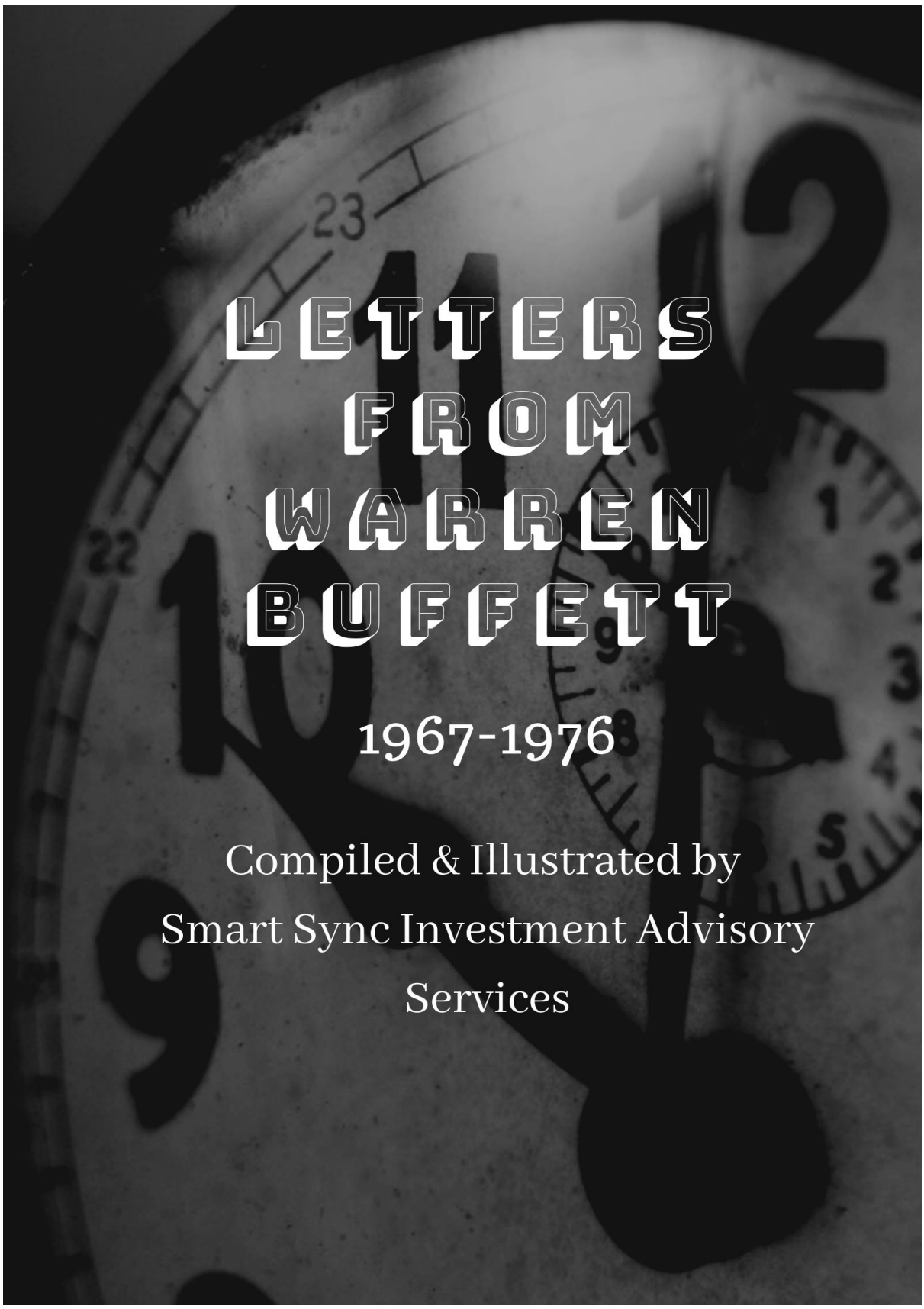


LETTERS FROM WARREN BUFFETT

1967-1976

Compiled & Illustrated by

Smart Sync Investment Advisory Services

January 25, 1967

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

The First Decade

The Partnership had its tenth anniversary during 1966. The celebration was appropriate -an all-time record (both past and future) was established for our performance margin relative to the Dow. Our advantage was 36 points which resulted from a plus 20.4% for the Partnership and a minus 15.6% for the Dow. This pleasant but non-repeatable experience was partially due to a lackluster performance by the Dow. Virtually all investment managers outperformed it during the year. The Dow is weighted by the dollar price of the thirty stocks involved. Several of the highest priced components, which thereby carry disproportionate weight (Dupont, General Motors), were particularly poor performers in 1966. This, coupled with the general aversion to conventional blue chips, caused the Dow to suffer relative to general investment experience, particularly during the last quarter.

