company that publishes The Washington Post and operates Cable ONE. The Company also owns Kaplan, Inc., the leading provider of educational and career services for individuals, schools and businesses.

Berkshire's equity investments like WPO are selected based on sustainable economic characteristics, competent and honest management, and an attractive purchase price. Recently, WPO's newspaper and magazine divisions suffered from advertising revenue decline as advertisers move towards the Internet and other media such as digital television. In 2010, Kaplan generated an impressive 61.3% of The Washington Post Company's revenue.

The Washington Post Company five main business divisions include education, newspapers, magazines, television broadcasting, and cable television. WPO owns The Washington Post; an online publishing subsidiary whose flagship products include washingtonpost.com, [Slate](http://Slate.com), BudgetTravel.com and Sprig.com; Express; El Tiempo Latino; The Gazette and Southern Maryland newspapers; The Herald (Everett, WA); Cable ONE, serving subscribers in midwestern, western and southern states; and CourseAdvisor, an online lead generation provider.

WPO also owns Kaplan, Inc., a provider of educational and career services. The Company has an ownership interests in the Los Angeles Times-Washington Post News Service and Bowater Mersey Paper Company. While most of the company's operations occur in the United States, some of Kaplan's operations are foreign. The 2008 Financial Crisis boosted enrollment in Kaplan's educational and professional programs as many sought to earn additional credentials to improve their job prospects.

In 2009, Kaplan reorganized its operations into four segments: Kaplan Higher Education, Kaplan Test Preparation, Kaplan International and Kaplan Ventures. Kaplan Higher Education provides a wide array of certificate, diploma and degree programs, on campus and online.

Accredited by the Higher Learning Commission of the North Central Association of Colleges and Schools, most of Kaplan University's programs are offered online, while others are offered in a traditional classroom format at ten campuses in Iowa, Nebraska and Maryland. Kaplan University also includes Concord Law School, the nation's first fully online law school.

Kaplan Test Preparation (KTP) includes the following businesses: Test Preparation and Tutoring; Professional and Licensure; and Kaplan Publishing. The test preparation and tutoring business prepares students for a broad range of college and graduate school admissions examinations, including the SAT, ACT, LSAT, GMAT, MCAT and GRE. Kaplan Test Preparation also offers courses online, which are delivered in a live online classroom and a self-study format. In addition, KTP licenses material for certain of its courses to third parties and a Kaplan affiliate, which, during 2009, offered courses at 55 locations in 11 countries outside the U.S.

Kaplan Medical and Kaplan Nursing prepare students for licensure exams including the USMLE and NCLEX exams. Kaplan PMBR, offers full-service legal bar review in 19 states, as well as review for the multistate portion of the bar exam nationwide. Kaplan Schweser offers test preparation courses to financial services professionals for the CFA, FRM and CPA exams, as well as continuing education for accountants. Kaplan Financial Education provides entrance exam preparation and continuing education courses for financial services professionals. Kaplan Real Estate

Education provides courses for real estate, home inspection, architecture and engineering.

In the education segment, WPO competes with Princeton Review (REVU) and McGraw-Hill Companies (MHP) also offer test and admission preparation services. Interestingly, “The No Child Left Behind Act” (NCLB) positively impacted Kaplan. Introduced in 2001, the NCLB requires states to develop exams in various subjects to be given to students in certain grades.

Newspaper Publishing accounted for about 14.4% of 2009 revenue. The Post’s two primary sources of revenue are advertising and subscription fees accounted for 68% and 29% of its total revenue, respectively. WP Company LLC, a subsidiary of the Company, publishes The Washington Post as a morning daily and Sunday newspaper primarily for home delivery in the Washington, DC, metropolitan area, Maryland, and northern Virginia.

The Slate Group publishes Slate, an online magazine, and several additional websites. The Express division also produces weekly military newspapers under agreements where editorial material is supplied by local military bases.

WPO owns The Daily Herald Company, publisher of The Herald in Everett, WA, about 30 miles north of Seattle. The Daily Herald Company also publishes La Raza del Noroeste, a weekly Spanishlanguage newspaper that is distributed free of charge. El Tiempo Latino provides a mix of local, national and international news together with sports and community-events coverage.

Television Broadcasting accounted for about 7.2% of 2009 revenue. The Post–Newsweek Stations, Inc. (“PNS”), a subsidiary of the Company, owns six television stations located in Houston, TX; Detroit, MI; Miami, FL; Orlando, FL; San Antonio, TX; and Jacksonville, FL.

