

# Chairman's Letter - 1992

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## BERKSHIRE HATHAWAY INC.

### To the Shareholders of Berkshire Hathaway Inc.:

Our per-share book value increased 20.3% during 1992. Over the last 28 years (that is, since present management took over) book value has grown from \$19 to \$7,745, or at a rate of 23.6% compounded annually.

During the year, Berkshire's net worth increased by \$1.52 billion. More than 98% of this gain came from earnings and appreciation of portfolio securities, with the remainder coming from the issuance of new stock. These shares were issued as a result of our calling our convertible debentures for redemption on January 4, 1993, and of some holders electing to receive common shares rather than the cash that was their alternative. Most holders of the debentures who converted into common waited until January to do it, but a few made the move in December and therefore received shares in 1992. To sum up what happened to the \$476 million of bonds we had outstanding: \$25 million were converted into shares before yearend; \$46 million were converted in January; and \$405 million were redeemed for cash. The conversions were made at \$11,719 per share, so altogether we issued 6,106 shares.

Berkshire now has 1,152,547 shares outstanding. That compares, you will be interested to know, to 1,137,778 shares outstanding on October 1, 1964, the beginning of the fiscal year during which Buffett Partnership, Ltd. acquired control of the company.

We have a firm policy about issuing shares of Berkshire, doing so only when we receive as much value as we give. Equal value, however, has not been easy to obtain, since we have always valued our shares highly. So be it: We wish to increase Berkshire's size only when doing that also increases the wealth of its owners.

Those two objectives do not necessarily go hand-in-hand as an amusing but value-destroying experience in our past illustrates. On that occasion, we had a significant investment in a bank whose management was hell-bent on expansion. (Aren't they all?) When our bank wooed a smaller bank, its owner demanded a stock swap on a basis that valued the acquiree's net worth and earning power at over twice that of the acquirer's. Our management - visibly in heat - quickly capitulated. The owner of the acquiree then insisted on one other condition: "You must promise me," he said in effect, "that once our merger is done and I have become a

major shareholder, you'll never again make a deal this dumb."

You will remember that our goal is to increase our per-share intrinsic value - for which our book value is a conservative, but useful, proxy - at a 15% annual rate. This objective, however, cannot be attained in a smooth manner. Smoothness is particularly elusive because of the accounting rules that apply to the common stocks owned by our insurance companies, whose portfolios represent a high proportion of Berkshire's net worth. Since 1979, generally accepted accounting principles (GAAP) have required that these securities be valued at their market prices (less an adjustment for tax on any net unrealized appreciation) rather than at the lower of cost or market. Run-of-the-mill fluctuations in equity prices therefore cause our annual results to gyrate, especially in comparison to those of the typical industrial company.

To illustrate just how volatile our progress has been - and to indicate the impact that market movements have on short-term results - we show on the facing page our annual change in per-share net worth and compare it with the annual results (including dividends) of the S&P 500.

You should keep at least three points in mind as you evaluate this data. The first point concerns the many businesses we operate whose annual earnings are unaffected by changes in stock market valuations. The impact of these businesses on both our absolute and relative performance has changed over the years. Early on, returns from our textile operation, which then represented a significant portion of our net worth, were a major drag on performance, averaging far less than would have been the case if the money invested in that business had instead been invested in the S&P 500. In more recent years, as we assembled our collection of exceptional businesses run by equally exceptional managers, the returns from our operating businesses have been high - usually well in excess of the returns achieved by the S&P.

A second important factor to consider - and one that significantly hurts our relative performance - is that both the income and capital gains from our securities are burdened by a substantial corporate tax liability whereas the S&P returns are pre-tax. To comprehend the damage, imagine that Berkshire had owned nothing other than the S&P index during the 28-year period covered. In that case, the tax bite would have caused our corporate performance to be appreciably below the record shown in the table for the S&P. Under present tax laws, a gain for the S&P of 18% delivers a corporate holder of that index a return well short of 13%. And this problem would be intensified if corporate tax rates were to rise. This is a structural disadvantage we simply have to live with; there is no antidote for it.

The third point incorporates two predictions: Charlie

Munger, Berkshire's Vice Chairman and my partner, and I are virtually certain that the return over the next decade from an investment in the S&P index will be far less than that of the past decade, and we are dead certain that the drag exerted by Berkshire's expanding capital base will substantially reduce our historical advantage relative to the index.

Making the first prediction goes somewhat against our grain: We've long felt that the only value of stock forecasters 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 the market like children. However, it is clear that stocks cannot forever overperform their underlying businesses, as they have so dramatically done for some time, and that fact makes us quite confident of our forecast that the rewards from investing in stocks over the next decade will be significantly smaller than they were in the last. Our second conclusion - that an increased capital base will act as an anchor on our relative performance - seems incontestable. The only open question is whether we can drag the anchor along at some tolerable, though slowed, pace.

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 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.

### **The Salomon Interlude**

Last June, I stepped down as Interim Chairman of Salomon Inc after ten months in the job. You can tell from Berkshire's 1991-92 results that the company didn't miss me while I was gone. But the reverse isn't true: I missed Berkshire and am delighted to be back full-time. There is no job in the world that is more fun than running Berkshire and I count myself lucky to be where I am.

The Salomon post, though far from fun, was interesting and worthwhile: In Fortune's annual survey of America's Most Admired Corporations, conducted last September, Salomon ranked second among 311 companies in the degree to which it improved its reputation. Additionally, Salomon Brothers, the securities subsidiary of Salomon Inc, reported record pre-tax earnings last year - 34% above the previous high.

Many people helped in the resolution of Salomon's problems and the righting of the firm, but a few clearly deserve special mention. It is no exaggeration to say that without the combined efforts of Salomon executives Deryck Maughan, Bob Denham, Don

Howard, and John Macfarlane, the firm very probably would not have survived. In their work, these men were tireless, effective, supportive and selfless, and I will forever be grateful to them.

Salomon's lead lawyer in its Government matters, Ron Olson of Munger, Tolles & Olson, was also key to our success in getting through this trouble. The firm's problems were not only severe, but complex. At least five authorities - the SEC, the Federal Reserve Bank of New York, the U.S. Treasury, the U.S. Attorney for the Southern District of New York, and the Antitrust Division of the Department of Justice - had important concerns about Salomon. If we were to resolve our problems in a coordinated and prompt manner, we needed a lawyer with exceptional legal, business and human skills. Ron had them all.

## **Acquisitions**

Of all our activities at Berkshire, the most exhilarating for Charlie and me is the acquisition of a business with excellent economic characteristics and a management that we like, trust and admire. Such acquisitions are not easy to make but we look for them constantly. In the search, 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.

