# Notes on Warren Buffett Letters (1957-2014)

1957

1. Market analysis should not be the foremost thing in our minds. Primary attention should be given at all times to the direction of substantially undervalued securities.
2. Work- Outs -> Special Situations-> Sales, Mergers, Liquidation, trends etc. Buffett Partnership used to allocate 10% to 25% of their portfolio in these kinds of situations.
3. Value investors perform better in bear market than in bull market.
4. During any acquisition period, primary interest should be to have the stock do nothing or rather decline than advance. So, at any given time, a fair proportion of your portfolio may be in sterile stage.
5. Point made in 4, requires patience, and should maximize long term profits.

1958

1. Our performance for any single year has serious limitations as a basis for estimating long term results. However, a program of investing in undervalued well protected securities offer the surest means of long term profits.

1959

1. It is better to sustain penalties resulting from over-conservatism than face consequences of error, perhaps with permanent capital loss.
2. One should attempt to invest in situations at least partially insulated from the behaviour of general market. This philosophy will lead to superior results in bear market, and average performance in bull markets.

1960

1. Objective should always be to achieve a long-term performance record, superior to that of Industrial Average.
2. This average, over a period of years, will approximately parallel the results of leading investment companies.
3. Unless we do not achieve this superior performance, there is no need to invest.
4. A year where we decline 15% and the average decline 30% should be considered far superior to a year when both we and the average advance 20%.
5. Over a period of time, there will be good and bad years, so no point being too excited or depressed during those times respectively.
6. Example of a company engaged in publication & continuous revision of extremely detailed maps of all cities of USA was given. (Good example of a strong, durable but eroding moat).
7. Due to good investment portfolio, the above mentioned company withstood a business level crisis and Buffett could make a profitable exit. (Read the example thoroughly in the letter).
8. The example points to the necessity for secrecy regarding portfolio operations as well as futility of measuring results over a short span of time.
9. Our bread and butter business is buying undervalued securities and selling them when the undervaluation is corrected along with investment in special situations, where profit is dependent on corporate action rather than market action.

July, 1961

1. One year is far too short a period to form any kind of an opinion as to investment performance. Buffett talks about five year performance, preferred with a taste of both strong and weak markets.

Jan, 1962

1. It is very important that we use the same yardsticks for performance. Otherwise, almost everything can be made to look good in relation to something or other.
2. It is difficult at the time of purchase to know any specific reason why depressed securities should appreciate in price. But, because of this lack of glamour, they are available cheap.
3. The above point creates a comfortable margin of safety in each transaction.
4. Over the years, Buffett recollects, that his timing of purchase has been considerably better than timing of sell. But we should not go into these stocks with the idea of getting the last nickel, but we are usually content at selling out at an intermediate level between purchase price and what we regard as fair value to a private owner.
5. The above mentioned type of stocks are referred to as general stocks, they are positively co-related to Dow- Jones index. We have nothing to say about their corporate policies & no time-table as to when the undervaluation may correct itself.
6. You will not be right simply because a large number of people momentarily agree with you. You will not be right simply because important people agree with you. In many quarters, the simultaneous occurrence of these two factors is enough to make a course of action, to meet the test of conservatism. But, true conservatism is only possible through knowledge and reason.
7. Not having a conventional portfolio does not prove that we are more conservative or less conservative. It can be determined only by examining the methods or examining the results.
8. Increased funds can be disadvantageous in situations like generals & work-outs, but advantageous i situation of control.
9. “Sanborn Map” example in earlier letters was a classic example of advantageous situation in control.
10. Over any long period of years, Dow will probably produce something like 5% to 7% per year compounded from a combination of dividend & market value gain. Anyone expecting substantially better than that from the general market, probably faces disappointment.

July, 1962

1. Investment performance must be judged over a period of time with such a period including both advancing and declining markets.

Nov, 1962

1. Our performance is mainly the result of having a large portion of our money in controlled assets and special situations rather than general market situations at a time when the Dow declined substantially. If Dow had advanced materially in 1962, we could have looked very bad on the relative basis and our success to date in 1962 certainly does not reflect any ability on my part to guess the market (I never try), but merely reflects the fact that the high prices of generals partially forced me into other categories or investment.
2. I certainly do not want anyone to think that the pattern of the last few years is likely to be repeated. I expect future performances to reflect much smaller advantages on average over the Dow.

Jan, 1963

1. Whenever we talk of yearly gains or losses, we are talking about market values, that is, how we stood on the same basis at the beginning of the year. This may bear very little relationship to the realized results for tax purpose in a given year.
2. I am not in the business of predicting general stock market or business fluctuations. If you think I can do this, or think it is essential to an investment program, you should not be in the partnership.
3. Instead of focussing much on results, we should try:
   1. To choose investments on the basis of value, not popularity.
   2. Attempt to bring risk of permanent capital loss (not short term quotation loss) to an absolute minimum by obtaining a wide margin of safety in each commitment and a diversity of commitments.
4. Many times generals represent a form of “coattail riding” where we feel the dominating stock holder group has plans for the conversion of unprofitable or under-utilized assets to a better use. Not only does the value have to be ample in a case like this, we also have to be careful as to whose coat we are holding.
5. By buying assets at a bargain price, we don’t need to pull any rabbits out of a hat to get extremely good percentage gains. This is the cornerstone of our investment philosophy:- “Never count on making a good sale. Have the purchase price to be so attractive that even a mediocre sale gives good results. The better sales will be the frosting on the cake.”

July, 1963

No Points

Nov, 1963

No Points

Jan, 1964

1. Read about “Dempster Mill Manufacturing” in the Appendix section of the letter.
2. Dempster saga points up several morals:
   1. Investing is a business which requires patience.
   2. It has little in common with a portfolio of high-flying glamour stocks and during periods of popularity for the latter, we may appear quite stodgy.
   3. It is to our advantage to have securities do nothing price wise for months, or perhaps years, while we are buying them. This fact points up the need to measure our results over an adequate period of time.

July, 1964

1. It is essential that investors establish standards of performance and regularly and objectively study their own results just as carefully as they study their investments.

Jan, 1965

1. A fellow applied for an investment job and stated he had 20 years of experience- which are corrected by the former employer to read, “one year’s experience-twenty times”.
2. The first job of any investment management organization is to analyze its own techniques and results before pronouncing judgement on the management abilities and performance of the major corporate of the USA.
3. Lack of performance in many investment organization is due to:
   1. Group Decision: It is impossible for outstanding investment to come from a group.
   2. A desire to confirm to the policies and (to an extent) the portfolios of other large well-regulated organizations.
   3. An institutional framework whereby average is “safe” and the personal rewards for independent action are in no way commensurate with the general risk attached to such action.
   4. An adherence to certain diversification practices which are irrational.
   5. Inertia
4. Both our partners and stockholders feel their managements are seeking the same goal- the maximum long-term average return on capital obtainable with the minimum risk of permanent loss consistent with a program of continuous investment in equities.
5. It is of enormous dollars and cents importance to evaluate objectively the accomplishments of the fellow who is actually handling your money-even if it’s you.
6. It is unquestionably true that the investment companies have their money more conventionally invested than we do. To many people, conventionally is indistinguishable from conservatism. Neither a conventional nor an unconventional approach per se is conservative. Truly conservative actions arise from intelligent hypothesis, correct facts and sound reasoning. These qualities may lead to conventional acts, but there have been many times, when they have led to unorthodoxy. In some corner of the world they are probably still holding regular meetings of the Flat Earth Society. We derive no comfort because important people, vocal people or great numbers of people agree with us. Nor do we derive comfort if they don’t. A public opinion poll is no substitute for thought. When we really sit back with a smile on our face is when we run into a situation we can understand, where the facts are ascertainable and clear, and the course of action obvious. In that case- whether they are conventional or unconventional-whether they agree or disagree-we feel- we are progressive in a conservative manner. In any event, evaluation of the conservatism of any investment program or management (including self- management) should be based upon rational objective standards, and I suggest performance in declining markets to be at least one meaningful test.
7. Read the Manhattan Indians story to understand the Joys of compounding.
8. My own investment philosophy has developed around the theory that prophecy reveals far more of the frailties of the prophet than it reveals of the future.
9. Buffett demonstrates the fallacy of tax saving financial instruments and their lack of performance.

July, 1965

1. Our constant admonitions have been:
   1. That short term results ( less than 3 years) have little meaning, particularly in reference to an investment operation such as ours that may devote a portion of resources to control situations
   2. That our results, relative to the Dow and other common-stock-from media usually be better in declining markets and may well have a difficult time just matching such media in a very strong bull markets.
2. You are always entitled to know when I am wrong as well as right. It demonstrates that although we deal with probabilities and expectation, the actual results can deviate substantially from such expectations, particularly on a short-term basis.

Nov, 1965

No Points

Jan, 1966

1. A disadvantage of investment business is that it does not possess momentum to any significant degree. If General Motors accounts for 54% of domestic new car registrations in 1965, it is pretty safe bet that they are going to come fairly close to that figure in 1966 due to owner loyalties, dealer capabilities, productive capacity, consumer image, etc. Not so for Buffett Partnership Limited (BPL). We start from scratch each year with everything valued at market when the gun goes off.
2. The success of past methods and ideas does not transfer forward to future ones.
3. Our business is that of ascertaining facts and then applying experiences and reason to such facts to reach expectations. Imprecise and emotionally influenced as our attempts may be, that is what business is all about. The results of many years of decision making in securities will demonstrate how well you are doing on many calculations-whether you consciously realize you are making the calculations or not. I believe the investor operate at a distinct advantage when he is aware of what path his thought process is following.
4. Buffett talks about how diversification beyond a point is of no use. In fact, beyond a point diversification hurts performance.
5. The literature of investment management is virtually devoid of material relating to deductive calculation of optimal diversification. All texts counsel “adequate” diversification, but the ones who quantify “adequate” virtually never explain how they arrive at their conclusion. Hence, for our summation on over-diversification, we turn to that eminent academician Billy Rose, who says, “You’ve got a harem of seventy girls; you don’t get to know any of them very well.

July, 1966

1. If ‘conservative’ is interpreted to mean “productive of results varying only slightly from average experience”, I believe the characterization is proper. Such results are always bound to flow from wide diversification among high grade securities. Since, over a long period, “average experience” is likely to be good experience, there is nothing wrong with the typical investor utilizing this form of investment routine.
2. However, I believe that conservatism is more properly interpreted to mean “subject to substantially less temporary and permanent shrinkage in value than total experience”.
3. The first interpretation might be better labelled “conventional”. What it really says is that, “when others are making money in the general run of securities, so will we and to about the same degree; when they are losing money, we will do it about the same rate”. This is not to be equated with “when others are making it, we will make as much and when others are losing it, we will lose less”. Very few investment programs accomplish the latter-we certainly don’t promise it but we intend to keep trying.
4. We don’t buy or sell stocks based upon what other people in the stock market are going to do ( I never have an opinion) but rather upon what we think the company is going to do. The course of the stock market will determine to a great degree, when we will be right, but the accuracy of our analysis of the company will largely determine whether we will be right.
5. We tend to concentrate on what should happen, not when it should happen.
   1. The future has never been clear to me (give us a call when the next few months are obvious to you-or, for that matter the next few hours).
   2. No one ever seems to call after the market has gone up one hundred points to focus my attention on how unclear everything is.
6. We will not sell our interests in businesses (stocks) when they are attractively priced just because some astrologer thinks the quotations may go lower even though such forecasts are obviously going to be right some of the time. Similarly, we will not buy fully priced securities because “experts” think prices are going higher.

Jan, 1967

1. We will not follow the frequently prevalent approach of investing in securities where an attempt to anticipate market action overrides business valuations. Such so-called “fashion” investing has frequently produced very substantial and quick profits in recent years. It represents an investment technique whose soundness I can neither affirm nor deny. It does not completely satisfy my intellect (or perhaps my prejudices), and most definitely does not fit my temperament.

July, 1967

No points

Oct, 1967

1. There are both quantitative and qualitative factors in investment. Although I consider myself to be primarily in the quantitative school, the really sensational ideas I have had over the years have been heavily weighted towards the qualitative side where I have had a “high-probability insight”. The really big money tends to be made by investors who are right to qualitative decisions but, at least in my opinion, the more sure money tends to be made on the obvious quantitative decisions. But such statistical bargains have tended to disappear over the years.
2. I will not abandon a previous approach whose logic I understand (although I find it difficult to apply even though it may mean foregoing large and apparently easy profits to embrace an approach which I don’t fully understand, have not practiced successfully and which possibly, could lead to substantial permanent loss of capital.

Jan, 1968

No points

July, 1968

1. Buffett ridicules the chain-letter type stock promotion vogue and advises people to read the book, “The Money Game” by Adam Smith

Jan, 1969

1. Buffett makes fun of one investment manager representing an organization handling mutual funds aggregating well over one billion dollar. The same manager upon launching a new advisory service said, “The complexities of national and international economics make money management a full time job. A good manager cannot maintain a study of securities on a week-by-week or even a day-by-day basis. Securities must be studied in a minute-by-minute program.”
2. In making our retrospective survey of our financial assets, our conclusion need not parallel that of Gypsy Rose Lee who opined, when receiving her physical assets on her fifty fifth birthday, “I have everything I had, twenty years ago-it’s just that it’s all lower.”

May, 1969

1. It seems to me that :
   1. Opportunities for investments are open to the analyst who stress quantitative factors have virtually disappeared, after rather steadily drying up over the past twenty years.
   2. Our $100 million of assets further eliminates a large portion of this seemingly barren investment world, since commitments of less than about $3 million cannot have a real impact on our overall performance, and this virtually rules out companies with less than about $100 million of common stock at market value.
   3. A swelling interest in investment performance has created an increasingly short-term oriented and (in my opinion) more speculative market.

Oct, 1969

1. There is no way to eliminate the possibility of error when judging humans particularly in regard to further behaviour in an unknown environment. However, decisions have to be made-whether actively or passively-and I consider Bill to be an exceptionally high probability decision on character and a high probability one on investment performance. I also consider it likely that Bill will continue as a money manager for many years to come.
2. For the first time in my investment lifetime, I now believe there is little choice for the average investor between professionally managed money in stocks and passive investment in bonds.
3. Ben Graham said, “In the long run, the market is a weighing machine-in the short run, a voting machine”. I have always found it easier to evaluate the weghts dictated by fundamentals than votes dictated by psychology.