The recent economic crisis put downward pressure on advertising revenue as businesses cut their advertising budgets. The automobile industry, historically a large buyer of television advertising, contracted dramatically in recent years and reduced overall advertising spending accordingly.

Cable Television accounted for about 16.1% of 2009 revenue through its subsidiary Cable ONE, Inc. The Company owns and operates cable television systems that provide video, Internet and phone service to subscribers in 19 midwestern, western and southern states. Digital video, cable modem and VoIP services are available in markets serving virtually Cable ONE's entire subscriber base.

WPO, along with other leading newspaper publishers such as New York Times Company (NYT) and Gannett (GCI) have been impacted tremendously by the growth of the Internet and Digital Television. The Post's average weekday circulation and average Sunday circulation have dropped by about 12% since 2003.

Advertising on the Internet is generally much cheaper and can reach a larger audience than traditional newspapers or magazines. Advertisers use the metric cost per thousand or CPM to measure the effectiveness of advertising through a particular medium. So, the WPO has complemented many of its printed publications with online publishing activities, primarily through washingtonpost.com. This website averaged about 270 million page views per month and had an average of 28.2 million unique visitors per month during 2010.

One of the biggest expenses for the newspaper and magazine divisions is newsprint. It is generally the second largest expenses next to labor costs. WPO and other publishers have implemented various cost-cutting measures like using smaller pages and reducing circulation. WPO does own 49% of Bowater Mersey Paper Company which manufactures newsprint in Canada.

WPO's Cable One subsidiary is vulnerable to extreme weather conditions, especially hurricanes. Nearly 12% of Cable One's customers live in gulf coast areas. Following Hurricane Katrina, the cable division reported a loss of \$23.7 million in damaged property and lost subscriptions.

In the Cable TV industry, WPO competes not only against firms that provide cable service like DirecTV and Verizon Communications (VZ) but also against larger media conglomerates like News Corporation (NWS) that own networks across the U.S.

WPO's newspapers compete against numerous local newspapers in the markets in which they circulate. The Washington Post controls the Washington D.C. (DMA) market, with 43% of residents.

In August 2010, The Washington Post Company sold Newsweek magazine to Dr. Sidney Harman for \$1. Dr. Harman led the magazine through a rebranding and merged the company with The Daily Beast.

The Washington Post has prepared for these media changes by diversifying its companies and the products and services offered. NYT's New York Times, Gannett's USA Today, and News Corporation's Wall Street Journal are WPO's largest national competitors. WPO developed internet websites to follow along with the digitalization trend. Though their media is primarily US-based and posed a barrier for Washington Post Company to become international, they found a way to globalize through Kaplan, offering educational services and test preparation in over 30 countries.

The Washington Post Company achieves a competitive advantage through its diverse product and service lines. They are also innovative in their methods for marketing their services. For example, their Kaplan University developed a program called Kaplan Commitment, in which new students can take classes for up to 5 weeks and be able to quit and owe nothing for tuition. This development is a twofold advantage in that it brings in more students who might otherwise not try the program for fear they will not continue, but owe tuition. It also allows a reasonable timeframe for students to drop out, since most would drop out during those first few weeks. This mitigates the financial risk of default on tuition payments from those types of students. So not only does Washington Post Company create innovative ways to market their services, but they have also found ways to diversify their service and product lines to compete effectively, and they also found increased revenues through their education sector to mitigate the losses from the publishing subsidiary.

Are these competitive advantages sustainable for the next 10 years? The company, unlike most newspaper publishers, has maintained a recurring revenue stream by its ongoing diversification efforts in products and services. The growth of education and testing has offset losses in the declining Newsweek magazine division as well as the declining profitability of the newspaper. Kaplan also established a global footprint

for the firm and with recent regulatory changes concerning for-profit education providers, the move internationally reduces WPO's risk.

Recently, WPO's 5Yr Gross Margin (5-Year Avg.) is approximately 55.5% and its 5Yr Net Profit Margin (5-Year Avg.) is approximately 5.4%. Comparisons are somewhat arbitrary because of the diversified nature of WPO's businesses. WPO's gross margins are quite comparable to those of most education services companies such as Devry which has averaged 54.1% for the last five years but below those of Apollo which has 63.5% gross margins. Net margins for WPO are well below those of the education industry where Devry and Apollo demonstrated net margins of 12.1% and 14.0%. However, when compared to WPO's roots in the newspaper and broadcasting businesses, WPO stands out. Gannett's gross margins in newspapers are only around 33.2% and Time Warner Cable has averaged 52.9%. On a net profit margin basis, both Gannett and Time Warner show negative average profit margins for this period, due to the losses both suffered in 2008. Though net margins dropped to just 2.3% for WPO in 2008, the firm remained in the black unlike most of its peers. Will this competitive path make WPO's moat wider? WPO has unique and selective media positions that are still competitive. It has also built Kaplan into a brand that can continue to put up barriers between the company and its competitors.