In the past, I've observed that many acquisition-hungry managers were apparently mesmerized by their childhood reading of the story about the frog-kissing princess. Remembering her success, they pay dearly for the right to kiss corporate toads, expecting wondrous transfigurations. Initially, disappointing results only deepen their desire to round up new toads. ("Fanaticism," said Santyana, "consists of redoubling your effort when you've forgotten your aim.") Ultimately, even the most optimistic manager must face reality. Standing knee-deep in unresponsive toads, he then announces an enormous "restructuring" charge. In this corporate equivalent of a Head Start program, the CEO receives the education but the stockholders pay the tuition.

In my early days as a manager I, too, dated a few toads. They were cheap dates - I've never been much of a sport - but my results matched those of acquirers who courted higher-priced toads. I kissed and they croaked.

After several failures of this type, I finally remembered some useful advice I once got from a golf pro (who, like all pros who have had anything to do with my game, wishes to remain anonymous). Said the pro: "Practice doesn't make perfect; practice makes permanent." And thereafter I revised my strategy and tried to buy good businesses at fair prices rather than fair businesses at good prices.

Last year, in December, we made an acquisition that is a prototype of what we now look for. The purchase was 82% of Central States Indemnity, an insurer that makes monthly payments for credit-card holders who are unable themselves to pay because they have become disabled or unemployed. Currently the company's annual premiums are about \$90 million and profits about \$10 million. Central States is based in Omaha and managed by Bill Kizer, a friend of mine for over 35 years. The Kizer family - which includes sons Bill, Dick and John - retains 18% ownership of the business and will continue to run things just as it has in the past. We could not be associated with better people.

Coincidentally, this latest acquisition has much in common with our first, made 26 years ago. At that time, we purchased another Omaha insurer, National Indemnity Company (along with a small sister company) from Jack Ringwalt, another long-time friend. Jack had built the business from scratch and, as was the case with Bill Kizer, thought of me when he wished to sell. (Jack's comment at the time: "If I don't sell the company, my executor will, and I'd rather pick the home for it.") National Indemnity was an outstanding business when we bought it and continued to be under Jack's management. Hollywood has had good luck with sequels; I believe we, too, will.

Berkshire's acquisition criteria are described on page 23. Beyond purchases made by the parent company, however, our subsidiaries sometimes make small "add-on" acquisitions that extend their product lines or distribution capabilities. In this manner, we enlarge the domain of managers we already know to be outstanding - and that's a low-risk and high-return proposition. We made five acquisitions of this type in 1992, and one was not so small: At yearend, H. H. Brown purchased Lowell Shoe Company, a business with \$90 million in sales that makes Nursemates, a leading line of shoes for nurses, and other kinds of shoes as well. Our operating managers will continue to look for add-on opportunities, and we would expect these to contribute modestly to Berkshire's value in the future.

Then again, a trend has emerged that may make further acquisitions difficult. The parent company made one purchase in 1991, buying H. H. Brown, which is run by Frank Rooney, who has eight children. In 1992 our only deal was with Bill Kizer, father of nine. It won't be easy to keep this string going in 1993.

## **Sources of Reported Earnings**

The table below shows the major sources of Berkshire's reported earnings. In this presentation, amortization of Goodwill and other major purchase-price accounting adjustments are not charged against the specific businesses to which they apply, but are instead aggregated and shown separately. This procedure lets you view the earnings of our businesses as they would have been reported had we not purchased them. I've

explained in past reports why this form of presentation seems to us to be more useful to investors and managers than one utilizing GAAP, which requires purchase-price adjustments to be made on a business-by-business basis. The total net earnings we show in the table are, of course, identical to the GAAP total in our audited financial statements.

(000s omitted)

Berkshire's Share of Net Earnings (after taxes and Pre-Tax Earnings minority interests)				
	1992	1991	1992	1991
Operating Earnings:				
Insurance Group:				
Underwriting .....	\$(108,961)	\$(119,593)	\$ (71,141)	\$ (77,229)
Net Investment Income....	355,067	331,846	305,763	285,173
H. H. Brown (acquired 7/1/91)	27,883	13,616	17,340	8,611
Buffalo News .....	47,863	37,113	28,163	21,841
Fechheimer .....	13,698	12,947	7,267	6,843
Kirby .....	35,653	35,726	22,795	22,555
Nebraska Furniture Mart ...	17,110	14,384	8,072	6,993
Scott Fetzer				
Manufacturing Group ....	31,954	26,123	19,883	15,901
See's Candies .....	42,357	42,390	25,501	25,575
Wesco - other than Insurance	15,153	12,230	9,195	8,777
World Book .....	29,044	22,483	19,503	15,487
Amortization of Goodwill ..	(4,702)	(4,113)	(4,687)	(4,098)
Other Purchase-Price				
Accounting Charges .....	(7,385)	(6,021)	(8,383)	(7,019)
Interest Expense* .....	(98,643)	(89,250)	(62,899)	(57,165)
Shareholder-Designated				
Contributions .....	(7,634)	(6,772)	(4,913)	(4,388)
Other .....	72,223	77,399	36,267	47,896
Operating Earnings .....	460,680	400,508	347,726	315,753
Sales of Securities .....	89,937	192,478	59,559	124,155
Total Earnings - All Entities	\$ 550,617	\$ 592,986	\$ 407,285	\$ 439,908

\*Excludes interest expense of Scott Fetzer Financial Group and Mutual Savings & Loan. Includes \$22.5 million in 1992 and \$5.7 million in 1991 of premiums paid on the early redemption of debt.

A large amount of additional information about these businesses is given on pages 37-47, where you will also find our segment earnings reported on a GAAP basis. Our goal is to give you all of the financial information that Charlie and I consider significant in making our own evaluation of Berkshire.

## "Look-Through" Earnings

We've previously discussed look-through earnings, which consist of: (1) the operating earnings reported in the previous section, plus; (2) the retained operating earnings of major investees that, under GAAP accounting, are not reflected in our profits, less; (3) an allowance for the tax that would be paid by Berkshire if these retained earnings of investees had instead been distributed to us. Though no single figure can be perfect, we believe that the look-through number more accurately portrays the earnings of Berkshire than does the GAAP number.

I've told you that over time look-through earnings must increase at about 15% annually if our intrinsic business value is to grow at that rate. Our look-through earnings in 1992 were \$604 million, and they will need to grow to more than \$1.8 billion by the year 2000 if we are to meet that 15% goal. For us to get there, our operating subsidiaries and investees must deliver excellent performances, and we must exercise some skill in capital allocation as well.