5th Dec, 1969

The textile operation presently employs $16 per share in capital and, while I think it has made some progress relative to the textile industry generally, cannot be judged as a satisfactory business. Its return on capital has not been sufficient to support the assets employed in the business and, realistically, an adequate return has less than an even chance of being averaged in the future. It represents the best segments of business that exited when we purchased control four and half years ago. Capital from other segments has been successfully redeployed-first on an interim basis into marketable securities and now on a permanent basis into insurance and banking. I like the textile operating people- they have worked hard to improve the business under difficult conditions-and, despite the poor returns, we expect to continue the textile operations as long as it produces near current levels.

26th Dec, 1969

If we are not getting a good return on the textile business of Berkshire Hathway Inc, why do we continue to operate it? I don’t want to liquidate a business employing 1100 people when the management has worked hard to improve their relative industry position, with reasonable results, and as long as the business does not require substantial additional capital investment. I have no desire to trade several human dislocations for a few percentage points additional return per annum. Obviously, if we faced material compulsory additional investment or sustained operating losses, the decision might have to be different, but I don’t anticipate such alternatives.

25th Feb, 1970

This letter is all about Tax Exempt Bonds. I found it a little difficult to understand and also lost interest. So no points noted.

1970

1. Four years ago, your management committed itself to the development of more substantial and more consistent earning power than appeared possible if capital continued to be invested exclusively in the textile industry. The funds for this program were temporarily utilized in marketable securities, pending the acquisition of operating business meeting our investment and management criteria.
2. The above policy has proved reasonably successful-particularly when contrasted with results achieved by firms which have continued to commit large sums of textile expansion in the face of totally inadequate returns. We have been able to conclude two major purchases of operating business, and their successful operations enabled Berkshire Hathway to achieve an over-all return of more than 10% on average stockholder’s equity last year in the face of our capital employed in the textile business.

1971-1976

No specific points. Just read to get to understand how Berkshire Hathway faired in each of its business segments.

1977

1. Capital gain or losses realized directly by Berkshire Hathaway or its insurance subsidiaries are not included in our calculation of operating earnings. While too much attention should not be paid to the figure for any single year, over the longer term, the record regarding aggregate capital gains or losses obviously is of significance.
2. Most companies define “record” earnings as a new high in EPS. Since business add year to year to their equity base, we find nothing particularly noteworthy in a management performance combining say, a 10% increase in equity capital and a 5% increase in EPS. After all, even a total dormant saving account will provide steadily rising interest earnings each year because of compounding.
3. Except for special case ( for example, companies with unusual debt-equity ratios, or those with important assets carried at unrealistic Balance Sheet Values) we believe a more appropriate measure of managerial economic performance to be return on equity capital.
4. We select our marketable equity securities in much the same way we would evaluate a business for acquisition in its entirety. We want the business to be:
   1. One that we understand
   2. With favourable long term prospects
   3. Operated by honest and competent people
   4. Available at a very attractive price
5. We ordinarily make no attempt to buy securities for anticipated favourable stock price behaviour in the short term. In fact, if their business experience continues to satisfy us, we welcome lower market prices of stocks we own as an opportunity to acquire even more of a good thing at a better price.
6. Our experience has been that pro-rata portions of truly outstanding businesses sometimes sell in the securities markets at very large discounts from the price they would command in negotiated transactions involving entire companies. Consequently, bargains in business ownership, which simply are not available directly through corporate acquisition, can be obtained indirectly through stock ownership.
7. When prices are appropriate, we are willing to take very large positions in selected companies, not with any intentions of taking control and not foreseeing sell-out or merger but with the expectation that excellent business results by corporations will translate over the long term into corresponding excellent market value and dividend results for owners, minority as well as majority.

1978

1. Textile plant and equipment are on the books for a very small fraction of what it would cost to replace such equipment today. And despite the age of the equipment, much of it is functionally similar to new equipments being installed by the industry. But despite this bargain cost of fixed assets, capital turnover is relatively low reflecting required high investment levels in receivables and inventory compared to sales.
2. Slow capital turnover, coupled with low profit margins on sales, inevitably produces inadequate return on capital.
3. Obvious approaches to improved profit margins involve:
   1. Differentiation of product
   2. Lowered manufacturing cost through efficient equipment or better utilization of people.
   3. Redirection towards fabrics enjoying stronger market trends.

Our management is diligent in pursuing such objectives. The problem, of course, is that our competitors are just as diligently doing the same thing

1. The textile industry illustrates in textbook style how products of relatively undifferentiated goods in capital intensive business must earn inadequate returns except under conditions of tight supply or real shortages. As long as excess productive capacity exists, prices tend to reflect direct operating costs rather than capital employed. Such a supply excess condition appears likely to prevail most of the time in the textile industry, and our expectations are for profits of relatively modest amounts in relation to capital.
2. Buffett talks about not getting into any business like textile because of such tough economic characteristics. But due to the reasons mentioned earlier, he continues to support textile business despite availability of more attractive alternate use of capital.
3. Referring to Point No 4 of the Notes of 1977 letter, Buffett says: “we can usually identify a small number of potential investments meeting requirements 1,2 and 3, but 4 often prevents action.
4. It seems quite clear to us that either corporations are making very significant mistakes in purchasing entire businesses at prices prevailing in negotiated transactions and takeover bids, or that we eventually are going to make considerable sums of money buying small proportions of such businesses at the greatly discounted valuations prevailing in the stock market.
5. We are not concerned with whether the market quickly revalue upward securities that we believe are selling at bargain prices. In fact, we prefer just the opposite since, in most years, we expect to have funds available to be a net buyer of securities. And consistent attractive purchasing is likely to prove to be of more eventual benefit to us than any selling opportunities provided by a short-term run up in stock prices to levels at which we are unwilling to continue buying.
6. Our policy is to concentrate holdings. We try to avoid a little of this or that when we are only lukewarm about the businesses or its price. When we are convinced as to attractiveness, we believe in buying worthwhile amounts.
7. While there may be less excitement and prestige in sitting back and letting others do the work, we think that is all one loses by accepting a passive participation in excellent management. Because, quite clearly, the proper policy would be to sit back and let management do its job.
8. We are not at all unhappy when our wholly-owned businesses retain all of their earnings if they can utilize internally those funds at attractive rates. Why should we feel differently about retention of earnings by companies in which we hold small equity interests, but where the record indicates even better prospects for profitable employment of capital? (This proposition cuts the other way, of course, in industries with low capital requirements or if management has a record of ploughing capital into projects of low profitability, then earnings should be paid out or used to repurchase shares-often by far the most attractive option for capital utilization).
9. Our experience has been that the manager of an already high-cost operation frequently is uncommonly resourceful in finding new ways to add to overhead, while the manager of a tightly-run operations usually continues to find additional methods to curtail costs, even when his costs are already well below those of his competitors.
10. Ben is now 75 and like Gene Abegg,81 at Illinois National and Louie Vincent,73, at Wesco, continues daily to bring an almost passionately proprietary attitude to the business. This group of top managers must appear to an outsider to be an over-reaction on our part to an OEO bulletin on age discrimination. While unorthodox, these relationships have been exceptionally rewarding, both financially and personally. It is a real pleasure to work with managers who enjoy coming to work each morning and, once there, instinctively and unerringly think like owners. We are associated with some of the very best.

1979

1. The primary test of managerial economic performance is the achievement of a high earnings rate on equity capital employed (without under leverage, accounting gimmickry etc) and not the achievement of consistent gains in EPS.
2. In measuring long-term performance- in contrast to yearly performance, we believe it is appropriate to recognize fully any realized capital gains or losses as well as extraordinary items, and also to utilize financial statements presenting equity securities at market value. Such capital gains or loss, either realized or unrealized, are fully as important to shareholder over a period of years as earnings realized in a more routine manner through operation, it is just that their impact is often extremely capricious in the short run, a characteristic that makes them inappropriate as an indicator of single year managerial performance.
3. The combination of inflation rate plus the % of capital that must be paid by the owner transfer into his own pocket the annual earnings achieved by the business (i.e. ordinary income tax on dividends and capital gains tax on retained earnings)- can be thought of as an “investor’s misery index”. When this index exceeds the rate of return earned on equity by the business, the investor’s purchasing power (real capital) shrinks even though he consumes nothing at all. We have no corporate solution to this problem; high inflation rates will not help us earn high rates of return on equity.
4. Despite a fancy tag, the “easy” business may be the better route to go. Both our operating and investment experience cause us to conclude that “turnarounds” seldom turn, and that the same energies and talent are much better employed in a good business purchased at a fair price than in a poor business purchased at a bargain price.
5. Philip Fisher, a respected investor and author, once likened the policies of the corporation in attracting shareholders to those of a restaurant attracting potential customers. A restaurant could seek a given clientele-patrons of fast foods, elegant dining, oriental food, etc-and eventually obtain an appropriate group of devotees. If the job was expertly done, that clientele, pleased with the service, menu and price level offered, would return consistently. But the restaurant could not change its character constantly and end up with a happy and stable clientele. If the business vacillated between French cuisine and take-out chicken, the result would be a revolving door of confused and dissatisfied customers.
6. Buffett in the end of the letter talks about the benefits of having a centralization of financial decisions at the very top and extreme delegation of operating authority to a number of key managers:-
7. It eliminates large layers of costs and dramatically speeds decision making.
8. Because everyone has a great deal to do, a very great deal gets done.
9. It enables to attract and retain some extra-ordinary talented individuals-people who simply can’t be hired in the normal course of events-who find working for Berkshire to be almost identical to running their own show. We have placed much trust in them-and their achievements have far exceeded that trust.

1980

1. We evaluate single year performance by comparing operating earnings to shareholder’s equity with securities valued at cost. Our long-term yardstick of a performance, however, includes all capital gains or losses, realized or unrealized. We continue to achieve a long term ROE that considerably exceeds the average of our yearly returns. The major factor causing this pleasant result is a simple one:- Retained earnings of non-controlled holdings, (the retained earnings of which are not reflected in accounts) have been translated into gains in market value.
2. Earnings reported in corporate financial statements are no longer the dominant variable that determines whether they are real earnings for you, the owner. For any gains in purchasing power represent real earnings on investment. If you
   1. Forego ten hamburgers to purchase an investment,
   2. Receive dividends, which after tax buy two hamburgers, and
   3. Receive upon sale of your holdings after-tax proceeds that will buy youeight hamburgers, then,
   4. You have had no real income from your investment, no matter how much it appreciated in dollars. You may feel richer but you won’t eat richer.
3. As we said last year, Berkshire has no corporate solution to the problem of inflation. (we will say it again next year). Inflation does not improve our ROE.
4. For capital to be truly indexed, ROE must rise and business earnings consistently must increase in proportion to the increase in price level without any need for business to add capital-including working capital-employed. (Increased earnings produced by increased investment don’t count). Only a few businesses come close to exhibiting this ability. And Berkshire Hathaway isn’t one of them.
5. Our conclusion is that, with a few exceptions, when a management with reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact.

1981

1. As our history indicates, we are comfortable both with total ownership of businesses and with marketable securities representing small portions of businesses. We continually look for ways to employ large sums in each area. (But we try to avoid small commitments-“If something’s not worth doing at all, it’s not worth doing well”.)
2. Our acquisition decisions will be aimed at maximising either managerial domain or reported number for acquisition purposes. (In the long run, management stressing accounting appearance over economic substance usually achieve little of either).
3. Regardless of the impact upon reportable earnings, we would rather buy 10% of wonderful business T at X per share than 100% of T at 2X per share. Most corporate managers prefer just the reverse, and have no shortage of stated rationales for their behaviour.
4. We suspect three motives-usually unspoken to be, singly or in combination, are the important ones in most high-premium takeovers
   1. Leaders seldom are deficient in animal spirits and often relish increased activity and challenge.
   2. Most organizations measure themselves on the basis of others and compensate their managers far more by the yardstick of size than by any other yardstick.
   3. Many managers apparently were over exposed in impressionable childhood years to the story in which the imprisoned handsome prince is released from a toad’s kiss from a beautiful princess.
5. Investors can always buy toads at the going price for toads. If investors instead bankroll princesses who wish to pay double the right to kiss the toad, those kisses had better pack some real dynamite. We’ve observed many kisses but very few miracles. Nevertheless, many managerial princesses remain serenely confident about the future potency of their kisses-even after their corporate backyards are knee-deep in unresponsive toads.
6. In fairness we should acknowledge that some acquisition records have been dazzling. Two major categories stand out:
   1. Companies that through design or accident have purchased only businesses that are particularly well adapted to an inflationary environment. Such favoured business must have two characteristics:
      1. An ability to increase prices rather easily without fear of significant loss of either market share or unit volume, and
      2. An ability to accommodate large dollar volume increases in business (often produced more by inflation than by real growth) with only minor additional investment of capital. Managers of ordinary ability, focusing solely on acquisition possibilities meeting these tasks, have achieved excellent results in recent decades.
   2. Managerial Superstars: These are men who can recognize that rare prince who is disguised as a toad, and who have managerial abilities that enable them to peel away the disguise. We salute such managers.
7. From both direct and vicarious experience, we recognize the difficulty and rarity of these executives’ achievements. (so do they, these champs have made very few deals in recent years, and often have found repurchase of their own shares to be the most sensible employment of corporate capital)
8. Our preaching was better than our performance. ( We neglected the Noah principle:- predicting rain doesn’t count, building arks does)
9. We have tried occasionally to buy toads at bargain prices with results that have been chronicled in past reports. Clearly our kisses fell flat. We have done well with a couple of princess-but they were princess when purchased. At least our kiss didn’t turn them into toads. And finally, we had occasionally been quite successful in purchasing fractional interests in easily identifiable princess at toad-like prices.
10. We expect that undistributed earnings from companies will produce full value (subject to tax when realized) for Berkshire and its shareholders. If they don’t, we have made mistakes as to either:
    1. The management we have elected to join; or
    2. The future economics of the business;
    3. The price we have paid
11. Like virginity, a stable prices level seem capable of maintenance, but not of restoration.
12. Because of unrelenting destruction of currency value, our corporate efforts will continue to do a much better job of filling your wallet than of filling your stomach.
13. While investors and managers must place their feet in the future, their memories and nervous systems often remain plugged into the past. It is much easier for investors to utilize historic P/E ratios or for managers to utilize historic business valuation yardsticks than it is for either group to rethink their premises daily. When change is slow, constant rethinking is actually undesirable; it achieves little and slow response time. But when change is great, yesterday’s assumptions can be retained only at great cost. And the pace of economic change has become breathtaking.

1982.

