# Berkshire Hathaway Inc.

*To the Stockholders of*
*Berkshire Hathaway Inc.:*

Our financial results for 1973 were satisfactory, with operating earnings of $11,930,592, producing a return of 17.4% on beginning stockholders' equity. Although operating earnings improved from $11.43 to $12.18 per share, earnings on equity decreased from the 19.8% of 1972. This decline occurred because the gain in earnings was not commensurate with the increase in shareholders' investment. We had forecast in last year's report that such a decline was likely. Unfortunately, our forecast proved to be correct.

Our textile, banking, and most insurance operations had good years, but certain segments of the insurance business turned in poor results. Overall, our insurance business continues to be a most attractive area in which to employ capital.

Management's objective is to achieve a return on capital over the long term which averages somewhat higher than that of American industry generally — while utilizing sound accounting and debt policies. We have achieved this goal in the last few years, and are trying to take those steps which will enable us to maintain this performance in the future. Prospects for 1974 indicate some further decline in rate of return on our enlarged equity base.

**Textile Operations**

Textile demand remained unusually strong throughout 1973. Our main problems revolved around shortages of fiber, which complicated operations and resulted in something less than full utilization of loom capacity. Prices of some fibers skyrocketed during the year.

Cost of Living Council regulations prevented the pricing of many finished products at levels of some of our competitors. However, profits were reasonably commensurate with our capital investment, although below those that apparently might have been achieved had we been able to price at market levels. The textile business has been highly cyclical and price controls may have served to cut down some of the hills while still leaving us with the inevitable valleys.

Because of the extraordinary price rises in raw materials during 1973, which show signs of continuing in 1974, we have elected to adopt the "lifo" method of inventory pricing. This method more nearly matches current costs against current revenues, and minimizes inventory "profits" included in reported earnings. Further information on this change is included in the footnotes to our financial statements.

**Insurance Operations**

During 1973, Jack Ringwalt retired as President of National Indemnity Company after an absolutely brilliant record since founding the business in 1940. He was succeeded by Phil Liesche who, fortunately for us, possesses the same underwriting and managerial philosophy that worked so well for Jack.

Our traditional business, specialized auto and general liability lines conducted through National Indemnity Company and National Fire and Marine Insurance Company, had an exceptionally fine underwriting year during 1973. We again experienced a decline in volume. Competition was intense, and we passed up the chance to match rate-cutting by more optimistic underwriters. There currently are faint indications that some of these competitors are learning of the inadequacy of their rates (and also of their loss reserves) which may result in easing of market pressures as the year develops. If so, we may again experience volume increases.

Our reinsurance operation had a somewhat similar year — good underwriting experience, but difficulty in maintaining previous volume levels. This operation, guided by the tireless and well-directed efforts of George Young, has been a major profit producer since its inception in 1969.

Our "home state" insurance companies made excellent progress in Nebraska and Minnesota, with both good growth in volume and acceptable loss ratios. We began operations late in the year in Iowa. To date, our big problem has been Texas. In that state we virtually had to start over during 1973 as the initial management we selected proved incapable of underwriting successfully. The Texas experience has been expensive, and we still have our work cut out for us. Overall, however, the home state operation appears to have a promising potential.

Our specialized urban auto operation, Home and Automobile Insurance Company, experienced very poor underwriting in Chicago during 1973. It would appear that rates are inadequate in our primary Cook County marketing area, although the current energy situation confuses the picture. The question is whether possible lowered accident frequency because of reduced driving will more than offset continuing inflation in medical and repair costs, as well as jury awards. We believe that inflation will hurt us more than reduced driving will help us, but some of our competitors appear to believe otherwise.

Home and Auto expanded into Florida and California during the year, but it is too early to know how these moves will prove out financially.

A contributing factor in our unsatisfactory earnings at Home and Auto during 1973 was an accounting system which was not bringing information to management on a sufficiently timely basis. This situation now is being corrected.