We cannot promise to achieve the \$1.8 billion target. Indeed, we may not even come close to it. But it does guide our decision-making: When we allocate capital today, we are thinking about what will maximize look-through earnings in 2000.

We do not, however, see this long-term focus as eliminating the need for us to achieve decent short-term results as well. After all, we were thinking long-range thoughts five or ten years ago, and the moves we made then should now be paying off. If plantings made confidently are repeatedly followed by disappointing harvests, something is wrong with the farmer. (Or perhaps with the farm: Investors should understand that for certain companies, and even for some industries, there simply is *no* good long-term strategy.) Just as you should be suspicious of managers who pump up short-term earnings by accounting maneuvers, asset sales and the like, so also should you be suspicious of those managers who fail to deliver for extended periods and blame it on their long-term focus. (Even Alice, after listening to the Queen lecture her about "jam tomorrow," finally insisted, "It must come sometimes to jam today.")

The following table shows you how we calculate look-through earnings, though I warn you that the figures are necessarily very rough. (The dividends paid to us by these investees have been included in the operating earnings itemized on page 8, mostly under "Insurance Group: Net Investment Income.")

Berkshire's Share of Undistributed Berkshire's Approximate Operating Earnings Berkshire's Major Investees Ownership at Yearend (in millions)		
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	1992	1991	1992	1991	
	-----	-----	-----	-----	
Capital Cities/ABC Inc. ....	18.2%	18.1%	\$ 70	\$ 61	
The Coca-Cola Company .....	7.1%	7.0%	82	69	
Federal Home Loan Mortgage Corp.	8.2%(1)	3.4%(1)	29(2)	15	
GEICO Corp. ....	48.1%	48.2%	34(3)	69(3)	
General Dynamics Corp. ....	14.1%	--	11(2)	--	
The Gillette Company .....	10.9%	11.0%	38	23(2)	
Guinness PLC .....	2.0%	1.6%	7	--	
The Washington Post Company ...	14.6%	14.6%	11	10	
Wells Fargo & Company .....	11.5%	9.6%	16(2)	(17)(2)	
	-----	-----	-----	-----	
Berkshire's share of					
undistributed earnings of major investees			\$298	\$230	
Hypothetical tax on these					
undistributed investee earnings			(42)	(30)	
Reported operating earnings of Berkshire			348	316	
			-----	-----	
Total look-through earnings of Berkshire			\$604	\$516	

(1) Net of minority interest at Wesco

(2) Calculated on average ownership for the year

(3) Excludes realized capital gains, which have been both recurring and significant

## Insurance Operations

Shown below is an updated version of our usual table presenting key figures for the property-casualty insurance industry:

	<i>Yearly Change in Premiums Written (%)</i>	<i>Combined Ratio After Policyholder Dividends</i>
	-----	-----
1981 .....	3.8	106.0
1982 .....	3.7	109.6
1983 .....	5.0	112.0
1984 .....	8.5	118.0
1985 .....	22.1	116.3
1986 .....	22.2	108.0
1987 .....	9.4	104.6
1988 .....	4.5	105.4
1989 .....	3.2	109.2
1990 .....	4.5	109.6
1991 (Revised) .....	2.4	108.8
1992 (Est.) .....	2.7	114.8

The combined ratio represents total insurance costs (losses incurred plus expenses) compared to revenue from premiums: A ratio below 100 indicates an underwriting profit, and one above 100 indicates a loss. The higher the ratio, the worse the year. When the investment income that an insurer earns from holding



policyholders' funds ("the float") is taken into account, a combined ratio in the 106 - 110 range typically produces an overall break-even result, exclusive of earnings on the funds provided by shareholders.

About four points in the industry's 1992 combined ratio can be attributed to Hurricane Andrew, which caused the largest insured loss in history. Andrew destroyed a few small insurers. Beyond that, it awakened some larger companies to the fact that their reinsurance protection against catastrophes was far from adequate. (It's only when the tide goes out that you learn who's been swimming naked.) One major insurer escaped insolvency solely because it had a wealthy parent that could promptly supply a massive transfusion of capital.

Bad as it was, however, Andrew could easily have been far more damaging if it had hit Florida 20 or 30 miles north of where it actually did and had hit Louisiana further east than was the case. All in all, many companies will rethink their reinsurance programs in light of the Andrew experience.

As you know we are a large writer - perhaps the largest in the world - of "super-cat" coverages, which are the policies that other insurance companies buy to protect themselves against major catastrophic losses. Consequently, we too took our lumps from Andrew, suffering losses from it of about \$125 million, an amount roughly equal to our 1992 super-cat premium income. Our other super-cat losses, though, were negligible. This line of business therefore produced an overall loss of only \$2 million for the year. (In addition, our investee, GEICO, suffered a net loss from Andrew, after reinsurance recoveries and tax savings, of about \$50 million, of which our share is roughly \$25 million. This loss did not affect our operating earnings, but did reduce our look-through earnings.)

In last year's report I told you that I hoped that our super-cat business would over time achieve a 10% profit margin. But I also warned you that in any given year the line was likely to be "either enormously profitable or enormously unprofitable." Instead, both 1991 and 1992 have come in close to a break-even level. Nonetheless, I see these results as aberrations and stick with my prediction of huge annual swings in profitability from this business.

Let me remind you of some characteristics of our super-cat policies. Generally, they are activated only when two things happen. First, the direct insurer or reinsurer we protect must suffer losses of a given amount - that's the policyholder's "retention" - from a catastrophe; and second, industry-wide insured losses from the catastrophe must exceed some minimum level, which usually is \$3 billion or more. In most cases, the policies we issue cover only a specific geographical area, such as a portion of the U.S., the entire U.S., or everywhere other than the U.S. Also, many policies are not activated by the first

super-cat that meets the policy terms, but instead cover only a "second-event" or even a third- or fourth-event. Finally, some policies are triggered only by a catastrophe of a specific type, such as an earthquake. Our exposures are large: We have one policy that calls for us to pay \$100 million to the policyholder if a specified catastrophe occurs. (Now you know why I suffer eyestrain: from watching The Weather Channel.)

Currently, Berkshire is second in the U.S. property-casualty industry in net worth (the leader being State Farm, which neither buys nor sells reinsurance). Therefore, we have the capacity to assume risk on a scale that interests virtually no other company. We have the appetite as well: As Berkshire's net worth and earnings grow, our willingness to write business increases also. But let me add that means good business. The saying, "a fool and his money are soon invited everywhere," applies in spades in reinsurance, 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: Ajit Jain, who runs our reinsurance operation, is simply the best in this business. In combination, these strengths guarantee that we will stay a major factor in the super-cat business so long as prices are appropriate.