1. We prefer a concept of “economic” earnings that includes all undistributed earnings, regardless of ownership percentage. In our view, the value to all owners of the retained earnings of a business enterprise is determined by the effectiveness with which those earnings are used-and not by the size of one’s ownership percentage.
2. Managers and investors alike must understand that accounting numbers are the beginning, not the end, of business valuation.
3. It is our business with economic characteristics allowing each dollar of retained earnings to be translated eventually into at least a dollar of market value.
4. As we look at major acquisitions that others made during 1982, our reaction is not envy, but relief that we were non-participants. For, in many of these acquisitions, managerial intellect wilted in competition with managerial adrenalin. The thrill of the chase blinded the pursuers to the consequences of the catch. Pascal’s observation seems apt: “It has struck me that all men’s misfortunes spring from the single cause that they are unable to stay quietly in one room.”
5. The market, like the lord, helps those who help themselves. But, unlike the Lord, the market does not forgive those who know not what they do. For the investors, a too-high purchase price for the stocks of an excellent company can undo the effects of a subsequent decade of favourable business developments.
6. Year to year variances, however, cannot consistently be in our favour. Even if our partially-owned businesses continue to perform well in economic sense, there will be years when they perform poorly in the market. At such times our net-worth could shrink significantly. We will not be distressed by such shrinkage, if the business continues to look attractive and we have cash available, we simply add to our holdings at even more favourable prices.
7. To understand the change, we need to look at some major factors that affect levels of corporate profitability generally. Business 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. These may be escaped, true, if prices or costs are administered in some manner and thereby insulated at least partially from normal market forces. This administration can be carried out
   1. Legally through government intervention
   2. Illegally through collusion; or
   3. “extra-legally” through OPEC-style foreign cartelization

If, however, costs and prices are determined by full-bore competition, there is more than ample capacity, and the buyer cares little about whose product or distribution services he uses, industry economics are almost certain to be unexciting. They may well be disastrous.

1. 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. By definition, such exceptions are few, and in many industries, are non-existent. For the great majority of companies selling “commodity” products, a depressing equation of business economics prevails: - persistent over-capacity without administered prices (or costs) equals poor profitability.
2. What finally determines levels of long term profitability in such industries is the ratio of supply-tight to supply-ample years. Frequently, that ratio is dismal. In some industries, however, capacity-tight conditions can last a long time. Sometimes actual growth in demand will outrun forecasted growth for an extended period. In other cases adding capacity requires very long lead times because complicated manufacturing facility must be planned and built.
3. Buffett explains how over-supply has troubled the insurance sector as well. He adds further that the supply of available insurance coverage must be curtailed. “Supply”, in this context, is mental rather than physical: plants or companies need not be shut; only the willingness of underwriters to sign their names needs to be curtailed.
4. In a market like mentioned above, major capacity withdrawals require a shock factor such as a natural or financial “MEGADISASTER”. One might occur tomorrow or many years from now.
5. When supply ultimately contracts, large amounts of business will be available for the few with large capital capacity, a willingness to commit it, and in-place distribution system.
6. In case of mergers and acquisitions, the thirst for size and action is strong enough for the acquirer’s manager to find ample rationalizations for such a value-destroying issuance of stock. Friendly irrelevant bankers will reassure him as to the soundness of his actions. ( Don’t ask the barber whether you need a haircut).
7. A few favourite rationalizations employed by stock issuing managements follow:
   1. The company we are buying is going to be worth a lot more in the future.
   2. We have to grow
   3. Our stock is undervalued and we have minimised its use in the deal-but we need to give the selling shareholders 51% in stock and 49% in cash so that certain of those shareholders can get tax-free exchange they want
8. While deals often fail in practice, they never fail in projections-if the CEO is visibly panting over a prospective acquisition, subordinated and consultants will supply the requisite projections to rationalize any price.

1983

1. Buffett summarizes the major business principles followed by Berkshire:
   1. Form is corporate but attitude is partnership. Shareholders are owner partners while Chairman and Vice Chairman are managing partners.
   2. Long term economic goal (subject to qualifications) is to maximize the average annual rate of gain in intrinsic value on a per share basis. Per-share progress is preferred to size as a benchmark. With a greatly enlarged capital base, rate of per-share progress will diminish in the future, but this rate would certainly be much better than average large American Corporations.
   3. Two Modus of Operandi:
      1. First: Directly owning a diversified group of businesses.
      2. Second: Owning part of wonderful business at bargain prices.
   4. Accounting consequences do not influence our operating and capital-allocation decisions.
   5. Minimal debt is used, and whenever used, it is structured on a long term fixed rate basis. We will reject interesting opportunities rather than over-leverage our Balance Sheet.
   6. A managerial “wish list” will not be filled at shareholder’s expense
   7. Importance of checking retained earnings: We test the wisdom of retained earnings by assessing whether retention, over time, delivers shareholders at least $1 of Market Value for each $1 retained. We will continue to apply it on a 5 year rolling basis.
   8. We will issue common stock only when we receive as much in business value as we give.
   9. Regardless of price, we have no interest at all in selling any good business
   10. Good investment ideas are rare, valuable and subject to competitive appropriation just as good product or business acquisition ideas are. Therefore, we normally will not talk about our investment ideas.
2. In appraising the business model of Nebraska Furniture Mart, Buffett says: - “One question I always ask myself in appraising a business is how I would like, assuming I had ample capital and skilled personnel, to compete with it. I would rather wrestle grizzlies than compete with Mrs. B and her progeny. 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. It’s the ideal business-one built upon exceptional value to customers that in turn translates into exceptional economics for its owners.”
3. It is important to understand that book value and intrinsic value have very different meanings. Book value is an accounting concept, regarding the accumulated financial input from both contributed capital and retained earnings. Intrinsic business value is an economic concept, estimating future cash output discounted to present value. Book value tells you what has been put in. Intrinsic business value estimates what can be taken out.
4. You can live a full and rewarding life without even thinking about Goodwill and its amortization. But students of investment and management should understand the nuances of the subject. My own thinking has changed drastically from 35 years ago when I was taught to favour tangible assets and shun businesses whose value depends upon economic goodwill. This bias caused me to make many important business mistakes of omission although relatively few of commission.
5. Keynes identified my problem, “The difficulty lies not in the new ideas but in escaping from the old ones.” My escape was long delayed, in part because most of what I had been taught by the same teacher had been (and continues to be) so extraordinarily valuable. Ultimately business experience, direct and vicarious, produced my present strong preference for business that possesses large amounts of enduring goodwill and that utilize a minimum amount of tangible assets.
6. We believe a newspaper’s penetration ratio to be the best measure of the strength of its franchise. Papers with unusually high penetration in the geographical area that is of prime interest to major local retailers and with relatively little circulation elsewhere, is exceptionally efficient buys for those retailers. Low-penetration papers have a far less compelling message to present to advertisers.
7. We regard the most important measure of retail trends to be units sold per stores rather than dollar volume.
8. Buffett talks about the fallacy of stock splits and hyper activity in stock market.
9. Hyperactive equity markets subvert rational capital allocation and act as pie-shrinkers. Adam Smith felt that non collusive acts in a free market were guided by an invisible hand that led an economy to maximum progress; our view is that casino-type markets and hair-trigger investment management act as an invisible foot that trips up and slows down a forward-moving economy.
10. Notes from the Appendix-Goodwill & its Amortization:- The rules and realities
    1. Purchase Price-Net Asset Acquired = Accounting Goodwill. This accounting goodwill is amortized for a fixed period.
    2. Businesses logically are worth far more than net tangible assets when they can be expected to produce earnings on such assets considerably in excess of market rates of return. The capitalized value of this excess return is economic goodwill. Read the Blue Chip Stamps bought See’s candy case to fully understand the effect.
    3. A good business is not always a good purchase-although it’s a good place to look for one.

1984

1. When companies with outstanding businesses and comfortable financial positions find their shares selling far below intrinsic value in the market place, no alternative action can benefit shareholders as surely as repurchases.
2. Our endorsement of repurchases is limited to those dictated by price/value relationships and does not extend to the “greenmail” repurchase-a practice we find odious and repugnant. In these transactions, two parties (the extortionist shareholders and corporate insiders) achieve their personal ends by exploitation of an innocent and un-consulted third party (minority shareholders).
3. The companies in which Berkshire has its largest investments have all engaged in significant stock repurchases at times when wide discrepancies existed between price and value. It served two important purposes for the existing shareholders:
   1. Major repurchases at prices well below per-share intrinsic business value immediately increase, in a highly significant way, that value.
   2. Management clearly demonstrates that it is given to actions that enhance the wealth of shareholders, rather than to actions that expand management’s domain, but that do nothing for (or even harm) shareholders. Seeing this shareholders and potential shareholders increase their estimates of future returns from the business.
4. A manager, who consistently turns his back on repurchases, when these clearly are in the interests of owners, reveals more than he knows of his motivation. No matter how often or how eloquently he mouths some public relations-inspired phase such as “maximising shareholders’ wealth,” the market correctly discounts assets lodged with him. His heart is not listening to his mouth-and, after a while, neither will the market.
5. It’s been over ten years since it has been as difficult as now to find equity investments that meet both our qualitative standards and quantitative standards of value versus price. We try to avoid compromise of these standards, although we find doing nothing the most difficult task of all.
6. The economics of a dominant newspaper are excellent, among the very best in the business world. Owners, naturally, would like to believe that their wonderful profitability is achieved only because they unfailingly turn out a wonderful product. While first-class newspapers make excellent profits, the profits of a third-rate paper are as good or better-as long as either a class of paper is dominant within its community.
7. Once dominant, the newspaper itself, not the marketplace, determines just how good or how bad the paper will be. Good or bad, it will prosper. That is not true of most businesses: inferior quality generally inferior economics. But even a poor newspaper is a bargain to most citizens, and what commands their attention will command the attention of advertisers.
8. In most businesses, of course, insolvent companies run out of cash. Insurance is different:- you can be broke but flush. Since cash comes in at the inception of an insurance policy and losses are paid much later, insolvent insurers don’t run out of cash until long after they have run out of net-worth. In fact these “walking dead” often redouble their efforts to write businesses, accepting almost any price or risk, simply to keep the cash flowing in. With an attitude like that of an embezzler who has gambled away his purloined funds, these companies hope that somehow they can get lucky on the next batch of business and thereby cover up earlier shortfalls. Even if they don’t get lucky, the penalty to mangers is usually no greater for a $100 million shortfall than one of $10 million, in the meantime, while the losses mount, the managers keep their jobs and perquisites.
9. Most managers have very little incentive to make the intelligent-but-with-some-chance-of-looking-like-an-idiot decision. Their personal gain/loss ratio is all too obvious:-if an unconventional decision works out well, they get a pat on the back and, if it works out poorly, they get a pink slip. (Failing conventionally is the route to go; as a group, lemmings may have a rotten image, but no individual lemming has ever received bad press.)
10. Allocation of capital is crucial to business & investment management. Because it is, we believe managers and owners should think hard about the circumstances under which earnings should be retained and under which they should be distributed.
11. All earnings are not created equal. In many businesses particularly those that have high asset/profit ratio-inflation causes some or all of the reported earnings to become ersatz. The ersatz portion-let’s call these earnings “restricted”-cannot, if he business is to retain its economic position, be distributed as dividends. Were these earnings to be paid out, the business would lose ground in one or more of the following areas: its ability to maintain its unit volume of sales; its long term competitive position; its financial strength. No matter how conservative its payout ratio, a company that consistently distributes restricted earnings is destined for oblivion unless equity capital is otherwise infused.
12. Unrestricted earnings should be retained only when there is a reasonable prospect-backed preferably by historical evidence or, when appropriate, by a thoughtful analysis of the future-that for every dollar retained by the corporation, at least one dollar of market value will be created for owner. This will happen only if the capital retained produces incremental earnings equal to, or above, those generally available to investors.
13. Managers of High-return businesses who consistently employ much of the cash thrown off by those businesses in other ventures with low returns should be held to account for those allocation decisions, regardless of how profitable the overall enterprise is.
14. Shareholders of public corporation understandably prefer that dividends be consistent and predictable. Payments, therefore, should reflect long-term expectations for both earnings and returns on incremental capital. Since the long-term corporate outlook changes only infrequently, divided patterns should change no more often. But over time, distributable earnings that have been withheld by managers should earn their keep. If earnings have been unwisely retained.

1985

1. We have several things going for us:
   1. We don’t have to worry about quarterly or annual figures but, instead, can focus on whatever actions maximize long-term value.
   2. We can expand the business into any areas that make sense-our scope is not circumscribed by history, structure or concept.
   3. We love our work
2. You might think that institutions with their large staffs of highly-paid and experienced investment professionals would be a force for stability and reason in financial markets. They are not: stocks heavily owned and constantly monitored by institutions have often been among the most inappropriately valued. Read the Ben Graham story about the Oil Prospector from the letter.
3. Our Vice Chairman, Charlie Munger, has always emphasized the study of mistakes rather than successes, both in business and other aspects of life. He does so in the spirit of the man who said, “All I want to know is where I am going to die, so I will never go there.”
4. The textile business is suggestive of Samuel Johnson’s horse: “A horse that can count to ten is a remarkable horse-not a remarkable mathematician.” Likewise, a textile company that allocates capital brilliantly within its industry is a remarkable textile company but not a remarkable business.
5. My conclusion from my own experiences and from observation of other businesses is that a good managerial record (measured by economic returns) is far more a function of what business boat you get into than it is of how effectively you row (though intelligence and effort help considerably, of course, in any, business, good or bad). Some years ago I wrote:- “When a management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the business that remains intact.” Nothing has changed my point of view on that matter. Should you find yourself in a chronically-leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks.
6. Some investors weigh book value heavily in their stock-buying decisions (as I, in my early years, did myself). And some economists and academicians believe replacement values are of considerable importance in calculating appropriate price level for the stock market as a whole. Those of both persuasions would have received an education at the auction we held in early 1986 to dispose of our textile machinery. Ponder this: the economic goodwill attributable to two paper routes in Buffalo-or a single See’s candy store-considerably exceeds the proceeds we received from this massive collection of tangible assets that not too many years ago, under different competitive conditions, was able to employ over 1000 people.
7. Despite their shortcomings, options can be appropriate under some circumstances. My criticism relates to their indiscriminate use and, in that connection, I would like to emphasize three points:
   1. Stock options are inevitably tied to the overall performance of a corporation. Logically, therefore, they should be awarded only to those manager with overall responsibility
   2. Options should be structured carefully. Absent special factors, they should have built into them a retained-earnings or carrying-cost factor. Equally important, they should be priced realistically. Except in highly unusual cases, owners are not well served by the sale of part of their business at a bargain price-whether the sale is to outsiders or to insiders. The obvious conclusion: - options should be priced at true business value.
   3. Some managers whom I admire enormously-and whose operating records are far better than mine-disagree with me regarding fixed-price options. They have built corporate culture that works, and fixed-price options have been a tool that helped them. By their leadership and example, and by their use of options as incentives, these managers have taught their colleagues to think like owners. Such a culture is rare and when it exists should perhaps be left intact.