At the end of 2010, Kaplan's Higher Education Campuses business consisted of 63 schools in 17 states that were providing classroom-based instruction to approximately 38,500 students (including the 7,400 students enrolled at Kaplan. The schools have competitive advantages by focusing on selected certificate and degree paths. However, because Kaplan Higher Education receives a significantly lower level of taxpayer-funded grants and subsidies than community colleges, state schools and not-for-profit schools, Kaplan Higher Education's schools are more dependent on tuition, and its students are more dependent on loans. Most of Kaplan University's programs are offered online including Concord Law School, a fully online law school. In addition, Kaplan has a well recognized brand in test preparation and licensure for a variety of licensing and advanced designation exams. The strong brand portfolio in education facilitates easy consumer recall which supports the largest revenue generation segment of the business.

By selectively choosing niche areas to excel in, the Washington Post Company and its subsidiaries are adjusting to new competitive forces. In contrast to its newspaper peers, WPO has demonstrated great flexibility in adjusting its business model to other free cash flow generative businesses, the primary metric that drew Buffett's attention to newspapers half a century ago. Though for-profit education faces some near term challenges as a result of government crackdowns and increased scrutiny of student lending, technical education has received little response from state governments as a result of state budget conditions. Kaplan's niche that addresses older students who are undertaking career development and enhancement, we believe is an attractive and sustainable niche.

WPO's cable business locates itself in regions that are relatively small and less likely to attract as much competition as large urban markets. Like most cable businesses, the growth driver is data services and alternate telephone services through VoIP.

Finally, the newspaper business in general has been marginalized by the ubiquitous availability of the internet and its technological ability to target many specific geographic areas and demographic groups.

Charlie Munger said that local and regional newspapers are more resistant to broad negative trends in newspapers than others. Newspapers generally are in a relentless cost cutting mode. WPO has continued this restructuring pursuit and has decreased its capital commitment to these businesses in order to improve its return on invested capital.

Buffett has viewed himself as a "newspaper man" from his earliest days of operating a paper route. Beyond Berkshire's current investment in WPO and its recent purchase of the Omaha World-Herald, Berkshire owns the Buffalo News and at various times has held positions in Scripps, Harte-Hanks, and Affiliated Publications among others. The recurring revenue nature of these businesses and the strong free cash flow generation capabilities were the attraction historically. We believe that these characteristics are inherent in the mix of businesses that WPO manages now.

WELLS FARGO (WFC) COMPETITIVE ADVANTAGES

BUD LABITAN WITH NATALJA CALLAHAN, UNO-CBA

Wells Fargo is a well-managed, high-return banking operation in which Berkshire Hathaway increased its ownership to around 11%. About onesixth of the position was bought in 1989, the rest in 1990 and 2010.

Buffett wrote: “The banking business is no favorite of ours. When assets are twenty times equity - a common ratio in this industry - mistakes that involve only a small portion of assets can destroy a major portion of equity. And mistakes have been the rule rather than the exception at many major banks. Most have resulted from a managerial failing that we described when discussing the “institutional imperative:” the tendency of executives to mindlessly imitate the foolish behavior of their peers. Because leverage of 20:1 magnifies the effects of managerial strengths and weaknesses, we have no interest in purchasing shares of a poorly managed bank at a “cheap” price.”

With Wells Fargo, Buffett was thinking about “the best managers in the business, Carl Reichardt and Paul Hazen.” He liked the pair of managers. Both managed costs wisely when profits were at record levels as well as when they are under pressure. Both managers did what they understood and did not let their egos determine what they attempt.

Buffett’s Berkshire purchases of Wells Fargo in 1990 were helped by investors’ flight away from bank stocks. Berkshire purchased a 10% interest in Wells Fargo for \$290 million, which was less than five times after-tax earnings. Interestingly, Buffett did a similar move to buy more Wells Fargo stock in 2010 for similar bargain reasons.