The following summarizes the year-by-year performance of the Dow, the performance of the Partnership before allocation (one quarter of the excess over 6%) to the general partner, and the results for limited partners:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	-8.4%	10.4%	9.3%
1958	38.5%	40.9%	32.2%
1959	20.0%	25.9%	20.9%
1960	-6.2%	22.8%	18.6%
1961	22.4%	45.9%	35.9%
1962	-7.6%	13.9%	11.9%
1963	20.6%	38.7%	30.5%
1964	18.7%	27.8%	22.3%
1965	14.2%	47.2%	36.9%
1966	-15.6%	20.4%	16.8%
Cumulative Results	**141.1%**	**1028.7%**	**641.5%**
Annual Compounded Rate	**9.7%**	**29.0%**	**23.5%**

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses, but before distributions to partners or allocations to the general partner.

(3) For 1957-61 computed on the basis of the preceding column of partnership results allowing for allocation to the general partner based upon the present partnership agreement. but before monthly withdrawals by limited partners.

On a cumulative or compounded basis, the results are:

Year	Overall Results From Dow	Partnership Results	Limited Partners' Results
1957	-8.4%	10.4%	9.3%
1957 – 58	26.9%	55.6%	44.5%
1957 – 59	52.3%	95.9%	74.7%
1957 – 60	42.9%	140.6%	107.2%
1957 – 61	74.9%	251.0%	181.6%
1957 – 62	61.6%	299.8%	215.1%
1957 – 63	95.1%	454.5%	311.2%
1957 – 64	131.3%	608.7%	402.9%
1957 – 65	164.1%	943.2%	588.5%
1957 – 66	122.9%	1156.0%	704.2%
Annual Compounded Rate	**11.4%**	**29.8%**	**23.9%**

Investment Companies

On the following page is the usual tabulation showing the results of the two largest open-end investment companies (mutual funds) that follow a policy of being, typically, 95-100% invested in common stocks, and the two largest diversified closed-end investment companies.

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont (2)	Dow	Limited Partners
1957	-11.4%	-12.4%	-11.4%	-2.4%	-8.4%	9.3%
1958	42.7%	47.5%	40.8%	33.2%	38.5%	32.2%
1959	9.0%	10.3%	8.1%	8.4%	20.0%	20.9%
1960	-1.0%	-0.6%	2.5%	2.8%	-6.2%	18.6%
1961	25.6%	24.9%	23.6%	22.5%	22.4%	35.9%
1962	-9.8%	-13.4%	-14.4%	-10.0%	-7.6%	11.9%
1963	20.0%	16.5%	23.7%	18.3%	20.6%	30.5%
1964	15.9%	14.3%	13.6%	12.6%	18.7%	22.3%
1965	10.2%	9.8%	19.0%	10.7%	14.2%	36.9%
1966	-7.7%	-10.0%	-2.6%	-6.9%	-15.6%	16.8%
Cumulative Results	**118.1%**	**106.3%**	**142.8%**	**126.9%**	**141.1%**	**641.5%**
Annual Compounded Rate	**8.6%**	**7.9%**	**9.8%**	**9.0%**	**9.7%**	**23.5%**

(1) Computed from changes in asset value plus any distributions to holders of record during year.

(2) From 1966 Moody's Bank & Finance Manual for 1957-1965.

Estimated for 1966.

These investment company performance figures have been regularly reported here to show that the now is no patsy as an investment standard. It should again be emphasized that the companies were

not selected on the basis of comparability to Buffett Partnership, Ltd. There are important differences including: (1) investment companies operate under both internally and externally imposed restrictions on their investment actions that are not applicable to us; (2) investment companies diversify far more than we do and, in all probability, thereby 101 have less chance for a really bad performance relative to the now in a single year; and (3) their managers have considerably less incentive for abnormal performance and greater incentive for conventionality.

However, the records above do reveal what well-regarded, highly paid, full-time professional investment managers have been able to accomplish while working with common stocks. These managers have been favorites of American investors (more than 600,000) making free choices among many alternatives in the investment management field. It is probable that their results are typical of the overwhelming majority of professional investment managers. It is not true, however, that these are the best records achieved in the investment field. A few mutual funds and some private investment operations have compiled records vastly superior to the Dow and, in some cases, substantially superior to Buffett Partnership, Ltd. Their investment techniques are usually very dissimilar to ours and not within my capabilities. However, they are generally managed by very bright, motivated people and it is only fair that I mention the existence of such superior results in this general discussion of the record of professional investment management.