What constitutes an appropriate price, of course, is difficult to determine. Catastrophe insurers can't simply extrapolate past experience. If there is truly "global warming," for example, the odds would shift, since tiny changes in atmospheric conditions can produce momentous changes in weather patterns. Furthermore, in recent years there has been a mushrooming of population and insured values in U.S. coastal areas that are particularly vulnerable to hurricanes, the number one creator of super-cats. A hurricane that caused x dollars of damage 20 years ago could easily cost 10x now.

Occasionally, also, the unthinkable happens. Who would have guessed, for example, that a major earthquake could occur in Charleston, S.C.? (It struck in 1886, registered an estimated 6.6 on the Richter scale, and caused 60 deaths.) And who could have imagined that our country's most serious quake would occur at New Madrid, Missouri, which suffered an estimated 8.7 shocker in 1812. By comparison, the 1989 San Francisco quake was a 7.1 - and remember that each one-point Richter increase represents a ten-fold increase in strength. Someday, a U.S. earthquake occurring far from California will cause enormous losses for insurers.

When viewing our quarterly figures, you should understand that our accounting for super-cat premiums differs from our accounting for other insurance premiums. Rather than recording our super-cat premiums on a pro-rata basis over the life of a given policy, we defer recognition of revenue until a loss occurs or until the policy expires. We take this conservative approach because the likelihood of super-cats causing us losses is

particularly great toward the end of the year. It is then that weather tends to kick up: Of the ten largest insured losses in U.S. history, nine occurred in the last half of the year. In addition, policies that are not triggered by a first event are unlikely, by their very terms, to cause us losses until late in the year.

The bottom-line effect of our accounting procedure for super-cats is this: Large losses may be reported in any quarter of the year, but significant profits will only be reported in the fourth quarter.

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As I've told you in each of the last few years, what counts in our insurance business is "the cost of funds developed from insurance," or in the vernacular, "the cost of float." Float - which we generate in exceptional amounts - is the total of loss reserves, loss adjustment expense reserves and unearned premium reserves minus agents' balances, prepaid acquisition costs and deferred charges applicable to assumed reinsurance. The cost of float is measured by our underwriting loss.

The table below shows our cost of float since we entered the business in 1967.

	(1) Underwriting Loss	(2) Average Float	Yearend Yield Approximate Cost of Funds	on Long-Term Govt. Bonds
	(In \$ Millions)		(Ratio of 1 to 2)	
1967 .....	profit	\$17.3	less than zero	5.50%
1968 .....	profit	19.9	less than zero	5.90%
1969 .....	profit	23.4	less than zero	6.79%
1970 .....	\$ 0.37	32.4	1.14%	6.25%
1971 .....	profit	52.5	less than zero	5.81%
1972 .....	profit	69.5	less than zero	5.82%
1973 .....	profit	73.3	less than zero	7.27%
1974 .....	7.36	79.1	9.30%	8.13%
1975 .....	11.35	87.6	12.96%	8.03%
1976 .....	profit	102.6	less than zero	7.30%
1977 .....	profit	139.0	less than zero	7.97%
1978 .....	profit	190.4	less than zero	8.93%
1979 .....	profit	227.3	less than zero	10.08%
1980 .....	profit	237.0	less than zero	11.94%
1981 .....	profit	228.4	less than zero	13.61%
1982 .....	21.56	220.6	9.77%	10.64%
1983 .....	33.87	231.3	14.64%	11.84%
1984 .....	48.06	253.2	18.98%	11.58%
1985 .....	44.23	390.2	11.34%	9.34%
1986 .....	55.84	797.5	7.00%	7.60%
1987 .....	55.43	1,266.7	4.38%	8.95%
1988 .....	11.08	1,497.7	0.74%	9.00%

1989 .....	24.40	1,541.3	1.58%	7.97%
1990 .....	26.65	1,637.3	1.63%	8.24%
1991 .....	119.59	1,895.0	6.31%	7.40%
1992 .....	108.96	2,290.4	4.76%	7.39%

Last year, our insurance operation again generated funds at a cost below that incurred by the U.S. Government on its newly-issued long-term bonds. This means that in 21 years out of the 26 years we have been in the insurance business we have beaten the Government's rate, and often we have done so by a wide margin. (If, on average, we didn't beat the Government's rate, there would be no economic reason for us to be in the business.)

In 1992, as in previous years, National Indemnity's commercial auto and general liability business, led by Don Wurster, and our homestate operation, led by Rod Eldred, made excellent contributions to our low cost of float. Indeed, both of these operations recorded an underwriting profit last year, thereby generating float at a less-than-zero cost. The bulk of our float, meanwhile, comes from large transactions developed by Ajit. His efforts are likely to produce a further growth in float during 1993.

Charlie and I continue to like the insurance business, which we expect to be our main source of earnings for decades to come. The industry is huge; in certain sectors we can compete world-wide; and Berkshire possesses an important competitive advantage. We will look for ways to expand our participation in the business, either indirectly as we have done through GEICO or directly as we did by acquiring Central States Indemnity.

## Common Stock Investments

Below we list our common stock holdings having a value of over \$100 million. A small portion of these investments belongs to subsidiaries of which Berkshire owns less than 100%.

		12/31/92	
<i>Shares</i>	<i>Company</i>	<i>Cost</i>	<i>Market</i>
-----	-----	-----	-----
(000s omitted)			
3,000,000	Capital Cities/ABC, Inc. ....	\$ 517,500	\$1,523,500
93,400,000	The Coca-Cola Company. ....	1,023,920	3,911,125
16,196,700	Federal Home Loan Mortgage Corp.		
	("Freddie Mac") .....	414,257	783,515
34,250,000	GEICO Corp. ....	45,713	2,226,250
4,350,000	General Dynamics Corp. ....	312,438	450,769
24,000,000	The Gillette Company .....	600,000	1,365,000
38,335,000	Guinness PLC .....	333,019	299,581
1,727,765	The Washington Post Company .....	9,731	396,954
6,358,418	Wells Fargo & Company .....	380,983	485,624

Leaving aside splits, the number of shares we held in these

companies changed during 1992 in only four cases: We added moderately to our holdings in Guinness and Wells Fargo, we more than doubled our position in Freddie Mac, and we established a new holding in General Dynamics. We like to buy.

Selling, however, is a different story. There, our pace of activity resembles that forced upon a traveler who found himself stuck in tiny Podunk's only hotel. With no T.V. in his room, he faced an evening of boredom. But his spirits soared when he spied a book on the night table entitled "Things to do in Podunk." Opening it, he found just a single sentence: "You're doing it."