Wells Fargo is big, and it has been earning higher than average returns on equity and returns on assets. The purchase of one-tenth of the bank has been described as roughly equivalent to Berkshire buying 100% of a \$5 billion bank with identical financial characteristics.

Buffett described these risks. California banks face the specific risk of a major earthquake that could destroy banks. Another risk is a systemic risk. This almost came true during the great recession of 2008 and 2009. Buffett described this as: “the possibility of a business contraction or financial panic so severe that it would endanger almost every highly leveraged institution, no matter how intelligently run.”

In the recent financial crisis, WFC and other major banks were forced by the U.S. government to undergo stress tests and take infusions of cash in an effort to moderate the great credit crisis. Charlie Munger said Wells Fargo and U.S. Bancorp avoided many of the banking mistakes that led to the worldwide credit crisis and recession.

Buffett wrote that a meaningful drop in real estate values is unlikely to cause major problems for well-managed institutions. In late 1980s, the market's major fear was that West Coast real estate values would tumble because of overbuilding. Because WFC was and is a leading real estate lender, Wells Fargo is thought to be vulnerable. Fears of a California real estate disaster caused the price of Wells Fargo stock to fall almost 50% in 1990. He welcomed the decline because it allowed him to buy more shares at the new, panic prices.

Wells Fargo & Company (NYSE:WFC), is the fourth largest bank holding company in the United States. It is best classified as a diversified financial services company with over 80 distinct businesses. WFC offers a full range of financial products and services. It targets all types of clients in all 50 states and the District of Columbia.

In 2010, Wells Fargo earned a total of \$85 billion in total revenues and a net income of \$12.4 billion. After acquiring Wachovia, it became the nation's largest mortgage lender and the second-largest diversified financial service deposits firm in the United States.

As part of the TARP deal to raise enough cash for the Wachovia rescue acquisition, Wells Fargo's sold \$12.6 billion in common stock and \$25 billion in preferred stock to the US Government through the \$700 Billion Troubled Assets Relief Program (TARP).

Like all major banks, Wells Fargo has been negatively impacted by the credit crunch and the economic decline. However, Wells Fargo was not forced to write down large losses on its assets.

Wells Fargo raised \$12.25 billion in a stock sale to help repay the \$25 billion in Troubled Assets Relief Program (TARP) crisis money. Although this diluted Wells Fargo's shares by approximately ten percent, it allows the bank to avoid paying an annual dividend to the government of \$1.25 billion. This also frees WFC from added government oversight.

Wells Fargo separates its businesses into three main segments for revenue reporting purposes: 1.) Community Banking, 2.) Wholesale Banking, and 3.) Wealth, Brokerage, and Retirement. Wells Fargo's Community Banking business serves small business clients as well as retail customers. It also provides a wide range of services in investment, insurance, and trust services to high-net-worth individuals.

WFC offers its products through a variety of channels, including the company's regional banking branches, over 6,700 ATMs, website, and telephone banking service.

Wells Fargo's large credit card business, now part of its Community Banking, has issued over 7.7 million credit cards and over 20 million debit cards. This makes it the second largest debit card issuer in the U.S. As a credit card issuer, it charges interchange fees, interest on outstanding customer balances, and fees such as late or missing payment fees, exceeding credit limit fees, and monthly or annual membership fees.

Wells Fargo's Wholesale Banking Group serves business clients with annual sales exceeding \$10 million. Wholesale Banking is responsible for a line of corporate, commercial, and real estate banking products and services. This includes institutional investments, employee benefit trusts, investment banking, construction loans, and insurance.

After the Wachovia Bank acquisition, WFC was also able to expand its product services to include investment banking, equity trading, fixed income sales and trading, and equity and fixed-income research.

Wells Fargo has also teamed up with Visa (V) to pilot test a mobile payments system. Competition for mobile payments dominance between credit card companies and telecom companies may have huge implications for future earnings as this market develops.

Wells Fargo's mortgage lending business was hit by slow growth and falling residential real estate prices. The number of total housing starts fell about 63% since peak levels during the end of the housing boom. However, Wells Fargo dealt with mortgage setbacks relatively well due to its wide diversification in product offerings.

The housing slowdown is often attributed to the collapse of the subprime lending market. Wells Fargo fared better than most competitors in the mortgage business because its mortgages are predominately prime and near-prime. As a result, Wells Fargo did not experience the high rates of default seen in the subprime market. Wells Fargo has avoided much of these losses by deciding not to extend or purchase option adjustable rate mortgages (option ARMs). However, the Wachovia Bank, acquired by Wells Fargo at a bargain, took part in Option ARMs and subprime lending.