Trends in Our Business

A keen mind working diligently at interpreting the figures on page one could come to a lot of wrong conclusions. The results of the first ten years have absolutely no chance of being duplicated or even remotely approximated during the next decade. They may well be achieved by some hungry twenty-five-year-old working with $105,100 initial partnership capital and operating during a ten-year business and market environment which is frequently conducive to successful implementation of his investment philosophy. They will not be achieved by a better fed thirty-six-year-old working with our $54,065,345 current partnership capital who presently finds perhaps one-fifth to one-tenth as many really good ideas as previously to implement his investment philosophy.

Buffett Associates. Ltd. (predecessor to Buffett Partnership. Ltd.) was founded on the west banks of the Missouri. May 5. 1956 by a hardy little band consisting of four family members, three close friends and $105,100. (I tried to find some brilliant flash of insight regarding our future or present conditions from my first page and a half annual letter of January, 1957 to insert as a quote here. However, someone evidently doctored my file copy so as to remove the perceptive remarks I must have made.) At that time, and for some years subsequently, there were substantial numbers of securities selling at well below the "value to a private owner" criterion we utilized for selection of general market investments. We also experienced a flow of “workout” opportunities where the percentages were very much to our liking.

The problem was always which, not what. Accordingly, we were able to own fifteen to twenty-five issues and be enthusiastic about the probabilities inherent in all holdings. In the last few years this

situation has changed dramatically. We now find very few securities that are understandable to me, available in decent size, and which offer the expectation of investment performance meeting our yardstick of ten percentage points per annum superior to the Dow. In the last three years we have come up with only two or three new ideas a year that have had such an expectancy of superior performance. Fortunately, in some cases, we have made the most of them. However, in earlier years, a lesser effort produced literally dozens of comparable opportunities. It is difficult to be objective about the causes for such diminution of one's own productivity.

Three factors that seem apparent are: (1) a somewhat changed market environment; (2) our increased size; and (3) substantially more competition. It is obvious that a business based upon only a trickle of fine ideas has poorer prospects than one based upon a steady flow of such ideas. To date the trickle has provided as much financial nourishment as the flow. This is true because there is only so much one can digest (million dollar ideas are of no great benefit to thousand-dollar bank accounts - this was impressed on me in my early days) and because a limited number of ideas causes one to utilize those available more intensively. The latter factor has definitely been operative with us in recent years. However, a trickle has considerably more chance of drying up completely than a flow.

These conditions will not cause me to attempt investment decisions outside my sphere of understanding (I don't go for the "If you can't lick 'em, join 'em" philosophy - my own leaning is toward "If you can't join 'em, lick 'em"). We will not go into businesses where technology which is away over my head is crucial to the investment decision. I know about as much about semi-conductors or integrated circuits as I do of the mating habits of the chrzaszcz. (That's a Polish May bug, students - if you have trouble pronouncing it, rhyme it with thrzaszcz.) Furthermore, 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 (and currently as I write this in January). 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. I will not

invest my own money based upon such an approach hence, I will most certainly not do so with your money.

Finally, we will not seek out activity in investment operations, even if offering splendid profit expectations, where major human problems appear to have a substantial chance of developing. What I do promise you, as partners, is that I will work hard to maintain the trickle of ideas and try to get the most out of it that is possible – but if it should dry up completely, you will be informed honestly and promptly so that we may all take alternative action.

Analysis of 1966 Results

All four main categories of our investment operation worked out well in 1966. Specifically, we had a total overall gain of $8,906,701 derived as follows:

Category	Average Investment	Overall Gain
Controls	$17,259,342	$1,566,302
Generals – Private Owner	$1,359,340	$1,004,362
Generals – Relatively Undervalued	$21,847,045	$5,124254
Workouts	$7,666314	$1,714,181
Miscellaneous, including US Treasury Bills	$1,332,609	$(18,422)
Total Income		$9,390,677
Less: General Expense		$483,976
Overall Gain		$8,906,701

A few caveats are necessary before we get on with the main discussion:

1. An explanation of the various categories listed above was made in the January 18, 1965 letter. If your memory needs refreshing and your favorite newsstand does not have the pocketbook edition. we'll be glad to give you a copy.

2. The classifications are not iron-clad. Nothing is changed retroactively but the initial decision as to category is sometimes arbitrary.