We were lucky in our General Dynamics purchase. I had paid little attention to the company until last summer, when it announced it would repurchase about 30% of its shares by way of a Dutch tender. Seeing an arbitrage opportunity, I began buying the stock for Berkshire, expecting to tender our holdings for a small profit. We've made the same sort of commitment perhaps a half-dozen times in the last few years, reaping decent rates of return for the short periods our money has been tied up.

But then I began studying the company and the accomplishments of Bill Anders in the brief time he'd been CEO. And what I saw made my eyes pop: Bill had a clearly articulated and rational strategy; he had been focused and imbued with a sense of urgency in carrying it out; and the results were truly remarkable.

In short order, I dumped my arbitrage thoughts and decided that Berkshire should become a long-term investor with Bill. We were helped in gaining a large position by the fact that a tender greatly swells the volume of trading in a stock. In a one-month period, we were able to purchase 14% of the General Dynamics shares that remained outstanding after the tender was completed.

\* \* \* \* \*

Our equity-investing strategy remains little changed from what it was fifteen years ago, when we said in the 1977 annual report: "We select our marketable equity securities in much the way we would evaluate a business for acquisition in its entirety. We want the business to be one (a) that we can understand; (b) with favorable long-term prospects; (c) operated by honest and competent people; and (d) available at a very attractive price." We have seen cause to make only one change in this creed: Because of both market conditions and our size, we now substitute "an attractive price" for "a very attractive price."

But how, you will ask, does one decide what's "attractive"? In answering this question, most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth." Indeed, many investment professionals see any mixing of the two terms as a form of intellectual cross-dressing.

We view that as fuzzy thinking (in which, it must be confessed, I myself engaged some years ago). In our opinion, the two approaches are joined at the hip: Growth is *always* a component in the calculation of value, constituting a variable whose importance can range from negligible to enormous and whose impact can be negative as well as positive.

In addition, we think the very term "value investing" is redundant. What is "investing" if it is not the act of seeking value at least sufficient to justify the amount paid? Consciously paying more for a stock than its calculated value - in the hope that it can soon be sold for a still-higher price - should be labeled speculation (which is neither illegal, immoral nor - in our view - financially fattening).

Whether appropriate or not, the term "value investing" is widely used. Typically, it connotes the purchase of stocks having attributes such as a low ratio of price to book value, a low price-earnings ratio, or a high dividend yield. Unfortunately, such characteristics, even if they appear in combination, are far from determinative as to whether an investor is indeed buying something for what it is worth and is therefore truly operating on the principle of obtaining value in his investments. Correspondingly, opposite characteristics - a high ratio of price to book value, a high price-earnings ratio, and a low dividend yield - are in no way inconsistent with a "value" purchase.

Similarly, business growth, per se, tells us little about value. It's true that growth often has a positive impact on value, sometimes one of spectacular proportions. But such an effect is far from certain. For example, investors have regularly poured money into the domestic airline business to finance profitless (or worse) growth. For these investors, it would have been far better if Orville had failed to get off the ground at Kitty Hawk: The more the industry has grown, the worse the disaster for owners.

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 a low-return business requiring incremental funds, growth hurts the investor.

In The Theory of Investment Value, written over 50 years ago, John Burr Williams set forth the equation for value, which we 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 maturity date that define 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 management is so inept

or dishonest that payment of interest is suspended. In contrast, the ability of management can dramatically affect the equity "coupons."

The investment shown by the discounted-flows-of-cash calculation to be the cheapest is the one that the investor should purchase - irrespective of whether the business grows or doesn't, displays volatility or smoothness in its earnings, or carries a high price or low in relation to its current earnings and book value. Moreover, though the value equation has usually shown equities to be cheaper than bonds, that result is not inevitable: When bonds are calculated to be the more attractive investment, they should be bought.

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 business to own is one that must, or *will*, do the opposite - that is, 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 makes significant stock repurchases.

Though the mathematical calculations required to evaluate equities are not difficult, an analyst - even one who is experienced and intelligent - can easily go wrong in estimating future "coupons." At Berkshire, we attempt to deal with this problem in two ways. First, we try to stick to businesses we believe we understand. That means they must be relatively simple and stable in character. If a business is complex or subject to constant change, we're not smart enough to predict future cash flows. Incidentally, that shortcoming doesn't bother us. 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.

Second, and equally important, we insist on a margin of safety in our purchase price. If we calculate the value of a common stock to be only slightly higher than its price, we're not interested in buying. We believe this margin-of-safety principle, so strongly emphasized by Ben Graham, to be the cornerstone of investment success.

## Fixed-Income Securities

Below we list our largest holdings of fixed-income securities:

(000s omitted)		
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Issuer	Cost of Preferreds and	
	Amortized Value of Bonds	Market



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ACF Industries Debentures .....	\$133,065(1)	\$163,327
American Express "Percs" .....	300,000	309,000(1)(2)
Champion International Conv. Pfd.	300,000(1)	309,000(2)
First Empire State Conv. Pfd. ..	40,000	68,000(1)(2)
Salomon Conv. Pfd. ....	700,000(1)	756,000(2)
USAir Conv. Pfd. ....	358,000(1)	268,500(2)
Washington Public Power Systems Bonds	58,768(1)	81,002

(1) Carrying value in our financial statements

(2) Fair value as determined by Charlie and me

During 1992 we added to our holdings of ACF debentures, had some of our WPPSS bonds called, and sold our RJR Nabisco position.

Over the years, we've done well with fixed-income investments, having realized from them both large capital gains (including \$80 million in 1992) and exceptional current income. Chrysler Financial, Texaco, Time-Warner, WPPSS and RJR Nabisco were particularly good investments for us. Meanwhile, our fixed-income losses have been negligible: We've had thrills but so far no spills.

Despite the success we experienced with our Gillette preferred, which converted to common stock in 1991, and despite our reasonable results with other negotiated purchases of preferreds, our overall performance with such purchases has been inferior to that we have achieved with purchases made in the secondary market. This is actually the result we expected. It corresponds with our belief that an intelligent investor in common stocks will do better in the secondary market than he will do buying new issues.

The reason has to do with the way prices are set in each instance. The secondary market, which is periodically ruled by mass folly, is constantly setting a "clearing" price. No matter how foolish that price may be, it's what counts for the holder of a stock or bond who needs or wishes to sell, of whom there are always going to be a few at any moment. In many instances, shares worth  $x$  in business value have sold in the market for  $1/2x$  or less.