1986

1. Three factors that make allocation of capital at Berkshire a considerably important challenge than at most companies are:
   1. We earn more money than average
   2. We retain all that we earn, and
   3. We are fortunate to have operations that, for the most part require little incremental capital to remain competitive and to grow.
2. Under current stock market conditions, we have little hope of finding equities to buy for our insurance companies. Markets will change significantly- you can be sure of that and some day we will again get our turn at bat. However, we haven’t the faintest idea when that might happen.
3. Even if the securities, we own, were to appear significantly overpriced, we would not anticipate selling them, even if someone were to offer us a price far above what we believe those businesses are worth. This attitude may seem old fashioned in a corporate world in which activity has become the order of the day.
4. Owner’s Earnings explained:-
   1. Reported Earnings, plus
   2. Depreciation, Depletion, Amortization and other non-cash charges, minus
   3. Average annual amount of capitalized expenditures of plant and equipment etc that the business requires to fully maintain its long-term competitive position and its unit volume.
5. Accounting numbers, of course, are the language of business and as such are of enormous help to anyone evaluating the worth of a business and tracking its progress. Charlie and I would be lost without these numbers:- they invariably are the starting point for us in evaluating our own businesses and those of others. Managers and owners need to remember, however, that accounting is but an aid to business thinking, never a substitute for it.

1987

1. Three important inferences can be drawn from results of the seven units:-
   1. The current business value of the seven units is far above their historical book value and also far above the value at which they are carried on Berkshire’s balance sheet.
   2. Because so little capital is required to run these businesses, they can grow while concurrently making almost all of their earnings available for deployment in new opportunities.
   3. These businesses are run by truly extraordinary managers.
2. Severe change and exceptional returns usually don’t mix. Most investors, of course, behave as if just the opposite were true. That is, they usually confer the highest price-earnings ratios on exotic sound businesses that hold out the promise of feverish change. That prospect lets investor-dreamers, any blind date is preferable to one with the girl next door, and no matter how desirable she may be.
3. Experience indicates that 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.
4. Only 25 of the 1000 companies meet two tests of economic excellence- an average ROE of over 20% in ten years (1977 through 1986), and no year worse than 15%. (As reported in Fortune Study).
5. The Fortune champs (as mentioned above) surprise you in two respects:-
   1. Most use very little leverage compared to their interest paying capacity. Really good businesses usually don’t need to borrow.
   2. Except for one company that is “high-tech” and several others that manufacture ethical drugs, the companies are in the businesses that, on balance, seem rather mundane. Most sell non-sexy products or services in much the same manner as they did ten years ago (though in larger quantities now, or at high prices, or both). The record of these 25 companies confirms that making the most of an already strong business franchise, or concentrating on a single winning theme, is what usually produces exceptional economics.
6. It’s vital, of course, for a newspaper to cover national and international news well and in depth. But it is also vital for it to do what only a local newspaper can:- promptly and extensively chronicle the personally-important, otherwise-unreported details of community life. Doing this job well requires a very broad range of news- and that means lots of space, intelligently used.
7. The insurance industry is cursed with a set of dismal economic characteristics that make for a poor long-term outlook: hundreds of competitors, ease of entry, and a product that cannot be differentiated in any meaningful way. In such a commodity like business, only a very low-cost operator or someone operating in a protected and usually small, niche can sustain high profitability levels.
8. When shortages exist, however, even commodity businesses flourish. The insurance industry enjoyed that kind of climate for a while but it is now gone. One of the ironies of capitalism is that most managers in commodity industries abhor shortage conditions-even though those are the only circumstances permitting them good returns. Whenever shortages appear, the typical manager simply can’t wait to expand capacity and thereby plug the hole through which money is showering upon him.
9. At Berkshire, we work to escape the industry’s commodity economics in two ways:-
   1. We differentiate our products by our financial strength
   2. We differentiate ourselves by total indifference to volume that we maintain. We hope, of course, that conditions allow us large volume. But we can’t control market prices. If they are unsatisfactory, we will simply do very little business. No other major insurer acts with equal restraint.
10. Three conditions that prevail in insurance, but not in most businesses, allow us our flexibility:
    1. Market share is not an important determinant of profitability
    2. Distribution channels are not proprietary and can be easily entered. Small volume this year does not preclude huge volume next year.
    3. Idle-capacity- which in this industry largely means people-does not result in intolerable costs. In a way that industries such as printing and steel cannot, we can operate at quarter-speed much of the time and still enjoy long-term prosperity.
11. We are always available, given prices that we believe are adequate, to write huge volumes of almost any type of property-casualty insurance. Many other insurers follow an in-and-out approach. When they are “out”-because of mounting losses, capital inadequacy, or whatever-we are available. Of course, when others are panting to do business we are also available-but at such times we often find ourselves priced above market. In effect, we supply insurance buyers and brokers with a large reservoir of standing capacity.
12. We look at the economic prospects of the business, the people in charge of running it, and the price we must pay. We do not have in mind any time or price for sale. Indeed, we are willing to hold a stock indefinitely so long as we expect the business to increase in intrinsic value at a satisfactory rate. When investing, we view ourselves as business analysts-not market analysts, not as macroeconomic analysts, and not even as security analysts.
13. If you aren’t certain that you understand and can value your business far better than Mr. Market, you don’t belong in the game. As they say in Poker, “If you’ve in the game 30 minutes and you don’t know who the patsy is, you’re the patsy”.
14. In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behaviour of stocks and markets. Rather an investor will succeed by coupling good business judgement with an ability to insulate his thoughts and behaviour from the super-contagious emotions that swirl about the market place. In my own efforts to stay insulated, I have found it highly useful to keep Ben’s Mr. Market concept firmly in mind.
15. The market may ignore business success for a while, but eventually will confirm it. The speed at which a business’s success is recognized is not that important as long as the company’s intrinsic value is increasing at a satisfactory rate. In fact delayed recognition can be an advantage: - it may give us the chance to buy more of a good thing at a bargain price.
16. Sometimes, of course, the market may judge a business to be more valuable than the underlying facts would indicate it is. In such a case, we will sell our holdings. Sometimes, also we will sell a security that is fairly valued or even undervalued because we require funds for a still more undervalued investment or one we believe we understand better.
17. We need to emphasize, however, that we do not sell holdings just because they have appreciated or because we have held them for a long time. We are quite content to hold any security indefinitely so long as the prospective ROE of the underlying business is satisfactory, management is competent and honest, and the market does not overvalue the business.
18. A determination to have and to hold, which Charlie and I share, obviously involves a mixture of personal and financial considerations. To some, our stand may seem highly eccentric. (Charlie and I have long followed David Ogilvy’s advice, “Develop your eccentricities while you are young. That way, when you get old, people won’t think you are going ga-ga”).
19. Our goal is to find an outstanding business at a sensible price, not a mediocre business at a bargain price.
20. Controlled company offers two main advantage:-
    1. We get to allocate capital, and
    2. Tax advantages.
21. The disadvantages of owning marketable securities are sometimes offset by a huge advantage: - occasionally the stock market offers us the chance to buy non-controlling pieces of extraordinary business at truly ridiculous prices-dramatically below those commanded in negotiated transactions that transfer control.
22. Many commentators have drawn an incorrect conclusion upon observing recent events: - They are fond of saying that the small investor has no chance in a market now dominated by the erratic behaviour of the big boys. This conclusion is dead wrong: Such markets are ideal for any investor-small or large-so long as he sticks to his investment knitting. Volatility caused by money managers who speculate irrationally with huge sums will offer the true investor more chances to make intelligent investment moves. He can be hurt by such volatility only if he is forced; by either financial or psychological pressures, to sell at untoward times.
23. Unlike many in the business world, we prefer to finance in anticipation of need rather than in reaction to it. A business obtains the best financial results possible by managing both sides of its balance sheet well. This means obtaining the highest-possible return on assets and the lowest possible cost on liabilities. It would be convenient if opportunities for intelligent action on both fronts coincided. However, reasons tell us that just the opposite is likely to be the case: - Tight money conditions, which translate into high cost of liabilities, will create the best opportunities for acquisitions and cheap money will cause assets to be bid to the sky. Our conclusion: Action on the liability side should sometimes be taken independent of any action on the asset side.
24. We simply borrow when conditions seem non-oppressive and hope that we will later find intelligent expansion or acquisition opportunities which-as we have said- are most likely to pop up when conditions in the debt market are clearly oppressive. Our basic principle is that if you want to shoot rare, fast-moving elephants, you should always carry a loaded gun.

1988

1. As long as investors-including supposedly sophisticated institutions- placing fancy valuations on reported “earnings” that march steadily upward, you can be sure that some manager and promoters will exploit GAAP to produce such numbers, no matter what the truth may be. Over the years, Charlie and I have observed many accounting based frauds of staggering size. Few of the perpetrators have been punished; many have not even been censured. It has been far safer to steal large sums with a pen than small sums with a gun.
2. You won’t be surprised that Friedman and his family brings to the jewellery business precisely the same approach that the Bumpkins bring to the furniture business. The cornerstone for both enterprises is Mrs B’s creed: “Sell cheap and tell the truth.” Other fundamentals at both businesses are:
   1. Single store operations featuring huge inventories that provide customers with an enormous selection across all price ranges.
   2. Daily attention to details by the top management
   3. Rapid turnover
   4. Shrewd buying
   5. Incredibly low expense

Both family focus on what’s right for the customers and that, inevitably, works out well for themselves.

1. Take the breakfast cereal industry, whose Returns on Invested capital is more than double that of the auto insurance industry (which is why companies like Kellogg and General Mills sell at five times book value and most large insurers sell close to book). The cereal companies regularly impose price increases, few of them related to a significant jump in their costs. Yet not a peep is heard from the customers. But when auto insurers raise prices by amounts that do not even match cost increases, customers are outraged. If you want to be loved, it’s clearly better to sell high-priced corn flakes than low-priced auto insurance.

1989

1. What counts, however, is intrinsic value- the figure indicating what all of our constituent businesses is rationally worth. With perfect foresight, this number can be calculated by taking all future cash flows of a business-in and out-and discounting them at prevailing interest rates. So valued, all businesses, from manufacturers of buggy whips to operators of cellular phones, become economic equals.
2. In a finite world, high growth rates must self-destruct. If the base from which the growth rate is taking place is tiny, this law may not operate for a time. But when the base balloons, the party ends. A high growth eventually forges its own anchor.
3. In economic terms Deferred Tax Liability resembles an interest-free loan from the US treasury that comes due only at our election (unless, of course, Congress moves to tax gains before they are realized). This “loan” is peculiar in other respects as well: It can be used only to finance the ownership of the particular, appreciated stocks and it fluctuates in size-daily as market price change and periodically if tax rates change. In effect, The DTL is equivalent to a very large transfer tax that is payable only if we elect to move from one asset to another. Indeed we sold some relatively small holdings in 1989, incurring about $76 million of “transfer” tax on $224 million of gains. Because of the way the tax law works, the Rip Van Winkle style of investing that we favour-if successful- has an important mathematical edge over more frenzied approach. Read example in the letter to understand better.
4. In an industry where hundreds of participants are selling a commodity-like product at independently- established prices, whether the product being sold is steel or insurance policies- it is certain to cause subnormal profitability in all circumstances but one: a shortage of usable capacity. Just how often these periods occur and how long they last determines the average profitability of the industry in question. Good profits will be realized only when there is a shortage of capacity. Shortages will occur only when industry players are frightened. That happens rarely- and most assuredly is not happening now.
5. We have no interest in writing insurance that carries a mathematical expectation of loss; we experience enough disappointments doing transactions we believe to carry an expectation of profit.
6. We are willing to look foolish as long as we don’t feel we have acted foolishly.
7. Our method of operation, incidentally, makes us a stabilizing force in the industry. We add huge capacities when capacity is short and we become less competitive only when capacity is abundant. Of course, we don’t follow this policy in the interest of stabilization- we follow it because we believe it to be the most sensible and profitable course of action. Nevertheless, our behaviour steadies the market. In this case, Adam Smith’s invisible hand works as advertised.
8. Read Coca-Cola story from the letter.
9. In Wall Street, all too often, what the wise do in the beginning, fools do in the end.
10. Read the section in the letter thoroughly where, Buffett talks about the mistake of judging interest paying capacity of a company by EBITDA. He argues in favour of the fact that depreciation though non cash is a real expense. So the capability of a company to pay its bondholders should be arrived after subtracting depreciation from the income. Moreover, Buffett also argues on the fact that investment bankers make a grave mistake by measuring EBITDA against cash interest only. (thereby mistake of ignoring interest accruing on zero coupon bonds while assessing the financial feasibility of a transaction)
11. The zero-coupon bond possesses one additional attraction for the promoter and investment banker, which is that the time elapsing between folly and failure can be stretched out. This is no small benefit. If the period before all costs must be faced is long, promoters can create a string of foolish deals and take in lots of fees before any chickens come home to roost from their earlier ventures.
12. But in the end, alchemy, whether it is metallurgical or financial, fails. A base business cannot be transformed into a golden business by tricks of accounting or capital structure. The man claiming to be a financial alchemist may become rich. But gullible investors rather than business achievements will usually be the source of his wealth.
13. To quote Robert Benchley, “Having a dog teaches a boy fidelity, perseverance and to turn around three times before lying down.” Such are the shortcomings of experience. Nevertheless, it’s a good idea to review past mistakes before committing new ones.
14. It’s far better to buy a wonderful company at a fair price than a fair company at a wonderful price. Charlie understood this early; I was a slow learner. But now, when buying companies or common stocks, we look for first-class business accompanied by first-class managements.
15. Good jockeys will do well on good horses, but not on broken down nags. I’ve said many times that when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of business that remains intact. I just wish I hadn’t been so energetic in creating examples. My behaviour has matched that admitted by Mae West: “I was Snow White, but I drifted.”
16. Easy does it. After 25 years of buying and supervising a great variety of businesses, Charlie and I have not learned how to solve difficult business problems. What we have learned is to avoid them. To the extent we have been successful, it is because we concentrated on identifying one-foot hurdles that we could step over rather than because we acquired any ability to clear seven-footers. The finding may seem unfair, but in both business and investment, it is usually far more profitable to simply stick with the easy and obvious than it is to resolve the difficult. Overall, we’ve done better by avoiding dragons than by slaying them.
17. Rationality frequently wilts when the institutional imperative comes into play. For example:
    1. As if governed by Newton’s First Law of Motion, an institution will resist change in its current direction.
    2. Just as work expands to fill available time, corporate projects or acquisition will materialize to soak up available funds.
    3. Any business craving of the leader, however foolish, will be quickly supported by detailed rate of return and strategic studies prepared by his troops.
    4. The behaviour of peer companies will be mindlessly imitated.
18. Our constantly-conservative financial policies may appear to have been a mistake, but in my view were not. If your acts are sensible, you are certain to get good results; in most such cases, leverage just moves things along faster. Charlie and I have never been in a big hurry. We enjoy the process far more than the proceeds-though we have learned to live with those also.