With 6,795 branches and \$760 billion in total domestic deposits, Wells Fargo focuses its business operations on the domestic U.S. market. Its major competitors include Bank of America (BAC), JP Morgan Chase (JPM), and Citigroup (C).

Wells Fargo is strongly focused on the United States market. Wells Fargo has less international exposure than its top competitors. While this does allow Wells Fargo to focus its resources on gaining greater market share within the U.S., it is more vulnerable to U.S. economic cycles. WFC does not have foreign markets to buffer domestic performance.

According to John Stumpf, Chairman and CEO, Wells Fargo's biggest competitive advantage is its employees. The company looks for talents in different cultures and backgrounds and provides them with the necessary training. Wells Fargo's culture recognizes and rewards an outstanding performance. As a result, twenty seven years is an average tenure for Wells Fargo's wholesale leadership members.

Wells Fargo also focuses on customer retention. It has over ten year long relationships with forty percent of its customers. Such high retention rates enable cross-selling of products. In 2009, an average number of products per wholesale relationship were 6.47, a steady increase from 4.84 in 2003.

Recently, WFC's 5Yr Net Profit Margin (5-Year Avg.) is approximately 15.4%, while the industry Net Profit Margin (5-Year Avg.) is 16.5%, and the S&P Net Profit Margin (5-Year Avg.) is 11.5%.

Wells Fargo also uses its size and financial reserves as a competitive advantage. The current economical crisis has shown that no bank is too big to fail. Therefore, Wells Fargo will have to stay with its core values by

focusing on its current customers and refrain from assuming too much risk in the mortgage market.

WESCO FINANCIAL CORPORATION COMPETITIVE ADVANTAGES

BUD LABITAN WITH STEPHEN CHAN, UNIVERSITY OF MANCHESTER

Wesco Financial Corporation has profitable operations in three main areas: the insurance business, the furniture rental business, and the steel industry. While it has been affected by the downturn in the macro economy, notice the moves it has done at Wes-FIC and CORT to build up its economic moat. Much of the data in this chapter is from the 2009 Wesco Annual Report.

Since 1973 it has been 80% equity controlled by Berkshire Hathaway, and Charlie Munger has been its chairman. In 2011, Wesco became a wholly owned subsidiary of Berkshire Hathaway. Charlie Munger said, “Wesco had a market capitalization of \$40 million when we bought it in the early 1970s. It’s (\$2.7 billion in total shareholders’ equity) now. It’s been a long slog to a perfectly respectable outcome - not as good as Berkshire Hathaway or Microsoft, but there’s always someone in life who s done better.”

In 1973, the directors approved the merger of Diversified Retailing Company, Inc. into Berkshire Hathaway Inc. Diversified operated a chain of popular-priced women’s apparel stores and conducted a reinsurance business. The most important asset at that time was a 16% ownership of the stock of Blue Chip Stamps. However, the Blue Chip’s trading stamp business has declined drastically.

Diversified had two important sources of earning power in its See’s Candy Shops subsidiary and Wesco Financial Corporation. Wesco was a 54% owned subsidiary engaged in the savings and loan business.

Now, Wesco has four major subsidiaries: (1) Wesco-Financial Insurance Company (“Wes-FIC”), headquartered in Omaha and engaged principally in the reinsurance business, (2) The Kansas Bankers Surety Company (“Kansas Bankers”), owned by Wes-FIC and specializing in insurance products tailored to Midwestern community banks, (3) CORT Business

Services Corporation (“CORT”), headquartered in Fairfax, Virginia and engaged principally in the furniture rental business, and (4) Precision Steel Warehouse, Inc. (“Precision Steel”), headquartered in Chicago and engaged in the steel warehousing and specialty metal products businesses.

Wesco sells primary insurance as well as reinsurance through two subsidiaries called Wesco-Financial Insurance Company (Wes-FIC) and The Kansas Bankers Surety Company.

Wesco operates its furniture rental division through a subsidiary called CORT Business Services Corporation. Cort offers a large selection of assorted office furniture to customers who can either lease or rent-to-own the products. Cort is covered in chapter 18.

The Industrial Segment for Wesco is operated through a subsidiary called Precision Steel that has plants in both Chicago, IL and Charlotte, NC. Revenues are generated through the purchase of raw metals that are then cut to a customer's specifications and sold. Precision steel specializes in producing niche steel products for a small number of customers.