The new-issue market, on the other hand, is ruled by controlling stockholders and corporations, who can usually select the timing of offerings or, if the market looks unfavorable, can avoid an offering altogether. Understandably, these sellers are not going to offer any bargains, either by way of a public offering or in a negotiated transaction: It's rare you'll find  $x$  for  $1/2x$  here. Indeed, in the case of common-stock offerings, selling shareholders are often motivated to unload *only* when they feel the market is overpaying. (These sellers, of course, would state that proposition somewhat differently, averring instead that they simply resist selling when the market is underpaying for their goods.)

To date, our negotiated purchases, as a group, have fulfilled but not exceeded the expectation we set forth in our 1989 Annual



Report: "Our preferred stock investments should produce returns modestly above those achieved by most fixed-income portfolios." In truth, we would have done better if we could have put the money that went into our negotiated transactions into open-market purchases of the type we like. But both our size and the general strength of the markets made that difficult to do.

There was one other memorable line in the 1989 Annual Report: "We have no ability to forecast the economics of the investment banking business, the airline industry, or the paper industry." At the time some of you may have doubted this confession of ignorance. Now, however, even my mother acknowledges its truth.

In the case of our commitment to USAir, industry economics had soured before the ink dried on our check. As I've previously mentioned, it was I who happily jumped into the pool; no one pushed me. Yes, I knew the industry would be ruggedly competitive, but I did not expect its leaders to engage in prolonged kamikaze behavior. In the last two years, airline companies have acted as if they are members of a competitive tontine, which they wish to bring to its conclusion as rapidly as possible.

Amidst this turmoil, Seth Schofield, CEO of USAir, has done a truly extraordinary job in repositioning the airline. He was particularly courageous in accepting a strike last fall that, had it been lengthy, might well have bankrupted the company. Capitulating to the striking union, however, would have been equally disastrous: The company was burdened with wage costs and work rules that were considerably more onerous than those encumbering its major competitors, and it was clear that over time any high-cost producer faced extinction. Happily for everyone, the strike was settled in a few days.

A competitively-beset business such as USAir requires far more managerial skill than does a business with fine economics. Unfortunately, though, the near-term reward for skill in the airline business is simply survival, not prosperity.

In early 1993, USAir took a major step toward assuring survival - and eventual prosperity - by accepting British Airways' offer to make a substantial, but minority, investment in the company. In connection with this transaction, Charlie and I were asked to join the USAir board. We agreed, though this makes five outside board memberships for me, which is more than I believe advisable for an active CEO. Even so, if an investee's management and directors believe it particularly important that Charlie and I join its board, we are glad to do so. We expect the managers of our investees to work hard to increase the value of the businesses they run, and there are times when large owners should do their bit as well.

## **Two New Accounting Rules and a Plea for One More**

A new accounting rule having to do with deferred taxes becomes

effective in 1993. It undoes a dichotomy in our books that I have described in previous annual reports and that relates to the accrued taxes carried against the unrealized appreciation in our investment portfolio. At yearend 1992, that appreciation amounted to \$7.6 billion. Against \$6.4 billion of that, we carried taxes at the current 34% rate. Against the remainder of \$1.2 billion, we carried an accrual of 28%, the tax rate in effect when that portion of the appreciation occurred. The new accounting rule says we must henceforth accrue all deferred tax at the current rate, which to us seems sensible.

The new marching orders mean that in the first quarter of 1993 we will apply a 34% rate to all of our unrealized appreciation, thereby increasing the tax liability and reducing net worth by \$70 million. The new rule also will cause us to make other minor changes in our calculation of deferred taxes.

Future changes in tax rates will be reflected immediately in the liability for deferred taxes and, correspondingly, in net worth. The impact could well be substantial. Nevertheless, what is important in the end is the tax rate at the time we sell securities, when unrealized appreciation becomes realized.

Another major accounting change, whose implementation is required by January 1, 1993, mandates that businesses recognize their present-value liability for post-retirement health benefits. Though GAAP has previously required recognition of pensions to be paid in the future, it has illogically ignored the costs that companies will then have to bear for health benefits. The new rule will force many companies to record a huge balance-sheet liability (and a consequent reduction in net worth) and also henceforth to recognize substantially higher costs when they are calculating annual profits.

In making acquisitions, Charlie and I have tended to avoid companies with significant post-retirement liabilities. As a result, Berkshire's present liability and future costs for post-retirement health benefits - though we now have 22,000 employees - are inconsequential. I need to admit, though, that we had a near miss: In 1982 I made a huge mistake in committing to buy a company burdened by extraordinary post-retirement health obligations. Luckily, though, the transaction fell through for reasons beyond our control. Reporting on this episode in the 1982 annual report, I said: "If we were to introduce graphics to this report, illustrating favorable business developments of the past year, two blank pages depicting this blown deal would be the appropriate centerfold." Even so, I wasn't expecting things to get as bad as they did. Another buyer appeared, the business soon went bankrupt and was shut down, and thousands of workers found those bountiful health-care promises to be largely worthless.

In recent decades, no CEO would have dreamed of going to his board with the proposition that his company become an insurer of uncapped post-retirement health benefits that other corporations

chose to install. A CEO didn't need to be a medical expert to know that lengthening life expectancies and soaring health costs would guarantee an insurer a financial battering from such a business. Nevertheless, many a manager blithely committed his own company to a self-insurance plan embodying precisely the same promises - and thereby doomed his shareholders to suffer the inevitable consequences. In health-care, open-ended promises have created open-ended liabilities that in a few cases loom so large as to threaten the global competitiveness of major American industries.

I believe part of the reason for this reckless behavior was that accounting rules did not, for so long, require the booking of post-retirement health costs as they were incurred. Instead, the rules allowed cash-basis accounting, which vastly understated the liabilities that were building up. In effect, the attitude of both managements and their accountants toward these liabilities was "out-of-sight, out-of-mind." Ironically, some of these same managers would be quick to criticize Congress for employing "cash-basis" thinking in respect to Social Security promises or other programs creating future liabilities of size.

Managers thinking about accounting issues should never forget one of Abraham Lincoln's favorite 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 behooves managers to remember that Abe's right even if an auditor is willing to certify that the tail is a leg.

\* \* \* \* \*

The most egregious case of let's-not-face-up-to-reality behavior by executives and accountants has occurred in the world of stock options. In Berkshire's 1985 annual report, I laid out my opinions about the use and misuse of options. But even when options are structured properly, they are accounted for in ways that make no sense. The lack of logic is not accidental: For decades, much of the business world has waged war against accounting rulemakers, trying to keep the costs of stock options from being reflected in the profits of the corporations that issue them.

Typically, executives have argued that options are hard to value and that therefore their costs should be ignored. At other times managers have said that assigning a cost to options would injure small start-up businesses. Sometimes they have even solemnly declared that "out-of-the-money" options (those with an exercise price equal to or above the current market price) have no value when they are issued.