1990

1. The term “earnings” has a precise ring to it. And when an earnings figure is accompanied by an unqualified auditor’s certificate, a naive reader might think it comparable in certitude to pi, calculated to dozens of decimal places.
2. In reality, however, earnings can be as pliable as putty when a charlatan heads the company reporting them. Eventually truth will surface, but in the meantime a lot of money can change hands. Indeed, some important American fortunes have been created by the monetization of accounting mirages.
3. Clearly, investors must always keep their guard up and use accounting numbers as a beginning, not an end, in their attempts to calculate true “economic earnings” accruing to them.
4. When Coca-Cola used retained earnings to repurchase its shares, the company increases our percentage ownership in what I regard to be the most valuable franchise in the world. (Coke also, of course, uses retained earnings in many other value enhancing ways) Instead of repurchasing stock, Coca-Cola could pay these funds to us in dividends, which we could then use to purchase more Coke shares. That would be a less efficient scenario. Because of taxes we would not be able to increase our proportionate ownership to the degree that Coke can, acting for us. If this less efficient procedure were followed, however, Berkshire would report far greater earnings.
5. I believe the best way to think of earnings is in terms of “look-through” results, calculated as follows: Take $250 million, which is roughly our share of the 1990 operating earnings retained by our investees; subtract $30 million for the incremental taxes we would have owed had that $250 million been paid to us in dividends; and add the remainder, $220 million to our reported earnings of $371 million. Thus, our 1990 “look through earnings” were about $590 million.
6. Our return was not earned from industries, such as cigarettes or network television stations, possessing spectacular economics for all participating in them. Instead, it came from a group of business operating in prosaic fields as furniture retailing, candy, vacuum cleaners, and even steel warehousing. The explanation is clear: Our extraordinary returns flow from outstanding operating managers, not fortuitous industry economics.
7. While many media businesses will remain economic marvels in comparison with American industry generally, they will prove considerably less marvellous than I, the industry, or lenders thought would be the case only a few years ago.
8. The reason media business have been so outstanding in the past was not physical growth, but rather the unusual pricing power that most participants wielded. Now, however, advertising dollars are growing slowly. In addition, retailers that do little or no media advertising (though they sometimes use the Postal Service) have gradually taken market share in certain merchandise categories. Most important of all, the number of both print and electronic advertising channels has substantially increased. As a consequence, advertising dollars are more widely dispersed and the pricing power of ad vendors has diminished. These circumstances materially reduce the intrinsic value of our major media investments and also the value of our operating unit, Buffalo News-though all remain fine businesses.
9. Figuring a cost of funds for an insurance business allows anyone analyzing it to determine whether the operation has a positive or negative value for shareholders. If this cost (including the tax penalty) is higher than that applying to alternative sources of funds, the value is negative. If the the cost is lower, the value is positive-and if the cost is significantly lower, the insurance business qualifies as a very valuable asset.
10. Many well-known insurance companies, on the other hand, incur an underwriting loss/float cost that, combined with tax penalty, produces negative results for owners. In addition, these companies, like all others in the industry, are vulnerable to catastrophe losses that could exceed their reinsurance protection and take their cost of float right off the chart. Unless these companies can materially improve their underwriting performance- and history indicates that is an impossible task-their shareholders will experience results similar to those borne by the owners of a bank that pays a higher rate of interest on deposits than it receives on loans.
11. Lethargy bordering on sloth remains the cornerstone of our investment style: This year we neither bought nor sold a share of five of the six major holdings.
12. Banking business is no favourite of ours. When assets are 20 times equity- a common ratio in these industry-mistakes that involve only a small portion of assets can destroy major portion of equity. Mistakes have been the rule rather than exception at many major banks. Because leverage of 20:1 magnifies the effect of managerial strengths and weaknesses, we have no interest in purchasing shares of poorly-managed banks at cheap price. Instead, our only interest is buying into well-managed banks at fair price.
13. Read Well Fargo story from the letter. It explains what to look for in a bank.
14. Investors who expect to be ongoing buyers of investments throughout their lifetimes should adopt a similar attitude towards market fluctuations, instead many illogically become euphoric when stock prices soar and unhappy when they fall. They show no such confusion in their reaction to food prices: knowing that they are forever going to be buyers of foods they welcome falling prices and deplore price increases.
15. The most common cause of low prices is pessimism- sometimes pervasive, sometimes specific to a company or industry. We want to do business in such an environment not because we like pessimism but because we like the prices it produces. It’s optimism that is the enemy of the rational buyer.
16. None of the above reasons in Point 15 means, however, that a business or stock is an intelligent purchase simply because it is unpopular; a contrarian approach is just as foolish as a follow-the-crowd strategy. What’s required is thinking rather than policy. Unfortunately, Bertrand Russell’s observation about life in general applies with unusual force in the financial world: “Most men would rather die than think. Many do.”
17. The disciples of debt assured us that this collapse wouldn’t happen: Huge debt, we were told, would cause operating managers to focus their efforts as never before, much as a dagger mounted on the steering wheel of a car could be expected to make its driver proceed with intensified care. We will acknowledge that such an attention-getter would produce a very alert driver. But another certain consequences would be a deadly-and unnecessary accident if the car hit even the tiniest pothole or silver of ice. The roads of business are riddled with potholes; a plan that requires dodging them all is a plan for disaster.
18. Buffett warns against financial sales person:-“Beware of past-performance proofs in finance. If history books were the key to riches, The Forbes 500 would consist of librarians.”
19. Read the Appendix A-An unpublished satire by Ben Graham, written in 1936.
20. Read the Appendix B-Some thoughts on selling your business.

1991

1. Coca-Cola and Gillettee are two of the best companies in the world and we expect their earnings to grow at hefty rates in the years ahead. Over time, also the value of our holdings in these stocks should grow in rough proportion. Last year, however, the valuations of these two companies rose far faster than their earnings. In effect, we got a double-dip benefit, delivered partly by the excellent earnings growth and even more so by the market’s reappraisal of these stocks. We believe their reappraisal was warranted. But it can’t recur annually. We will have to settle for single dip in the future.
2. It’s true of course that in the long run; the scoreboard for investment decisions is market price. But prices will be determined by future earnings. In investing, just as in baseball, to put runs on the scoreboard, one must look at the playing field, not the scorecard.
3. Difference between an “Economic Franchise” and a “Business”

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| --- | --- |
| An Economic Franchise | A Business |
| 1. It arises from a product or service that:  a. Is needed or desired  b. Is thought by its customers to have no close substitutes.  c. Is not subject to any price regulation | 1. It earns exceptional returns only if it is the low-cost operator or if supply of its product or service is tight. Tightness in supply, usually does not last long. |
| 2. The existence of all conditions above will be demonstrated by a company’s ability to regularly price its product or service aggressively and thereby to earn high rates of ROIC | 2. With superior management, a company may maintain its status of a low-cost operator for a much longer time, but even then unceasingly faces the possibility of competitive attack. |
| 3. They can tolerate mismanagement. Inept managers may diminish a franchise’s profitability, but they cannot inflict mortal damage. | 3. A business, unlike a franchise, can be killed by poor management. |

1. Read the letter to understand the media industry to lose its charm.
2. J M Keynes says, “As time goes on, I get more and more convinced that the right method in investment is to put fairly large sums into enterprises which one thinks one knows something about and in the management of which one thoroughly believes. It is a mistake to think that one limits one’s risks by spreading too much between enterprises about which one knows little and has no reason for special confidence....One’s knowledge and experience is definitely limited and there are seldom more than two or three enterprises at any given time in which I personally feel myself to put full confidence.”
3. Read in the letter how Buffett stopped adding positions to Fannie Mae, instead sold off the shares when they rose. It is a good practical example of errors of omission in investing. Learn from it.

1992

1. We’ve long felt that the only value of a stock forecaster is to make fortune tellers look good. Even now, Charlie and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in market like children.
2. We will continue to experience considerable volatility in our annual results. That’s assured by the general volatility of the stock market, by the concentration of our equity holdings in just a few companies, and by certain business decisions we have made, most especially our move to commit large resources to super-catastrophe insurance. We not only accept this volatility but also welcome it. A tolerance for short-term swings improves our long-term prospects. In baseball lingo, our performance yardstick is slugging percentage, not batting average.
3. In search (for quality investments), we adopt the same attitude one might find appropriate in looking for a spouse:- It pays to be active, interested and open-minded, but it does not pay to be in a hurry.
4. “Practice doesn’t make perfect, practice makes permanent.” Buffett says to carefully evaluate what we practice because practising a wrong thing can lead to permanent loss.
5. The saying, “a fool and his money are soon invited everywhere”, applies in spades in re-insurance, and we actually reject more than 98% of the business we are offered. Our ability to choose between good and bad proposals reflects a management strength that matches our financial strength.
6. Growth benefits investors only when the business in point can invest at incremental returns that are enticing-in other words, only when each dollar used to finance the growth creates over a dollar of long-term market value. In the case of low-return business requiring incremental funds, growth hurts the investor.
7. In “The Theory of Investment Value”, written over 50 years ago, John Burr Williams set forth the equations for value, which are condense here:- “The Value of any stock, bond or business today is determined by the cash inflows and outflows-discounted at an appropriate interest rate-that can be expected to occur during the remaining life of the asset.” Note that the formula is the same for stocks as for bonds. Even so, there is an important, and difficult to deal with, difference between the two: - A bond has a coupon and a maturity date that define the future cash flows; but in the case of equities. The investment analyst must himself estimate the future “coupons”. Furthermore, the quality of management affects the bond coupon only rarely-chiefly when the management is so inept or dishonest that payment of interest is suspended. In contrast, the ability of management can dramatically affect the equity “coupons”.
8. Leaving the question of price aside, the best business to own is one that over an extended period can employ large amounts of incremental capital at very high rates of return. The worst is the one that consistently employ ever-greater amounts of capital at very low rates of return. Unfortunately, the first type of business is very hard to find. Most high-return businesses need relatively little capital. Shareholders of such a business usually will benefit, if it pays out most of its earnings in dividends or stock purchases.
9. What counts for most people in investing is not how much they know, but rather how realistically they define what they don’t know. An investor needs to do very few things right as long as he or she avoids big mistakes. Secondly, and equally importantly, insist on a margin of safety in our purchase price.
10. Managers thinking about accounting issues should never forget one of Abraham Lincoln’s favourite riddles:- “How many legs does a dog have if you call his tail a leg?” The answer: “Four, because calling a tail a leg does not make it a leg.” It behoves managers to remember that Abe’s right even if an auditor is willing to certify that the tail is a leg.
11. Shareholders should understand that companies incur costs when they deliver something of value to another party and not just when cash changes hands. Moreover, it is both silly and cynical to say that an important item of cost should not be recognized simply because it can’t be quantified with pin point precision.
12. It seems to me the realities of stock options can be summarized quite simply: If options aren’t a form of compensation, what are they? If compensation isn’t an expense, what is it? And if expenses shouldn’t go into the calculation of earnings, where in the world should they go?

1993

1. We think it’s usually poison for a corporate giant’s shareholders if it embarks upon new ventures pursuant to some grand vision. We prefer instead to focus on the economic characteristics of businesses that we wish to own and the personal characteristics of managers with whom we wish to associate-and then to hope we get lucky in finding the two in combination. At Dexter, we did.
2. But we continue to think that it is usually foolish to part with an interest in a business that is both understandable and durably wonderful. Business interests of that kind are simply too hard to replace....In our view, what makes sense in business also makes sense in stocks: An outstanding business with the same tenacity that an owner would exhibit if he owned all of that business.
3. In 1938, more than 50 years after the introduction of Coke and long after the drink was firmly established as an American icon, Fortune did an excellent story on the company. In the second paragraph the writer reported: ”Several times every year a weighty and serious investor looks long and with profound respect at Coca-Cola’s record, but comes regretfully to the conclusion that he is looking too late. The spectres of saturation and competition rise before him.”
4. I can’t resist one more quote from that 1938 Fortune story, “It would be hard to name any company comparable in size to Coca-Cola and selling, as Coca-Cola does, an unchanged product that can point to a ten-year record anything like Coca-Cola’s.” In the 55 years that have since passed, Coke’s product line has broadened somewhat, but it’s remarkable how well that description still fits.
5. Charlie and I decided long ago that in an investment lifetime, it’s just too hard to make hundreds of smart decisions....Therefore, we adopted a strategy that required our being smart-(and not too smart at that)-only a very few times. Indeed, we’ll now settle for one good idea a year. ( Charlie says it’s my turn)
6. We define risk, using dictionary terms, as “the possibility of loss or injury”. Academics, however, like to define investment “risk” differently, averring that it is the relative volatility of a stock or portfolio of stocks-that is, their volatility as compared to that of a large universe of stocks... In their hunger for a single statistic to measure risk, however, they forget a fundamental principle:- “It is better to be approximately right than precisely wrong.”
7. After we buy a stock, consequently, we would not be disturbed if markets closed for a year or two. We don’t need a daily a quote on our 100% position is See’s or H H Brown to validate our well-being. Why then should we need a quote on our 7% interest in Coke?
8. Though risk cannot be calculated with engineering precision, it can in some cases be judged with a degree of accuracy that is useful. The primary factors bearing upon this evaluation are :-
   1. The certainty with which the long-term economic characteristics of the business can be evaluated
   2. The certainty with which management can be evaluated, both to its ability to realize the full potential of the business and to wisely employ its cash flows
   3. The certainty with which management can be counted on to channel the rewards from the business to the shareholders rather than to itself;
   4. The purchase price of the business
   5. The levels of taxation and inflation that will be experienced and that will determine the degree by which an investor’s purchasing power returns is reduced from his gross return.