During the second quarter of 2008, Wesco, like many other companies, felt the force of the financial crisis, posting a 22% drop in net income. Most of this decline is due to a reduced demand for its commercial property insurance services. However, in 2008, Wesco expanded its furniture rental segment's economic moat by purchasing Roomservice Group in the United Kingdom. It also purchased a division of Aaron Rents here in the United States.

The 2008 Financial Crisis and ensuing recession affected all segments of Wesco. In 2009, Wesco earned a total of \$813 million in total revenues. This was a modest increase from its 2008 total revenues of \$799 million. However, despite the slight increase in total revenues, Wesco's net income took a hit. Between 2008 and 2009, Wesco's net income declined from \$82 million in 2008 to \$54 million in 2009.

Insurance: During economic recoveries, businesses expand operations and seek to purchase the type of insurance offered by Wesco. During the downturns customers reduced their insurance coverage which negatively affected Wesco's revenue. Wes-FIC's underwriting results have typically fluctuated from year to year, but they have been satisfactory. When stated

as a percentage, the sum of insurance losses, loss adjustment expenses and underwriting expenses, divided by premiums, gives the combined ratio. A ratio below 100% indicates that the company is making underwriting profit while a ratio above 100% means that it is paying out more money in claims that it is receiving from premiums. Wes-FIC's combined ratios from reinsurance activities were 94.9% for 2009, 101.0% for 2008 and 93.9% for 2007. This is much better than the average for other insurers.

Kansas Bankers was purchased by Wes-FIC in 1996 for approximately \$80 million in cash. Its net worth now exceeds its acquisition price. It has been a profitable acquisition that reflects the good management by President Don Towle and his team.

Kansas Bankers was chartered in 1909 to underwrite deposit insurance for Kansas banks. Its offices are in Topeka, Kansas. Over the years its service has continued to adapt to the changing needs of the banking industry. It has offered insurance on bank deposits above the FDIC insurance level of \$100 K. Today, its customer base, consisting mostly of small and medium-sized community banks, is spread throughout 29 mainly Midwestern states.

Kansas Bankers offers policies for crime insurance, check kiting fraud indemnification, Internet banking catastrophe theft insurance, Internet banking privacy liability insurance, directors and officers liability, bank employment practices, and bank insurance agents professional errors and omissions indemnity.

Last year Wesco reported that events in the banking industry, including a number of bank failures, caused them to become less confident in the long-term profitability of Kansas Bankers' long-established line of deposit guarantee bonds. These deposit guarantee bonds insure specific customer bank deposits above Federal insurance limits. After sustaining a loss of \$4.7 million, after taxes, from a bank failure in the latter half of 2008, Kansas Bankers discontinued writing deposit guarantee bonds.

"In September 2008 it began to exit this line of insurance as rapidly as feasible. The aggregate face amount of outstanding deposit guarantee bonds has been reduced, from \$9.7 billion, insuring 1,671 institutions at September 30, 2008, to \$33 million, insuring 10 institutions." Wesco

managers believe that none of the current banks whose deposits are insured are facing significant risk of failure.

This decrease in exposure to loss has caused a sharp decline in Kansas Bankers' insurance volume. The premiums from guarantee bonds not only approximated half of Kansas Bankers' written premiums for 2008, but also represented the entirety of the business it had conducted in almost half of the states in which it was licensed to write insurance.

The insurance business is highly competitive, with lengthy periods during which competitors may offer coverages at prices irrationally. Kansas Bankers is now licensed to sell insurance in 29 states, down from 39 states one year earlier, with plans soon to withdraw from 4 more. Wesco management expects that Kansas Bankers will ultimately expand its premium volume, at decent prices.

When Wesco purchased Kansas Bankers, it had been ceding almost half of its premium volume to reinsurers. By 2009 this had shrunk to only about 1% needing additional reinsurance. And, because the Kansas Bankers unit has also restructured the layers of losses reinsured, it is now better protected from the downside risk of large losses. Effective in 2006, the insurance subsidiaries of Berkshire Hathaway became KBS's sole reinsurers. Previously, an unaffiliated reinsurer was also involved.

The increased volume of business retained comes with increased irregularity in the income stream. Kansas Bankers' combined ratios were 140.2% for 2009, 111.6% for 2008 and 55.1% for 2007.

Kansas Bankers' business activities require a base of operations supported by significant fixed operating costs which do not lend themselves to downsizing in proportion to the recent decline in premium volume. Wesco management continues to expect volatile but favorable long-term results from the now smaller business remaining in Kansas Bankers.