Oddly, the Council of Institutional Investors has chimed in with a variation on that theme, opining that options should not be viewed as a cost because they "aren't dollars out of a company's coffers." I see this line of reasoning as offering exciting possibilities to American corporations for instantly improving

their reported profits. For example, they could eliminate the cost of insurance by paying for it with options. So if you're a CEO and subscribe to this "no cash-no cost" theory of accounting, I'll make you an offer you can't refuse: Give us a call at Berkshire and we will happily sell you insurance in exchange for a bundle of long-term options on your company's stock.

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 pinpoint precision. Right now, accounting abounds with imprecision. After all, no manager or auditor knows how long a 747 is going to last, which means he also does not know what the yearly depreciation charge for the plane should be. No one knows with any certainty what a bank's annual loan loss charge ought to be. And the estimates of losses that property-casualty companies make are notoriously inaccurate.

Does this mean that these important items of cost should be ignored simply because they can't be quantified with absolute accuracy? Of course not. Rather, these costs should be estimated by honest and experienced people and then recorded. When you get right down to it, what other item of major but hard-to-precisely-calculate cost - other, that is, than stock options - does the accounting profession say should be ignored in the calculation of earnings?

Moreover, options are just not that difficult to value. Admittedly, the difficulty is increased by the fact that the options given to executives are restricted in various ways. These restrictions affect value. They do not, however, eliminate it. In fact, since I'm in the mood for offers, I'll make one to any executive who is granted a restricted option, even though it may be out of the money: On the day of issue, Berkshire will pay him or her a substantial sum for the right to any future gain he or she realizes on the option. So if you find a CEO who says his newly-issued options have little or no value, tell him to try us out. In truth, we have far more confidence in our ability to determine an appropriate price to pay for an option than we have in our ability to determine the proper depreciation rate for our corporate jet.

It seems to me that 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?

The accounting profession and the SEC should be shamed by the fact that they have long let themselves be muscled by business executives on the option-accounting issue. Additionally, the lobbying that executives engage in may have an unfortunate by-product: In my opinion, the business elite risks losing its credibility on issues of significance to society - about which it

may have much of value to say - when it advocates the incredible on issues of significance to itself.

## Miscellaneous

We have two pieces of regrettable news this year. First, Gladys Kaiser, my friend and assistant for twenty-five years, will give up the latter post after the 1993 annual meeting, though she will certainly remain my friend forever. Gladys and I have been a team, and though I knew her retirement was coming, it is still a jolt.

Secondly, in September, Verne McKenzie relinquished his role as Chief Financial Officer after a 30-year association with me that began when he was the outside auditor of Buffett Partnership, Ltd. Verne is staying on as a consultant, and though that job description is often a euphemism, in this case it has real meaning. I expect Verne to continue to fill an important role at Berkshire but to do so at his own pace. Marc Hamburg, Verne's understudy for five years, has succeeded him as Chief Financial Officer.

I recall that one woman, upon being asked to describe the perfect spouse, specified an archeologist: "The older I get," she said, "the more he'll be interested in me." She would have liked my tastes: I treasure those extraordinary Berkshire managers who are working well past normal retirement age and who concomitantly are achieving results much superior to those of their younger competitors. While I understand and empathize with the decision of Verne and Gladys to retire when the calendar says it's time, theirs is not a step I wish to encourage. It's hard to teach a new dog old tricks.

\* \* \* \* \*

I am a moderate in my views about retirement compared to Rose Blumkin, better known as Mrs. B. At 99, she continues to work seven days a week. And about her, I have some particularly good news.

You will remember that after her family sold 80% of Nebraska Furniture Mart (NFM) to Berkshire in 1983, Mrs. B continued to be Chairman and run the carpet operation. In 1989, however, she left because of a managerial disagreement and opened up her own operation next door in a large building that she had owned for several years. In her new business, she ran the carpet section but leased out other home-furnishings departments.

At the end of last year, Mrs. B decided to sell her building and land to NFM. She'll continue, however, to run her carpet business at its current location (no sense slowing down just when you're hitting full stride). NFM will set up shop alongside her, in that same building, thereby making a major addition to its furniture business.

I am delighted that Mrs. B has again linked up with us. Her business story has no parallel and I have always been a fan of hers, whether she was a partner or a competitor. But believe me, partner is better.

This time around, Mrs. B graciously offered to sign a non-compete agreement - and I, having been incautious on this point when she was 89, snapped at the deal. Mrs. B belongs in the Guinness Book of World Records on many counts. Signing a non-compete at 99 merely adds one more.

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Ralph Schey, CEO of Scott Fetzer and a manager who I hope is with us at 99 also, hit a grand slam last year when that company earned a record \$110 million pre-tax. What's even more impressive is that Scott Fetzer achieved such earnings while employing only \$116 million of equity capital. This extraordinary result is not the product of leverage: The company uses only minor amounts of borrowed money (except for the debt it employs - appropriately - in its finance subsidiary).

Scott Fetzer now operates with a significantly smaller investment in both inventory and fixed assets than it had when we bought it in 1986. This means the company has been able to distribute more than 100% of its earnings to Berkshire during our seven years of ownership while concurrently increasing its earnings stream - which was excellent to begin with - by a lot. Ralph just keeps on outdoing himself, and Berkshire shareholders owe him a great deal.

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Those readers with particularly sharp eyes will note that our corporate expense fell from \$5.6 million in 1991 to \$4.2 million in 1992. Perhaps you will think that I have sold our corporate jet, The Indefensible. Forget it! I find the thought of retiring the plane even more revolting than the thought of retiring the Chairman. (In this matter I've demonstrated uncharacteristic flexibility: For years I argued passionately against corporate jets. But finally my dogma was run over by my karma.)

Our reduction in corporate overhead actually came about because those expenses were especially high in 1991, when we incurred a one-time environmental charge relating to alleged pre-1970 actions of our textile operation. Now that things are back to normal, our after-tax overhead costs are under 1% of our reported operating earnings and less than 1/2 of 1% of our look-through earnings. We have no legal, personnel, public relations, investor relations, or strategic planning departments. In turn this means we don't need support personnel such as guards, drivers, messengers, etc. Finally, except for Verne, we employ no consultants. Professor Parkinson would like our operation - though Charlie, I must say, still finds it outrageously fat.