1994

1. We define intrinsic value as the discounted value of the cash that can be taken out of a business during its remaining life....Despite its fuzziness; however, intrinsic value is all-important and is the only logical way to evaluate the relative attractiveness of investments and businesses.
2. At Berkshire, we have rejected many mergers and purchase opportunities that would have boosted current and near-term earnings but that would have reduced per share intrinsic value. Our approach, rather, has been to follow Wayne Getzky’s advice: “Go to where the puck is going to be, not to where it is.”
3. Investors should remember that their scorecard is not computed using Olympic-diving methods:- Degree of difficulty doesn’t count. If you are right about a business whose value is largely dependent on a single key factor that is both easy to understand and enduring, the payoffs is the same as if you had correctly analyzed an investment alternative characterised by many constantly shifting and complex variables.
4. We try to price, rather than time purchases. In our view, it is folly to forgo buying shares in an outstanding business whose long term future is predictable, because of short term worries about an economy or stock market that we know to be unpredictable. Why scrap an informed decision because of an uninformed guess?
5. Before looking at new investments, we consider adding to old ones. If a business is attractive enough to buy once, it may well pay to repeat the process.
6. Whatever the outcome, we will heed a prime rule of investing: “You don’t have to make it back the way you lost it.”

1995

1. Buffett’s scepticism on M&A activities: We believe most deals do damage to the shareholders of the acquiring company... Sellers and their representatives invariably present financial projections having more entertained value than educational value. In the production of rosy scenarios, Wall Street can hold its own against Washington. In any case, why potential buyers even look at projections prepared by sellers baffles me. Charlie and I never give them a glance, but instead keep in mind the story of the man with an ailing horse. Visiting the vet, he said: “Can you help me? Sometimes my horse walks just fine and sometimes he limps.” The vet’s reply was pointed: “No problem-when he’s walking fine sell him.” In the world of M&A, that horse would be peddled as Secretariat.
2. Concluding this little dissertation on acquisition, I can’t resist repeating a tale told me last year by a corporate executive. The business he grew up in was a fine one, with a long-time record of leadership in its industry. Its main product, however, was distressingly glamour less. So several decades ago, the company hired a management consultant who-naturally-advised diversification, the then-current fad. (“Focus” was not yet in style). Before long, the company acquired a number of businesses, each after the consulting firm had gone through a long-and expensive-acquisition study. And the outcome? Said the executives sadly, “When we were getting 100% of our earnings from original business. After ten years, we were getting 150%”.
3. Retailing is a tough business. During my career, I have watched a large number of retailers enjoy terrific growth and superb returns on equity for a period, and then suddenly nosedive, often all the way into bankruptcy. This shorting-star phenomenon is far more common in retailing than it is in manufacturing or service business. In part, this is because a retailer must stay smart, day after day. Your competitor is always copying and then toppong whatever you do. Shoppers are meanwhile beckoned in every conceivable way to try a stream of new merchants. In retailing, to coast, is to fail. In contrast to all this have-to-be-smart-every-day business, there is what I call the have-to-be-smart-once business. For example, if you were smart enough to buy a network TV station very early in the game, you could put in a shiftless and backward nephew to run things, and the business would still do well for decades. You’d do far better, of course, if you put in Tom Murphy, but you could stay comfortable, in the black without him. For a retailer, hiring that nephew would be an express ticket to bankruptcy.
4. Read the Buffett’s narration about his 45-year association with GEICO Corporation from the 1995 letter.
5. I sold my entire GEICO position in 1952 for $15,259, primarily to switch into Western Insurance Securities. This act of infidelity can partially be excused by the fact that Western was selling for slightly more than one times its current earnings, a P/E ratio that for some reason caught my eye. But in the next 20 years, the GEICO stock I sold grew into value to about $1.3 million, which taught me a lesson about the inadvisability of selling a stake in an identifiably-wonderful company.
6. Any company’s level of profitability is determined by three items:
   1. What its asset earns
   2. What its liabilities cost
   3. Its utilization of “leverage”-

That is, the degree to which its asset are funded by liabilities rather than by equity. Over the years, we have done well on Point (i), having produced high returns on our assets. But we have also benefitted greatly-to a degree that is not generally well-understood-because our liabilities have cost us very little. An important reason for this low cost is that we have obtained float on very advantageous terms. The same cannot be said by many other property and casualty insurers, who may generate plenty of float, but at a cost that exceeds what the funds are worth to them. In those circumstances, leverage becomes a disadvantage. Since our float has cost us virtually nothing over the years, it has in effect served as equity.

1. We will get hit from time to time with large losses. Charlie and I, however, are quite willing to accept relatively volatile results in exchange for better long –term earnings than we would have otherwise have had. In other words, we prefer a lumpy 15% to a smooth 12%. Since most managers opt for smoothness, we are left with a competitive advantage that we try to maximize. We do, though, monitor our aggregate exposure in order to keep our “worst case” at a level that leaves us comfortable.

1996

1. Seriously, cost matters. For example, equity mutual funds incur corporate expenses-largely payments to the fund’s manager-that average about 100 basis points, a levy likely to cut the returns their investors earn by 10% or more over time. Charlie and I make no promises about Berkshire’s results. We do promise you, however, that virtually all of the gains of Berkshire makes will end up with shareholders. We are here to make money with you, not off you.
2. Of course, the longer a shareholder holds his share the more bearing Berkshire’s business results will have on his financial experience-and the less it will matter what premium or discount to intrinsic value prevails when he buys and sells his stock.
3. Our portfolio shows little change:- We continue to make more money when snoring than active. Inactivity strikes us an intelligent behaviour. Neither we nor most business managers would dream of feverishly trading highly-profitable subsidiaries because a small move in the Federal Reserve discount rate was predicted or because some Wall Street pundit had reversed his views on the market. Why, then, should we behave differently with our minority positions in wonderful businesses?......You simply want to acquire, at a sensible price, a business with excellent economies and able, honest management. Thereafter, you need to only monitor if these qualities are being preserved or not.
4. When carried out capably, an investment strategy of that type will often result in practitioner owning a few securities that will come to represent a very large portion of his portfolio. This investor would get a similar result if he followed a policy of purchasing an interest in, say, 20% of the future earnings of a number of outstanding college basketball stars. A handful of these would go on to achieve NBA stardom, and the investor’s take from them would soon dominate his royalty stream. To suggest that this investor should sell off portions of his most successful investments simply because they have come to dominate his portfolio is akin to suggesting that the Bulls trade Michael Jordan because he has become so important to the team.
5. We are searching for operations that we believe are virtually certain to possess enormous competitive strength ten or twenty years from now. A fast-changing industry environment may offer the chance for huge wins, but it precludes the certainty we seek.
6. Fresh ideas, new products, innovative processes and the like cause our country’s standard of living to rise, and that’s clearly good. As investors, however, our reaction to a fermenting industry is much like our attitude towards space exploration. We applaud the endeavour but prefer to skip the ride.
7. Companies such as Coca-Cola and Gillette might well be labelled “The Inevitables”. Forecasters may differ a bit in their predictions of exactly how much soft drink or shaving-equipment business these companies will be doing in ten or twenty years.... Obviously many companies in high-tech businesses or embryonic industries will grow much faster in percentage terms than will “The Inevitables.” But I would rather be certain of a good result than hopeful of a great one.
8. For every Inevitable, there are a dozens of Imposters, companies now riding high but vulnerable to competitive attacks. Considering what it takes to be an Inevitable, Charlie and I recognize that we will never be able to come up with a Nifty Fifty or even a Twinkling Twenty. To the Inevitables in our portfolio, therefore, we add a few “High Probables”.
9. Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily-understandable business whose earnings are virtually certain to be materially higher five, ten or twenty years from now. Over time, you will find only a few companies that meet those standards-so when you see one that qualifies, you should buy a meaningful amount of stock. You must also resist the temptation to stray from your guidelines:-If you aren’t willing to own a stock for ten years, don’t even think about owning it for ten minutes. Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio’s market value.

1997

1. If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net-buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall. In effect, they rejoice because prices have risen for the “Ham-burgers”, they will soon be buying. This reaction makes no sense.
2. In the summer of 1979, when equities looked cheap to me, I wrote a Forbes article entitled, “You pay a very high price in the stock market for a cheery consensus.” At that time scepticism and disappointment prevailed, and my point was that investors should be glad of the fact, since pessimism drives down prices to truly attractive levels. Now, however, we have a very cheery consensus. That does not necessarily mean this is the wrong time to buy stocks: Corporate America is now earning far more money than it was just a few years ago, and in the presence of lower interest rates, every dollar of earnings becomes more valuable. Today’s price levels, though, have materially eroded the “margin of safety” that Ben Graham identified as the cornerstone of intelligent investing.

1998

1. Read about accounting for stock options in the section Accounting Part1. Also read about accounting for acquisitions & restructuring in the section: Accounting Part2.

1999

1. Despite the extensive advertising we do, our best source of new business is word-of-mouth recommendations from existing policyholders, who on the whole are pleased with our prices and service. An article published last year by Kiplinger’s Personal Finance Magazine gives a good picture of where we stand in customer satisfaction:- The magazine’s survey of 20 state insurance departments showed that GEICO’s complaint ratio was well below the ratio for most of its major competitors.
2. Our strong referral business means that we probably could maintain our policy count by spending as little as $50 million annually on advertising. That’s a guess, of course, and we will never know whether it is accurate because Tony’s foot is going to stay on the advertising pedal (and my foot will be on his). Nevertheless, I want to emphasize that a major percentage of the $300-$350 million we will spend in 2000 on advertising, as well as large additional costs we will incur for sales counsellors, communications and facilities, are optional outlays we choose to make so that we can both achieve significant growth and extend and solidify the promise of the GEICO brand in the minds of Americans.
3. In the past three years, we have increased our market share in personal auto insurance from 2.7% to 4.1%. But we rightfully belong in many more households-maybe even yours.... Furthermore, in 40 states we can offer a special discount-usually 8%- to our shareholders. Just to be sure to identify yourself as a Berkshire owner so that our sales counsellor can make the appropriate adjustment.
4. At both GEICO and Executive Jet, our best source of new customers is the happy ones we already have. Indeed, about 65% of our new owners of aircrafts come as referral, from current owners who have fallen in love with the service. Our acquisitions usually develop in the same way. At other companies, executives may devote themselves to pursuing acquisition possibilities with investment bankers, utilizing an auction process that has become standardized. In this exercise the bankers prepare a “book” that makes me think of superman comics of my youth. In the wall street version, a formerly mild-mannered company emerges from the investment banker’s phone booth able to leap over competitors in a single bound and with earnings moving faster than a speeding bullet. Titillated by the book’s description of the acquiree’s powers, acquisition-hungry CEOs — Lois Lanes all, beneath their cool exteriors promptly swoon. What’s particularly entertaining in these books is the precision with which earnings are projected for many years ahead. If you ask the author-banker, however, what his own firm will earn next month, he will go into a protective crouch and tell you that business and markets are far too uncertain for him to venture a forecast. (Also read Scott Fetzer example in the letter).
5. Read the full section of Acquisition Accounting in the letter for better understanding. The most important is here: “Charlie and I believe there is a reality-based approach that should both satisfy the FASB, which correctly wishes to record purchase, and meet the objectives of managements to nonsensical charge for diminution of goodwill. We would first have the acquiring company record its purchase price-whether paid in cash or stock- at fair value. In most cases, this procedure would create a large asset representing economic goodwill. We would then leave this asset on the books, not requiring its amortization. Later, if the economic goodwill became impaired, as it sometimes would, it would be written down just as would any other asset judged to be impaired.
6. From the economic standpoint of acquiring company, the worst deal of all is a stock for-stock acquisition. Here, a huge price is often paid without there being any step-up in the tax basis of either the stock of the acquiree or its assets. If the acquired entity is subsequently sold, its owner may owe a large capital gains tax( at a 35% or greater rate) even though the sale may truly be producing a major economic loss.
7. We don’t own stocks of tech companies, even though we share the general view that our society will be transformed by their products and services. Our problem-which we can’t solve by studying up- is that we have no insights into which participants in the tech field posses a truly durable competitive advantage. Our lack of tech insights, we should add, does not distress us. After all, there are a great many business areas in which Charlie and I have no special capital-allocation expertise. For instance, we bring nothing to the table when it comes to evaluating patents, manufacturing processes or geological prospects. So we simply don’t get into judgements in those fields.
8. If the choice is between a questionable business at a comfortable price or a comfortable business at a questionable price, we must prefer the latter. What really gets our attention, however, is a comfortable business at a comfortable price.
9. Berkshire will someday have opportunities to deploy major amounts of cash in equity markets- we are confident of that. But as the song goes, “Who knows where and when? Meanwhile, if anyone starts explaining to you what is going on in the truly-manic portions of this “enchanted” market, you remember still another line of song: “Fools give you reasons, wise men never try.”
10. Read the section of Share Repurchases in detail. Some important parts are reproduced here: There is only one combination of facts that makes it advisable for a company to repurchases its shares. First, the company has available funds-cash plus sensible borrowing capacity-beyond the near-term needs of the business and, second, finds its stock selling in the market below its intrinsic value, conservatively-calculated.... The business”needs” that I speak of are of two kinds. First, expenditures that a company must make to maintain its competitive position (e.g., the remodelling of stores at Helzberg’s) and second, optional outlays, aimed at business growth, that management expects will produce more than a dollar of value for each dollar spent (R.C. Willey’s expansion into Idaho)... When available finds exceeds needs of those kinds, a company with growth-oriented shareholder population can buy new businesses or repurchase shares. If a company’s stock is selling well below intrinsic value, repurchases usually make the most sense...Please be clear about one point: We will never make purchases with the intention of stemming a decline in Berkshire price. Rather we will make them if and when we believe that they represent an attractive use od the company’s money. At best, repurchases are likely to have only a minor effect on the future rate of gain in our stock’s intrinsic value.