Furniture Rental: The same logic holds for this segment - during times of economic growth, businesses seek to acquire the necessary equipment for their offices. However, during periods of slower growth, Wesco will have to deal not only with diminishing demand but also with the increasing costs of holding furniture as inventory in warehouses.

Industrial: This segment, like the broader manufacturing industry, is intricately tied to consumer demand, which has historically diminished during economic downturns. These fluctuations are most strongly felt in the specialty stainless steel products produced by Wesco's Precision Steel Warehouses.

All that now remains outside Wes-FIC as a consequence of Wesco's former involvement with its Mutual Savings and Loan subsidiary, is a small real estate subsidiary called MS Property Company. That entity holds "tag ends of appreciated real estate assets" consisting mainly of the nine-story commercial office building and an adjacent multi-story luxury condominium building in downtown Pasadena.

Wesco Financial Corporation is a diversified financial corporation headquartered in Pasadena, California. It was originally a savings and loan association. Today, it operates through its insurance, furniture rental, and steel service center businesses. Unlike its larger competitors, Wesco specializes in producing niche steel products for a small number of customers. It is constantly expanding through time. The Company provides property and casualty insurance, as well as specialized insurance coverage for banks. Moreover, it provides rental furniture, accessories and related services to corporate and individual customers through its subsidiary CORT Business Services Corporation. Unlike its competitors, Wesco provides insurance for a wide range of assets.

Are the competitive advantages sustainable for the next 10 years? Wesco has shown that it can resize its insurance exposure, then ultimately expand its premium volume, at satisfactory prices. Wesco will perform profitably over time because of good systems and good management. It should do well because businesses will seek to purchase the type insurance and reinsurance offered by a tested and trusted partner like Wesco Financial Corporation and its subsidiaries.

When the business cycle turns upward, growing businesses will seek to acquire equipment for their offices from Wesco's Cort Business Services subsidiary. Precision Steel will sell more specialty steel products. And, Wesco will continue to compete and do well in selected insurance areas.

In the coming years, the economy may still fluctuate. However, with able trustworthy managers, specialty services in insurance, special business services, and special steel products, the Wesco franchise has “special” competitive advantages to ride these fluctuations and prosper.

XTRA CORPORATION COMPETITIVE ADVANTAGES

BUD LABITAN

XTRA Lease LLC is a leading provider of over-the-road trailers for rent or lease in the U.S. and Canada. XTRA leases freight transportation equipment. It has more than 65 North American locations. XTRA offers a fleet of about 80,000 trailers, including dry vans, flatbeds, reefers, storage trailers and specialty equipment. This includes over-the-road trailers, chassis, intermodal trailers, domestic containers, and marine containers.

XTRA leases to contract and common motor carriers, private fleet owners, and railroads. In addition, XTRA leases marine containers worldwide to steamship lines. It also offers value-added services for specified fees, including roadside assistance, various insurance alternatives, and trailer repair and maintenance.

It was founded in 1957 and it is headquartered in St. Louis, Missouri. XTRA's competitive advantage is their building solid customer relationships around their “Streetcorner Strategy” which is focused on each individual customer. This is restated here:

1. You need a trailer on a short-term basis. Perhaps it's your peak season. Or the rest of your fleet is committed and you have an emergency load. XTRA Lease is in "the emergency business" renting truck trailers.
2. You need to use your capital on something else besides trailers. XTRA Lease provides a wide variety of rental and lease options tailored to your requirements.

3. You need to evaluate a new technology, like trailer tracking, before making a decision. XTRA Lease's short-term rentals reduce the risk of trying out new specifications, equipment and technologies.

Charlie Munger has said, "For each of us, really good investment opportunities aren't going to come along too often and won't last too long, so you've got to be ready to act and have a prepared mind." In early 2000, Warren Buffett's friend, Julian Robertson, announced that he would terminate his investment partnership, Tiger Fund, and would liquidate it. One of the fund's assets was XTRA. Buffett called Julian, asking whether he might consider selling his XTRA block or whether, the management might entertain an offer for the entire company. Later, in June 2001, Robertson called to say that he had decided to sell his XTRA shares. The XTRA board accepted a proposal they made.

Trailer leasing is a cyclical business but one in which Berkshire Hathaway should earn decent returns over time. Founded in 1992 when two regional companies, AJF Leasing and Strick Lease, merged into one national company, XTRA has grown to more than 80 locations across the U.S. and Canada.