On the investment side of our insurance operation, we made substantial additional commitments in common stocks during 1973. We had significant unrealized depreciation — over $12 million — in our common stock holdings at year-end, as indicated in our financial statements. Nevertheless, we believe that our common stock portfolio at cost represents good value in terms of intrinsic business worth. In spite of the large unrealized loss at year-end, we would expect satisfactory results from the portfolio over the longer term.

**Banking Operations**

The Illinois National Bank & Trust Co. of Rockford again had a record year in 1973. Average deposits were approximately $130 million, of which approximately 60% were time deposits. Interest rates were increased substantially in the important consumer savings area when regulatory maximums were raised at mid-year.

Despite this mix heavily weighted toward interest bearing deposits, our operating earnings after taxes (including a new Illinois state income tax) were again over 2.1% of average deposits.

We continue to be the largest bank in Rockford. We continue to maintain unusual liquidity. We continue to meet the increasing loan demands of our customers. And we continue to maintain our unusual profitability. This is a direct tribute to the abilities of Gene Abegg, Chairman, who has been running the Bank since it opened its doors in 1931, and Bob Kline, our President.

**Merger With Diversified Retailing Company, Inc.**

Your Directors have approved the merger of Diversified Retailing Company, Inc. into Berkshire Hathaway Inc. on terms involving issuance of 195,000 shares of Berkshire stock for the 1,000,000 shares of Diversified stock outstanding. Because Diversified and its subsidiaries own 109,551 shares of Berkshire, the net increase in the number of shares of Berkshire outstanding after giving effect to this transaction will not exceed 85,449. Various regulatory approvals must be obtained before this merger can be completed, and proxy material will be submitted to you later this year so that you may vote upon it.

Diversified Retailing Company, Inc., through subsidiaries, operates a chain of popular-priced women's apparel stores and also conducts a reinsurance business. In the opinion of your management, its most important asset is 16% of the stock of Blue Chip Stamps.

**Blue Chip Stamps**

Our holdings of stock in Blue Chip Stamps at year-end amounted to approximately 19% of that company's outstanding shares. Since year-end, we have increased our holdings so that they now represent approximately 22½%; implementation of the proposed merger with Diversified Retailing Company, Inc. would increase this figure to about 38½%.

Our equity in earnings of Blue Chip Stamps became significant for the first time in 1973, and posed an accounting question as to just what period's earnings should be recognized by Berkshire Hathaway Inc. as applicable to the financial statements covered by this annual report.

Blue Chip's fiscal year ends on the Saturday closest to February 28, or two months after the fiscal year-end of Berkshire Hathaway Inc. Or, viewed, alternatively, their year ends ten months prior to Berkshire Hathaway's. An acceptable accounting choice for us, and one which, if made, would not have required an auditor's disclaimer as to scope, was to recognize in our 1973 income an equity of $632,000 in Blue Chip's earnings for their year ended March [illegible], 1973 with regard to the [illegible]

fewer shares of Blue Chip we owned during this earlier period. But such an approach seemed at odds with reality, and would have meant a ten month lag each year in the future. Therefore, we chose to reflect as 1973 income our equity of $1,008,000 in Blue Chip's earnings based upon unaudited interim earnings through November as publicly reported by Blue Chip Stamps and with regard to our shareholdings during 1973. Because we made this choice of unaudited but current figures, as opposed to the alternative of audited but far from current figures, Peat, Marwick, Mitchell & Co. were unable to express an opinion on our 1973 earnings attributable to Blue Chip Stamps.

The annual report of Blue Chip Stamps, which will contain financial statements for the year ending March 2, 1974 audited by Price, Waterhouse and Company, will be available in early May. Any shareholder of Berkshire Hathaway Inc. who desires an annual report of Blue Chip Stamps may obtain it at that time by writing Mr. Robert H. Bird, Secretary, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Blue Chip's trading stamp business has declined drastically over the past year or so, but it has important sources of earning power in its See's Candy Shops subsidiary as well as Wesco Financial Corporation, a 54% owned subsidiary engaged in the savings and loan business. We expect Blue Chip