2000

1. Buffett does an acquisition of as many as eight large corporations in the year of 2000. He specifies two economic factors contributing to the rush of acquisition activity:
   1. Depressed economic environment where many managers and owners foresee a near-term slowdown in their businesses.
   2. LBO operators became less aggressive in their bidding when businesses came up for sale in 2000. Because Berkshire analyze purchases on an all-equity basis, its evaluation did not change, which means it became considerably more competitive.
2. How much better it is for the “painter” of a business Rembrandt to personally select its permanent heirs than to have a trust officer or uninterested heirs auction it off. Throughout the years we have had great experiences with those who recognize that truth and apply it to their business creations. We’ll leave the auctions to others.
3. Many people assume that marketable securities are Berkshire’s first choice when allocating capital, but that’s not true: - Ever since we first published our economic principles in 1983, we have consistently stated that we would rather purchase businesses than stocks. One reason for that preference is personal, in that I love working with our managers... The other has to do with taxes... The government is our partner twice when we own a part of business through a stock investment, but only once when we own at least 80%.
4. The formula we use for evaluating stocks and business is identical. Indeed, the formula for valuing all assets that are purchased for financial gain has been unchanged since it was first laid out by a very smart man in about 600 BC. The oracle was Aesop and his enduring, though somewhat incomplete, investment insight was “a bird in the hand is worth two in the bush”. To flesh out this principle, you must answer only three questions. How certain are you that there are indeed birds in the bush? When will they emerge and how many will there be? What is the risk-free interest rate? If you can answer these three questions, you will know the maximum number of the birds you now posses that should be offered for it. And of course, don’t literally think birds. Think dollars.
5. Read the Inefficient Bush Theory (IBT) in detail for better understanding. It is clearly explained in the portion titled, “Investments” in the letter.
6. The line separating investment and speculation, which is never bright and clear, becomes blurred still further when market participants have recently enjoyed triumphs. Nothing sedates rationality like large doses of effortless money. After a heady experience of that kind, normally sensible people drift into behaviour akin to that of Cinderella at the ball. They know that overstaying the festivities-that is, continuously to speculate in companies that have gigantic valuations relative to the cash they are likely to generate in the future-will eventually bring on pumpkins and mice. But they nevertheless hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There’s a problem though: They are dancing in a room in which the clocks have no hands.
7. But a pin lies in wait for every bubble. And when the two eventually meet, a new wave of investors learn some very old lessons: First, many in Wall Street will sell investors anything they will buy. Second, speculation is most dangerous when it looks easiest.
8. Read the mistake Buffett committed in overpaying for Dexter in 1993 and compounding the mistake by using Berkshire’s shares in payment.
9. Charlie and I think it is both deceptive and dangerous for CEOs to predict growth rates for their companies. They are, of course, frequently egged on to do so by both analysts and their own investor relation departments. They should resist, however, because too often these predictions lead to trouble.
10. Its fine for a CEO to have his own internal goals, and, in our view, it’s even appropriate for the CEO to publicly express some hopes about the future, if these expectations are accompanied by sensible caveats. But for a major corporation to predict that its per-share earnings will grow over the long term at, say, 15% annually is to court trouble.
11. Here’s a test: Examine the record of, say, the 200 highest earning companies from 1970 or 1980 and tabulate how many have increased per-share earnings by 15% annually since those dates. You will find that only handfuls have. I would wager you a very significant sum that fewer than 10 of the 200 most profitable companies in 2000 will attain 15% annual growth in EPS over the next 20 years.

2001

1. Noan rule: Predicting rain doesn’t count; building arks does.
2. I have made three decisions relating to Dexter that have hurt you in a major way:
   1. Buying it in the first place
   2. Paying for it with stock
   3. Procrastinating when the need for changes in its operation was obvious.

Dexter, prior to our purchase, and indeed for a few years after purchase, prospered despite low-cost foreign competition, that was brutal. I concluded that Dexter could continue to cope with that problem, and I was wrong.

2002

1. In our view, derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal.
2. Despite three years of falling prices, which have significantly improved the attractiveness of common stocks, we still find very few that even mildly interest us. That dismal fact is testimony to the insanity of valuations reached during The Great Bubble. Unfortunately, the hangover may prove to be proportional to the binge.
3. Both the ability and fidelity of managers have long needed monitoring. Indeed, nearly 2000 years ago, Jesus Christ addressed this subject, speaking (Luke16:2) approvingly of “a certain rich man” who told his manager, “Give an account of thy stewardship; for thou mayest longer be steward”.
4. In 1993 annual report I said that directors “should behave as if there was a single absentee owner, whose long-term interest they should try to further in all proper ways”. This means that directors must get rid of a manager who is mediocre or worse, no matter how likeable he may be. Directors must react as did the chorus-girl bride of an 85 year old multi-millionaire when he asked whether she would love him if he lost all his money. “Of course”, the young beauty replied, “I would miss you, but I would still love you.”
5. In 1993 report, I also said directors had another job. “If able but greedy managers over-reach and try to dip too deeply into the shareholder’s pockets, directors must slap their hands.” Since I wrote that, over-reaching has become common but few hands have been slapped.
6. Three suggestions for investors:
   1. First, beware of companies displaying weak accounting
   2. Second, unintelligible footnotes usually indicate untrustworthy management. If you can’t understand a footnote or other managerial explanation, it’s usually because the CEO doesn’t want you to.
   3. Finally, be suspicious of companies that trumpet earnings projections and growth expectations. Business seldom operate in a tranquil, no-surprise environment, and earnings simply don’t advance smoothly ( except, of course, in the offering books of investment bankers)

Managers that always promise to “make the number” will at some point be tempted to “make up” the number.

2003

1. Investment Managers often profit far more from piling up assets than from handling those assets well. So, when one tells you that increased funds won’t hurt his investment performance, step back. His nose is about to grow.
2. Today, the manufactured housing industry remains awash in problems. Delinquencies continue high, repossessed units still abound and the number of retailers has been halved. A different model is required, one that eliminates the ability of the retailer and salesman to pocket substantial money upfront 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 1990s. But it will deliver to home buyers an asset in which they will have equity rather than disappointment, upon resale.
3. Within a few months, the world began to learn that many fund-management companies had followed policies that hurt the owners of the funds they managed, while simultaneously boosting the fees of the managers. Prior to their transgressions, it should be noted, these management companies were earning profit margins and returns on tangible equity that were the envy of Corporate America. Yet to swell profit further, they trampled on the interests of fund shareholders in an appalling manner.
4. When analyzing Berkshire, be sure to remember that the company should be viewed as an unfolding movie, not as a still photograph. Those who focussed in the past on only the snapshot of the day sometimes reached erroneous conclusions.
5. Float is wonderful-if it doesn’t come at a high price.
6. 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.
7. No matter how financially sophisticated you are, you can’t possibly learn from reading the disclosure documents of a derivatives-intensive company what risks lurk in its positions. Indeed, the more you know about derivatives, the less you feel you can learn from the disclosures normally proffered you. In Darwin’s words, “Ignorance more frequently begets confidence, than does knowledge.”
8. You may wonder why we borrow money while sitting on a mountain of cash. It’s because of our “every tub on its own bottom” philosophy. We believe 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.
9. We’ve repeatedly emphasized that realized gains at Berkshire are meaningless for analytical purposes. We have a huge amount of unrealized gains on our books, and our thinking about when, and if, to cash them depends not at all on a desire to report earnings at one specific time or another.
10. Books suggestion made by Buffett:
    1. Bull by Maggie Mahar
    2. The smartest Guys in the Room by Bethany Mclean and Peter Elkind
    3. In an uncertain World by Bob Rubin

2004

1. Over the 35 years, American business has delivered terrific results. It should therefore have been easy for investors to earn juicy returns. All they had to do was piggyback Corporate America in a diversified, low-expense way. An indexed fund that they never touched would have done the job. Instead many investors have had experiences ranging from mediocre to disastrous.
2. Three primary reasons for mediocre to disastrous experiences:
   1. High cost due to excessive trading or spent heavily on investment management (management fees)
   2. Portfolio decisions based on tips and fads rather than on thoughtful quantified evaluation of businesses.
   3. A start and stop approach to the market marked by untimely entries (after advances has been long underway) and exits (after periods of stagnation and decline)
3. Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy when others are fearful.

2005

1. When a problem exists, whether in personnel or in business operations, the time to act is now.
2. **Buffett on Widening of Moats:** Every day, in countless ways, the competitive position of each of our businesses grows either weaker or stronger. If we are delighting customers, eliminating unnecessary costs and improving our products and services, we gain strength. But if we treat customers with indifference or tolerate bloat, our business will wither. On a daily basis, the effects of our actions are imperceptible; cumulatively, though, their consequences are enormous. When our long term competitive position improves as a result of these almost unnoticeable actions, we describe the phenomenon as “widening the moat”. And doing that is essential if we are to have the kind of business we want a decade or two from now. We always, of course, hope to earn more money in the short-term. But when short-term and long-term conflicts, widening the moat must take precedence. If a management makes bad decisions in order to hit short-term earnings targets, and consequently gets behind the eight-ball in terms of costs, customer satisfactions or brand strength, no amount of subsequent brilliance will overcome the damage that has been inflicted. Charlie is fond of quoting Ben Franklin’s “An ounce of prevention is worth a pound of cure.” But sometimes no amount of cure will overcome the mistakes of the past.
3. Read about Gillette’s bad capital allocation & also read about CEO’s compensation and Stock Options and how Buffett calls the executive compensation of US Corporate ridiculous.
4. With unimportant exceptions, such as bankruptcies in which some of a company’s losses are borne by the creditors, “the most that owners in aggregate can earn between now and Judgement Day is what their businesses in aggregate earn.” True, by buying and selling that is clever or lucky, Investor A may take more than his share of the pie at the expense of investor B. And yes, all investors feel richer when stocks roar. For owners as a whole, there is simply no magic-no shower of money from outer space-that will enable them to extract wealth from their companies beyond that created by the companies themselves. Indeed, owners must earn less than their business earn because of “frictional costs”. And that’s my point: These costs are now being incurred in amounts that will cause shareholders to earn far less than they historically have. Read in the letter about the imaginary Gotrocks Family.
5. Long ago, Sir Issac Newton gave us three laws of motion, which were the work of genius. But Sir Issac’s talent didn’t extend to investing: He lost a bundle in the South Sea Bubble, explaining later, “I can calculate the movement of the stars, but not the madness of men”. If he had not been traumatized by this loss, Sir Issac might well have gone on to discover the Fourth Law of Motion: For investors as a whole, returns decrease as motion increases.

2006

1. Size seems to make many organizations slow-thinking resistant to change and smug. In Churchill’s words, “We shape our buildings and afterwards our buildings shape us.” Here’s a telling fact: Of the ten non-oil companies having the largest market capitalization in 1965-titans such as General Motors, Sear, Du Pont and Eastern Kodak-only one made the 2006 list.
2. Not all of our businesses are destined to increase profits. When an industry’s underlying economics are crumbling, talented management may slow the rate of decline. Eventually, though, eroding fundamentals will overwhelm managerial brilliance. ( As a wise friend told me long ago, “If you want to get a reputation as a good businessman, be sure to get into a good business.”) And fundamentals are definitely eroding in the newspaper industry, a trend that has crushed the profits of our Buffalo News to decline. The skid will almost certainly continue.
3. Read about the dwindling fortunes of Newspaper industry in the letter.
4. I want to emphasize that even though our course is unwise, Americans will live better ten or twenty years from now than they do today. Per-capita wealth will increase. But our citizens will also be forced every year to ship a significant portion of their current production abroad merely to service the cost of our huge debtor position. It won’t be pleasant to work part of each day to pay for the over-consumption of our ancestors. I believe, that at some point in the future, U.S> workers and voters will find the annual “tribute” so onerous that there will be a severe political backlash. How that will play out in the markets is impossible to predict-but to expect a “soft landing” seems like wishful thinking.
5. Read the portion about Walter Schloss in the letter in detail for better understanding.

2007

1. You may recall a 2003 Silicon Valley bumper sticker that implored, “Please, God, Just One More Bubble”. Unfortunately, the wish was promptly granted, as just about all Americans came to believe that house prices could forever rise. That conviction made a borrower’s income and cash equity seem unimportant to lenders, who shoved out money, confident that HAP- House Price Appreciation-would cure all problems. Today, our country is experiencing widespread pain because of that erroneous belief. As house prices fall, a huge amount of financial folly is being exposed. You only learn who has been swimming naked when the tide goes out-and what we are witnessing at some of our largest financial institution is an ugly sight.
2. A truly great business must have an enduring “moat” that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business “castle” that is earning high returns. Therefore, a formidable barrier such as a company’s being the low-cost producer (GEICO, Costco) or possessing a powerful world-wide brand (Coca-Cola, Gillette, American Express) is essential for sustained success. Business history is filled with “Roman Candles”, companies whose moats proved illusory and were soon eroded.
3. Our criterion of “enduring” causes us to rule out companies in industries prone to rapid and continuous change. Though capitalism’s “creative destruction” is a highly beneficial for society, it precludes investment certainty. A moat that must be continuously rebuilt is no moat at all.
4. Additionally, this criterion eliminates the business whose success depends on having a great manager. If a business requires a superstar to produce great results, the business itself cannot be deemed great.
5. Long-term competitive advantage in a stable industry is what we seek in a business. 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 business 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 business, 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.
6. Read See’s Candy Example in detail from the letter.
7. The worst sort of business is one that grows rapidly, requires significant capital to engender the growth and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers.
8. To sum up, think of three types of “savings accounts”. The great one pays extraordinarily high interest rates that will rise as the years pass. The good one pays an attractive rate of interest that will be earned also on deposits that are added. Finally, the gruesome account both pay an inadequate interest rate and requires you to keep adding money at those disappointing returns.
9. To date, Dexter is the worst deal that I’ve made. But I’ll make more mistakes in the future-you can bet on that. A line from Bobby Bare’s country song explains what too often happens with acquisitions: - “I’ve never gone to bed with an ugly woman, but I’ve sure woke up with a few.”
10. Naturally, every investor expects to be above average. And those “helpers” (consultants and high-priced managers) will certainly encourage their clients in this belief. But, as a class, the helper-aided group must be below average. The reason is simple:
    1. Investors, overall, will necessarily earn an average return, minus costs they incur.
    2. Passive and index investors, through their very inactivity, will earn that average minus costs that are very low;
    3. With that group earnings average returns, so must the remaining group-the active investors. But this group will incur high transaction, management, and advisory costs.

Therefore, the active investors will have their returns diminished by a far greater percentage than will their inactive brethren. This means the passive group-the “know-nothings”-must win.

1. Beware the glib “helper” who fills your head with fantasies while he fills his pocket with fees.
2. After decades of pushing the envelope-or worse-in its attempt to report the highest number possible for current earnings, Corporate America should ease up. It should listen to my partner, Charlie: “If you’ve hit three balls out of bounds to the left, aim a little to the right on the next swing.”
3. Read the story where the Girl says, “We buried Dad in a rented suit” for valuable insights.