XTRA employs approximately 600 people. It manages a fleet of over 100,000 dry vans, chassis, flatbeds, storage vans and temperaturecontrolled vans.

XTRA claims the industry's first in-house 24-hour emergency road service, RoadWatch™ with its own employees, rather than out-sourcing. Another competitive advantage is XTRA's industry-changing Repair Cost Standards of 1997. Also, XTRA offers trailer tracking technology for all over-the-road van rentals.

XTRA introduced XTRA Xpress® in 2004 to provide faster service in its branches.

XTRA also reaches across the borders. XTRA Canada serves the provinces with five branch locations and a fleet that meets the unique requirements of the Canadian supply chains and highways.

In 2011, XTRA Lease ordered 6,000 new fuel-efficient trailers equipped with aerodynamic side skirts and low rolling resistance tires. This "moat-

building” addition will provide fleets access to new equipment and opportunities to lower their fuel costs. XTRA Lease will add both features on new trailers, 53-foot and longer.

Not only will the new trailers provide added fuel efficiencies, they’ll comply with California’s Greenhouse Gas regulation and are safe to enter and operate in that state without penalty.

“We’re continuing to invest in the industry,” said Bill Franz, XTRA Lease CEO and President. “As we did last year, we’re ordering new equipment again to meet our customers’ critical need to have the right trailers at the right time.”

“Access to new, quality equipment is significant for fleets unable to invest or acquire the capital needed to obtain new trailers, particularly coming out of the economic cycle we’ve been in and continue to endure,” Franz added. “As capacity tightens, we’re focused on having a fleet size, mix and model-year make-up that evolves, stays fresh and provides fleets with good, versatile, cost-saving options.”

Trailers equipped with aerodynamic side skirts and low rolling resistance tires will provide customers considerable fuel cost savings. Aerodynamic side skirts will save fleets an estimated five percent in fuel, based on EPA estimates.

Low rolling resistance tires can save an additional 1.5 percent in fuel, again based on a carrier’s trucking operation. Combined, the two features on XTRA Lease’s new trailers can save fleets 6.5 percent in fuel costs.

With more than 100,000 trailers and more than 80 locations to choose from, XTRA’s equipment availability is a competitive advantage of scale. This economy of scale and efficiency adds value and added safety for XTRA’s commercial customers.

Berkshire Hathaway’s leasing businesses are XTRA (transportation equipment) and CORT (office furniture). Both operations have had poor earnings during the past two years as the recession caused demand to drop considerably more than was anticipated. However, they remain leaders in their fields, and they continue to build up their moats.

FINAL NOTES

I hope you have found value in reading this book. We tried to gather and describe the competitive advantages within the major holdings of Berkshire Hathaway, Inc. MOATS can also serve as case review and discussion book for business schools. These 70 businesses show us that some have one moat and others have double and triple moats. Each of them can be used as a starting point for discussions on marketing strategy and competition.

Long-term competitive advantage in a stable industry is what Warren Buffett and Charlie Munger seek in a good business. It is the economic moat around each business castle. Warren Buffett said, “If that comes with rapid organic growth, great. But even without organic growth, such a business is rewarding. We will simply take the lush earnings of the business and use them to buy similar businesses elsewhere. There’s no rule that you have to invest money where you’ve earned it. Indeed, it’s often a mistake to do so: Truly great businesses, earning huge returns on tangible assets, *can’t* for any extended period reinvest a large portion of their earnings internally at high rates of return.”

Some of you will review certain chapters and use this book as a reference for future discussions. Pay attention to the businesses that were acquiring tuck-in acquisitions and building up their moats in the middle of this recent “great recession.”

Thanks again to the many research volunteers, editors, and students listed in the Appendix. I extend a special thanks to Professor Phani Tej Adidam, Ph.D. who is the Chair, Department of Marketing and Management, College of Business Administration, University of Nebraska at Omaha. Professor Adidam’s summer MBA students of 2011 have contributed valuable ideas to many of these chapters. Thank you Richard Konrad, CFA, of Value Architects Asset Management. Rick has been an insightful contributor to several chapters. Thank you Dr. Maulik Suthar of Gujarat, India. Maulik has been a thoughtful contributor to several chapters, and an enthusiastic supporter of this project. Thank you Scott Thompson, MBA

for sharing your thoughts, analysis, and feedback. Thank you Tim Bishop and Tony Taleff for proofreading and editing.

I am grateful to my family and friends for their careful reading of the manuscript. Finally, thank you Janie Rueth for your love and support.

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