3. Percentage returns calculated on the average investment base by category would be understated relative to partnership percentage returns which are calculated on a beginning investment base. In the above figures, a security purchased by us at 100 on January 1 which appreciated at an even rate to 150 on December 31 would have an average investment of 125 producing a 40% result contrasted to a 50% result by the customary approach. In other words, the above figures use a monthly average of market values in calculating the average investment.

4. All results are based on a 100% ownership, non-leverage, basis. Interest and other general expenses are deducted from total performance and not segregated by category. Expenses directly related to specific investment operations, such as dividends paid on short stock, are deducted by category. When securities are borrowed directly and sold short, the net investment (longs minus shorts) is shown for the applicable average investment category.

5. The above table has only limited use. The results applicable to each category are dominated by one or two investments. They do not represent a collection of great quantities of stable data (mortality rates of all American males or something of the sort) from which conclusions can be drawn and projections made. Instead, they represent infrequent, non-homogeneous phenomena leading to very

tentative suggestions regarding various courses of action and are so used by us. 6. Finally, these calculations are not made with the same loving care we apply to counting the money and are subject to possible clerical or mathematical error since they are not entirely self-checking.

Controls

There were three main sources of gain during 1966 in respect to controlled companies. These arose through: (1) retained business earnings applicable to our holdings in 1966; (2) open market purchases of additional stock below our controlling interest valuation and; (3) unrealized appreciation in marketable securities held by the controlled companies. The total of all positive items came to $2,600,838 in 1966. However, due to factors mentioned in my November 1, 1966 letter, specific industry conditions, and other relevant valuation items, this gain was reduced by $1,034,780 in arriving at our fair valuation applicable to controlling interests as of December 31, 1966. Thus the overall gain in the control category was reduced to $1,566,058 for the year.

We were undoubtedly fortunate that we had a relatively high percentage of net assets invested in businesses and not stocks during 1966. The same money in general market holdings would probably have produced a loss, perhaps substantial, during the year. This was not planned and if the stock market had advanced substantially during the year, this category would have been an important drag on overall performance. The same situation will prevail during 1967.

Generals -Private Owner

Our performance here falls in the "twenty-one dollars a day, once a month" category. In the middle of 1965 we started purchasing a very attractive widely held security which was selling far below its value to a private owner. Our hope was that over a two or three-year period we could get $10 million or more invested at the favorable prices prevailing. The various businesses that the company operated were understandable and we could check out competitive strengths and weaknesses thoroughly with competitors, distributors, customers, 104 suppliers, ex-employees, etc. Market conditions peculiar to the stock gave us hope that, with patience, we could buy substantial quantities of the stock without disturbing the price.

At yearend 1965 we had invested $1,956,980 and the market value of our holding was $2,358,412 so that $401,432 was contributed to performance luring 1965. We would have preferred, of course, to have seen the market below cost since our interest was in additional buying, not in selling. This would have dampened Buffett Partnerships Ltd.’s 1965 performance and perhaps reduced the euphoria experienced by limited partners (psychically, the net result to all partners would have been a standoff since the general partner would have been floating) but would have enhanced long term performance. The fact that the stock had risen somewhat above our cost had already slowed down our buying program and thereby reduced ultimate profit.

An even more dramatic example of the conflict between short term performance and the maximization of long term results occurred in 1966. Another party, previously completely unknown to me, issued a tender offer which foreclosed opportunities for future advantageous buying. I made the decision that the wisest course (it may not have been) for us to follow was to dispose of our holdings and we thus realized a total profit of $1,269,181 in February, of which $867,749 was applicable to 1966. While any gains looked particularly good in the market environment that intimately developed in 1966, you can be sure I don't delight in going round making molehills out of mountains. The molehill, of course, was reflected in 1966 results.

However, we would have been much better off from a long range standpoint if 1966 results had been five percentage points worse and we were continuing to buy substantial quantities of the stock at the depressed prices that might have been expected to prevail in this year's market environment. Good ideas were a dime a dozen, such a premature ending would not be unpleasant. There is something to be said, of course, for a business operation where some of the failures produce moderate profits. However, you can see how hard it is to develop replacement ideas by examining our average investment in the Private Owner category - we came up with nothing during the remainder of the year despite lower stock prices, which should have been conducive to finding such opportunities.