2008

1. In good years and bad, Charlie and I simply focus on four goals:
   1. Maintaining Berkshire’s Gibraltar-like financial position, which features huge amounts of excess liquidity, near term obligation that are modest, and dozen of sources of earnings and cash.
   2. Widening the “moats” around our operating businesses that give them durable competitive advantage.
   3. Acquiring and developing new and varied streams of earnings.
   4. Expanding and nurturing the cadre of outstanding operating managers who, over the years, have delivered Berkshire exceptional results.
2. Berkshire is always a buyer of both businesses and securities and the disarray in markets gave us a tailwind in our purchases. When investing, pessimism is your friend, euphoria the enemy.
3. The market value of the bonds and stocks that we continue to hold suffered a significant decline along with the general market. This does not bother Charlie and me. Indeed, we enjoy such price declines if we have funds available to increase our positions. Long ago, Ben Graham taught me that, “Price is what you pay; value is what you get”. Whether we’re talking about socks or stocks, I like buying quality merchandise marked down.
4. Approval, though, is not the goal of investing. In fact, approval is often counter-productive because it sedates the brain and makes it less receptive to new facts or a re-examination of conclusion formed earlier. Beware the investment activity that produces applause; the great moves are usually greeted by yawns.
5. Read about Buffett’s mistake with respect of investing in Conco Phillios, read about Fannie Mac and Freddie Mac, read about the collapse of The Bear Stearns and read about the dangers of derivatives from the letter.
6. Read about the problems of Black Scholes Model.

2009

1. Important points from the portion, “What We Don’t Do”
   1. Charlie laid out his strongest ambition: “All I want to know is where I’m going to die, so I’ll never go there.” It was inspired by Jacobi, the great mathematician.
   2. In the past, it required no brilliance for people to foresee the fabulous growth that awaited such industries as autos (in 1910), aircraft (in 1930) & TV sets (in 1950). But the future then also included competitive dynamics that would decimate almost all of the companies entering those industries. Even the survivors tended to come away bleeding.
   3. Just because Charlie and I can clearly see dramatic growth ahead for an industry does not mean we can judge what its profit margins and ROC will be as a host of competitiors battle for supremacy. At Berkshire, we will stick with business whose profit picture for decades to come seems reasonably predictable. Even then, we will make mistakes.
   4. We will never become dependent on the kindness of strangers. Too-big-to-fail is not a fallback position at Berkshire
   5. When the financial system went into cardiac arrest in September 2008, Berkshire was a supplier of liquidity & capital to the system not a supplicant.
   6. We pay a steep price to maintain our premier strength. The $20 billion-plus of cash equivalent assets that we customarily hold is earning us a pittance at present. But we sleep well.
2. The best business by far for owners continue to be the ones that have high returns on capital and that require little incremental investment to grow. We are fortunate to own a number of such businesses and we would love to buy more.
3. We entered 2008 with $44.3 billion of cash-equivalents and we have since retained operating earnings of $17 billion. Nevertheless, at yearend 2009, our cash was down to $30.6 billion. We’ve put a lot of money to work during the chaos of the last two years. It’s been an ideal period for investors. A climate of fear is the best friend. Those who invest only when commentators are upbeat, end up paying a heavy price for meaningless reassurance. In the end, what counts in investing is what you pay for a business-through the purchase of a small portion of it in the stock market-and what that business earns in the succeeding decade or two.

2010

1. Money will always flow toward opportunity, and there is an abundance of that in America. Commentators today often talk of “great uncertainty”. But think back, for example to Dec 6, 1941, Oct 18, 1987, and Sep 10, 2001. No matter how serene today may be, tomorrow is always uncertain.
2. Market price and intrinsic value often follow very different paths-sometimes for extended periods-but eventually they meet.
3. Buffett again talks about the inappropriateness of Black Scholes model, especially in case of valuing long-dated options.
4. Buffett talks about the dangers of leverage and importance of saving for emergency or keeping cash.
5. Writer Ray De Voe’s observation, “More money has been lost reaching for a yield than at the point of a gun.”
6. Bu being so cautious in respect to leverage, we penalize our returns by a minor amount. Having loads of liquidity, though, lets us sleep well. Moreover, during the episodes of financial chaos that occasionally erupt in our economy, we will be equipped both financially and emotionally to play offense while others scramble for survival. That’s what allowed us to invest $ 15.6 billion in 25 days of panic following the Lehman bankruptcy in 2008.

2011

1. Read the IBM example in regards to share repurchase.
2. “Buy commodities, sell brands” has long been a formula for business success.
3. Investing is often described as the process of laying out money now in the expectation of receiving more money in the future. At Berkshire we take a more demanding approach, defining investing as the transfer to others of purchasing power now with the reassured expectation of receiving more purchasing power-after-taxes have been paid on nominal gains in the future. More succinctly, investing is forging consumption now in order to have the ability to consume more at a later date.
4. The riskiness of an investment is not measured by BETA but rather by the probability-the reasoned probability-of that investment causing its owner a loss of purchasing-power over his contemplated holding period. Assets can fluctuate greatly in price and not be risky as long as they are reasonably certain to deliver increased purchasing power over their holding period. And as we will see, a non-fluctuating asset can be laden with risk.
5. Money market instruments, bonds, mortgages & bank deposits are thought of as “safe”. In truth they are among the most dangerous of assets. Their beta may be zero, but their risk is huge. Over the past century these instruments have destroyed the purchasing power of investors in many countries, even as the holders continued to receive timely payments of interest and principal. This ugly result, moreover, will forever occur.
6. Under today’s conditions, therefore, I do not like currency based instruments. Even so, Berkshire holds significant amount of them, primarily of the short-term variety. At Berkshire, the need for ample liquidity occupies centre stage and will never be slighted, however inadequate rates may be. Accommodating this need, we primarily hold U.S. Treasury Bills, the only instrument that can be counted on liquidity under the most chaotic of economic conditions.
7. Buffett advises to not invest in gold because it’s unproductive. Read the story on Gold Cube Pile A&B.
8. Admittedly, when people a century from now are fearful, it’s likely many will still rush to gold. I am confident, however, that the $9.6 trillion current valuation of Pile A will compound over the century at a rate far inferior to that achieved by Pile B. ( Pile A: 1,70,000 metric tonnes of gold @ $1750 per ounce, equals to $9.6 trillion, Pile B: Using the $9.6 trillion we may buy all US cropland plus 16 Exxon Mobils and still have $1 trillion left.)
9. Buffett prefers investment in productive assets, whether businesses, farms or real estate. He says, “I believe that over any extended period of time, this category of investing will prove to be the runaway winner among the three categories of investments we’ve examined. More importantly, it will be by far the safest. The categories are:
   1. Currency based investments like bonds, money market instruments.
   2. Unproductive assets like gold
   3. Productive assets like business, farms or real estates.

2012

1. American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favour. (The Dow Jones Industrials advanced from 66 to 11497 in the 20th century, a staggering 17,320% increase that materialized despite four costly wars, a Great Depression and many recessions. And don’t forget that shareholders received substantial dividends throughout the century as well.)
2. Since the basic game is so favourable, Charlie and I believe it’s a terrible mistake to try to dance in and out of it based upon the turn of tarot cards, the predictions of “experts”, or the ebb and flow of business activity. The risks of being out of the game are huge compared to the risks of being in it.
3. So how our attractive float does affects the calculation of intrinsic value? When Berkshire’s book value is calculated, the full amount of float is deducted as a liability just as if we had to pay it out tomorrow and were unable to replenish. But that’s an incorrect way to look at float, which should instead be viewed as a revolving fund. If float is both costless and long enduring, which I believe Berkshire’s will be, the true value of this liability is dramatically less than the accounting liability.
4. That old line, “The other guy is doing it, so we must as well,” spells trouble in any business.
5. Serious investors should understand the disparate nature of intangible assets. Some truly deplete over time while others never lose value. With software, for example, amortization charges are very real expense. Charges against other intangibles such as amortization of customer relationships, however, arise through purchase-accounting rules and are clearly not real expenses. GAAP accounting draws no distinction between the two types of charges. Both, that is, are recorded as expenses when calculating earnings-even though from an investor’s viewpoint they could not be more different.
6. Read why Buffett buys 28 newspaper companies
7. Read Dividends column in detail.
8. Newspapers continue to rein supreme, however, in the delivery of local news. If you want to know what’s going on in your town-whether the news is about the mayor or taxes or high school football-there is no substitute for a local newspaper that is doing its job. A reader’s eyes may glaze over after they take in a couple of paragraphs about Canadian tariffs or political developments in Pakistan; a story about the reader himself or his neighbours will be read to the end. Whenever there is a persuasive sense of community, a paper that serves the special informational needs of that community will remain indispensable to a significant portion of its residents.
9. Charlie and I believe that papers delivering comprehensive and reliable information to tightly bound communities and having a sensible internet strategy will remain viable for a long time. We do not believe that success will come from cutting either the news content or frequency of publication. Indeed, skimpy news coverage will almost certainly lead to skimpy readership. And the less-than-daily publication that is now being tried in some large towns or cities-while it may improve profits in the short-term-seems certain to diminish the paper’s relevance over time. Our goal is to keep our papers loaded with content of interest to our readers and to be paid appropriately by those who find us useful, whether the product they view is in their hands or on the Internet.
10. Berkshire’s policy of capital allocation as explained by Buffett:
11. First examine reinvestment possibilities offered by its current business-projects to become more efficient, expand territorially, extend and improve product lines or to otherwise widen the economic moat separating the company from its competitors.
12. Next step is to search for acquisitions unrelated to current business but only if you leave shareholders wealthier on a per-share basis than they were prior to acquisition.
13. Next comes repurchase of its own shares, it is sensible for a company only when its shares sell at a meaningful discount to conservatively calculated intrinsic value. ( For Berkshire it is 110-120% of Book Value)
14. Berkshire is against dividends and they believe extra cash may be judiciously used for repurchase rather than dividends. Read example in the letter.
15. Above all, dividend policy should always be clear, consistent and rational. A capricious policy will confuse owners and drive away would-be investors. Phil Fisher put it wonderfully 54 years ago in Chapter 7 of his common stocks & Uncommon Profits, a book that ranks behind only The Intelligent Investor and the 1940 edition of Security Analysis in the all-time-best list for the serious investor. Phil explained that you can successfully run a restaurant that serves hamburger or, alternatively, one that features Chinese food. But you can’t switch capriciously between the two and retain the fans of either.

2013

1. Definition of interest coverage ratio for Berkshire is Pre-tax earnings/ Interest and not EBITDA/ Interest, a commonly used measure which Buffett views as seriously flawed.
2. Every dime of depreciation expense we report is a real cost. And that’s true at almost all other companies as well. When Wall Streeters tout EBITDA as a valuation guide, button your wallet.
3. Certain fundamentals of investing:
   1. You don’t need to be an expert in order to achieve satisfactory investment returns. But if you aren’t you must recognize your limitations and follow a course certain to work reasonably well. Keep things simple and don’t swing for the fences. When promised quick profits, response with a quick “no”.
   2. Focus on the future productivity of the asset you are considering. If you don’t feel comfortable making a rough estimate of the asset’s future earnings, just forget it and move on. No one has to evaluate every investment possibility. But omniscience isn’t necessary; you only need to understand the actions you undertake.
   3. If you instead focus on the prospective price change of a contemplated purchase, you are speculating. And the fact that a given asset has appreciated in the recent past is never a reason to buy it.
   4. Games are won by the players who focus on the playing field-not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.
   5. Forming macro opinions or listening to the macro or market predictions of other is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important.
4. There is one major difference between my two real estate investment s and an investment in stocks. Stocks provide you minute-to-minute valuations for your holdings whereas I have yet to see quotation for either my farm or the New York real estate.
5. Owners of stocks, too often let the capricious and often irrational behaviour of their fellow owners cause them to behave irrationally as well.
6. Those people who can sit quietly for decades when they own a farm or apartment house, too often become fanatic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of “Don’t just sit there, do something.”
7. Tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your friend when investing; a euphoric world is your enemy.

2014

1. If our insurance premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit is earned, we enjoy the use of free money-and, better yet, get paid for holding it. Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous indeed that if frequently causes the Property Casualty insurance industry as a whole to operate at a significant underwriting loss. This loss, in effect, is what the industry pays to hold its float. Competitive dynamics almost guarantee that the insurance industry, despite the float income all its companies enjoy, will continue its dismal record of earning subnormal returns on tangible net worth as compared to other American businesses. The prolonged period of low interest rates our country is now dealing with causes earnings on float to decrease, thereby exacerbating the profit problems of the industry.
2. The cost of the goodwill, however, has no bearing on its true value. For example, if an insurance company sustains large and prolonged underwriting losses, any goodwill asset carried on the books should be deemed valueless, whatever its original cost......Whereas in case of Berkshire, the true economic value of our insurance goodwill is far in excess of its historic carrying value. Under present accounting rules (with which we agree) this excess value will never be entered in our books. But I can assure you that it’s real. That’s one reason- a huge reason- why we believe Berkshire’s intrinsic business value substantially exceeds its book value.
3. The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been far safer to invest in a diversified collection of American businesses than to invest in securities-Treasuries, for example-whose values have been tied to American currency. That was also true in the preceding half-century, a period including Great Depression and two world wars. Investors should heed this history. To one degree or another it is almost certain to be repeated during the next century.
4. Stock prices will always be far more volatile than cash equivalent holdings. Over the long term, however, currency denominated instruments are riskier investments far riskier investments than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is far from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray.
5. It is true, of course, that owning equities for a day or a week or a year is far riskier (in both nominal and purchasing-power terms) than leaving funds in cash equivalents.... For the great majority of investors, however, who can and should invest with a multi-decade horizon, quotational declines are unimportant. Their focus should remain fixed on attaining significant gains in purchasing power over their investing lifetime. For them, a diversified equity portfolio, bought over time, will prove far less risky than dollar-based securities.
6. Investors, of course, can, by their own behaviour, make stock ownership highly risky. And many do. Active trading attempts to “time” market movements, inadequate diversification, the payment of high and unnecessary fees to managers and advisors, and the use of borrowed money can destroy the decent returns that a lifelong owner of equities would otherwise enjoy.
7. Market forecasters will fill your ear but will never fill your wallet.
8. Decades ago, Ben Graham pinpointed the blame for investment failure, using a quote from Shakespeare: “The fault, dear Brutus, is not in our stars, but in ourselves”
9. Read the thoughts of Buffett & Munger at the end of the letter for gaining insights into their minds.
10. Book recommendations:
    1. Where are the customer’s yachts? By Fred Schwed
    2. The little book of common sense Investing by Jack Bogle