At some companies, corporate expense runs 10% or more of operating earnings. The titling that operations thus makes to headquarters not only hurts earnings, but more importantly slashes capital values. If the business that spends 10% on headquarters' costs achieves earnings at its operating levels identical to those achieved by the business that incurs costs of only 1%, shareholders of the first enterprise suffer a 9% loss in the value of their holdings simply because of corporate overhead. Charlie and I have observed no correlation between high corporate costs and good corporate performance. In fact, we see the simpler, low-cost operation as more likely to operate effectively than its bureaucratic brethren. We're admirers of the Wal-Mart, Nucor, Dover, GEICO, Golden West Financial and Price Co. models.

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Late last year Berkshire's stock price crossed \$10,000. Several shareholders have mentioned to me that the high price causes them problems: They like to give shares away each year and find themselves impeded by the tax rule that draws a distinction between annual gifts of \$10,000 or under to a single individual and those above \$10,000. That is, those gifts no greater than \$10,000 are completely tax-free; those above \$10,000 require the donor to use up a portion of his or her lifetime exemption from gift and estate taxes, or, if that exemption has been exhausted, to pay gift taxes.

I can suggest three ways to address this problem. The first would be useful to a married shareholder, who can give up to \$20,000 annually to a single recipient, as long as the donor files a gift tax return containing his or her spouse's written consent to gifts made during the year.

Secondly, a shareholder, married or not, can make a bargain sale. Imagine, for example, that Berkshire is selling for \$12,000 and that one wishes to make only a \$10,000 gift. In that case, sell the stock to the giftee for \$2,000. (Caution: You will be taxed on the amount, if any, by which the sales price to your giftee exceeds your tax basis.)

Finally, you can establish a partnership with people to whom you are making gifts, fund it with Berkshire shares, and simply give percentage interests in the partnership away each year. These interests can be for any value that you select. If the value is \$10,000 or less, the gift will be tax-free.

We issue the customary warning: Consult with your own tax advisor before taking action on any of the more esoteric methods of gift-making.

We hold to the view about stock splits that we set forth in the 1983 Annual Report. Overall, we believe our owner-related policies - including the no-split policy - have helped us assemble



a body of shareholders that is the best associated with any widely-held American corporation. Our shareholders think and behave like rational long-term owners and view the business much as Charlie and I do. Consequently, our stock consistently trades in a price range that is sensibly related to intrinsic value.

Additionally, we believe that our shares turn over far less actively than do the shares of any other widely-held company. The frictional costs of trading - which act as a major "tax" on the owners of many companies - are virtually non-existent at Berkshire. (The market-making skills of Jim Maguire, our New York Stock Exchange specialist, definitely help to keep these costs low.) Obviously a split would not change this situation dramatically. Nonetheless, there is no way that our shareholder group would be upgraded by the new shareholders enticed by a split. Instead we believe that modest degradation would occur.

\* \* \* \* \*

As I mentioned earlier, on December 16th we called our zero-coupon, convertible debentures for payment on January 4, 1993. These obligations bore interest at 5 1/2%, a low cost for funds when they were issued in 1989, but an unattractive rate for us at the time of call.

The debentures could have been redeemed at the option of the holder in September 1994, and 5 1/2% money available for no longer than that is not now of interest to us. Furthermore, Berkshire shareholders are disadvantaged by having a conversion option outstanding. At the time we issued the debentures, this disadvantage was offset by the attractive interest rate they carried; by late 1992, it was not.

In general, we continue to have an aversion to debt, particularly the short-term kind. But we are willing to incur modest amounts of debt when it is both properly structured and of significant benefit to shareholders.

\* \* \* \* \*

About 97% of all eligible shares participated in Berkshire's 1992 shareholder-designated contributions program. Contributions made through the program were \$7.6 million, and 2,810 charities were recipients. I'm considering increasing these contributions in the future at a rate greater than the increase in Berkshire's book value, and I would be glad to hear from you as to your thinking about this idea.

We suggest that new shareholders read the description of our shareholder-designated contributions program that appears on pages 48-49. To participate in future programs, you must make sure your shares are registered in the name of the actual owner, not in the



nominee name of a broker, bank or depository. Shares not so registered on August 31, 1993 will be ineligible for the 1993 program.

In addition to the shareholder-designated contributions that Berkshire distributes, managers of our operating businesses make contributions, including merchandise, averaging about \$2.0 million annually. These contributions support local charities, such as The United Way, and produce roughly commensurate benefits for our businesses.

However, neither our operating managers nor officers of the parent company use Berkshire funds to make contributions to broad national programs or charitable activities of special personal interest to them, except to the extent they do so as shareholders. If your employees, including your CEO, wish to give to their alma maters or other institutions to which they feel a personal attachment, we believe they should use their own money, not yours.

\* \* \* \* \*

This year the Annual Meeting will be held at the Orpheum Theater in downtown Omaha at 9:30 a.m. on Monday, April 26, 1993. A record 1,700 people turned up for the meeting last year, but that number still leaves plenty of room at the Orpheum.

We recommend that you get your hotel reservations early at one of these hotels: (1) The Radisson-Redick Tower, a small (88 rooms) but nice hotel across the street from the Orpheum; (2) the much larger Red Lion Hotel, located about a five-minute walk from the Orpheum; or (3) the Marriott, located in West Omaha about 100 yards from Borsheim's, which is a twenty minute drive from downtown. We will have buses at the Marriott that will leave at 8:30 and 8:45 for the meeting and return after it ends.

Charlie and I always enjoy the meeting, and we hope you can make it. The quality of our shareholders is reflected in the quality of the questions we get: We have never attended an annual meeting anywhere that features such a consistently high level of intelligent, owner-related questions.

An attachment to our proxy material explains how you can obtain the card you will need for admission to the meeting. With the admission card, we will enclose information about parking facilities located near the Orpheum. If you are driving, come a little early. Nearby lots fill up quickly and you may have to walk a few blocks.

As usual, we will have buses to take you to Nebraska Furniture Mart and Borsheim's after the meeting and to take you from there to downtown hotels or the airport later. I hope that you will allow plenty of time to fully explore the attractions of both stores.

Those of you arriving early can visit the Furniture Mart any day of the week; it is open from 10 a.m. to 5:30 p.m. on Saturdays and from noon to 5:30 p.m. on Sundays. While there, stop at the See's Candy Cart and find out for yourself why Charlie and I are a good bit wider than we were back in 1972 when we bought See's.

Borsheim's normally is closed on Sunday but will be open for shareholders and their guests from noon to 6 p.m. on Sunday, April 25. Charlie and I will be in attendance, sporting our jeweler's loupes, and ready to give advice about gems to anyone foolish enough to listen. Also available will be plenty of Cherry Cokes, See's candies, and other lesser goodies. I hope you will join us.

March 1, 1993

Warren E. Buffett  
Chairman of the Board