Generals - Relatively Undervalued

Our relative performance in this category was the best we have ever had - due to one holding which was our largest investment at yearend 1965 and also yearend 1966. This investment has substantially out-performed the general market for us during each year (1964, 1965, 1966) that we have held it. While any single year's performance can be quite erratic, we think the probabilities are highly favorable for superior future performance over a three or four year period. The attractiveness and relative certainty of this particular security are what caused me to introduce Ground Rule 7 in November, 1965 to allow individual holdings of up to 40% of our net assets. We spend considerable effort continuously evaluating every facet of the company and constantly testing our hypothesis that this security is superior to alternative investment choices. Such constant evaluation and comparison at shifting prices is absolutely essential to our investment operation. It would be much more pleasant (and indicate a more favorable future) to report that our results in the Generals -Relatively Undervalued category represented fifteen securities in ten industries, practically all of which outperformed the market. We simply don't have that many good ideas. As mentioned above, new ideas are continually measured against present ideas and we will not make shifts if the effect is to downgrade expectable performance. This policy has resulted in limited activity in recent years when we have felt so strongly about the relative merits of our largest holding. Such a condition has meant that realized gains have been a much smaller portion of total performance than in earlier years when the flow of good ideas was more substantial.

The sort of concentration we have in this category is bound to produce wide swings in short term performance – some, most certainly, unpleasant. There have already been some of these applicable to shorter time spans than I use in reporting to partners. This is one reason I think frequent reporting to be foolish and potentially misleading in a long term oriented business such as ours. Personally, within the limits expressed in last year's letter on diversification, I am willing to trade the pains (forget about the pleasures) of substantial short term variance in exchange for maximization of long term performance.

However, I am not willing to incur risk of substantial permanent capital loss in seeking to better long term performance. To be perfectly clear - under our policy of concentration of holdings, partners should be completely prepared for periods of substantial underperformance (far more likely in sharply rising markets) to offset the occasional over performance such as we have experienced in 1965 and 1966, and as a price we pay for hoped-for good long term performance. All this talk about the long pull has caused one partner to observe that “even five minutes is a long time if one's head is being held under water." This is the reason, of course, that we use borrowed money very sparingly in our operation. Average bank borrowings during 1966 were well under 10% of average net worth.

One final word about the Generals - Relatively Undervalued category. In this section we also had an experience which helped results in 1966 but hurt our long term prospects. We had just one really important new idea in this category in 1966. Our purchasing started in late spring but had only come to about $1.6 million (it could be bought steadily but at only a moderate pace) when outside conditions drove the stock price up to a point where it was not relatively attractive. Though our overall gain was $728,141 on an average holding period of six and a half months in 1966, it would have been much more desirable had the stock done nothing for a long period of time while we accumulated a really substantial position.

Workouts

In last year's letter I forecast reduced importance for workouts. While they were not of the importance of some past years. I was pleasantly surprised by our experience in 1966 during which we kept an average of $7,666,314 employed in this category. Furthermore, we tend to ascribe borrowings to the workout section so that our net equity capital employed was really something under this figure and our return was somewhat better than the 22.4% indicated on page six. Here, too, we ran into substantial variation. At June 30, our overall profit on this category was $16,112 on an average investment of $7,870,151 so that we really had a case of an extraordinarily good second half offsetting a poor first half. In past years, sometimes as much as 30-40% of our net worth has been invested in workouts, but it is highly unlikely that this condition will prevail in the future. Nevertheless, they may continue to produce some decent returns on the moderate amount of capital employed.

Miscellaneous

Operationally, we continue to function well above rated capacity with Bill, John, Elizabeth and Donna all contributing excellent performances. At Buffett Partnership. Ltd. we have never had to divert investment effort to offset organizational shortcomings and this has been an important ingredient in the performance over the years. Peat, Marwick, Mitchell & Co., aided for the second year by their computer, turned in the usual speedy, efficient and comprehensive job. We all continue to maintain

more than an academic interest in the Partnership. The employees and I, our spouses and children, have a total of over $10 million invested at January 1, 1967. In the case of my family, our Buffett Partnership, Ltd. investment represents well over 90% of our net worth.

Within the coming two weeks you will receive:

1. A tax letter giving you all BPL information needed for your 1966 federal income tax return. This letter is the only item that counts for tax purposes.

2. An audit from Peat, Marwick, Mitchell & Co. for 1966, setting forth the operations and financial position of BPL, as well as your own capital account.

3. A letter signed by me setting forth the status of your BPL interest on January 1, 1967. This is identical with the figures developed in the audit.

Let me know if anything in this letter or that occurs during the year needs clarifying. My next letter will be about July 15 summarizing the first half of this year.

Cordially,

Warren E. Buffett

July 12, 1967

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

First Half Performance

Again, this is being written in late June prior to the family's trip to California. To maintain the usual chronological symmetry (I try to sublimate my aesthetic urges when it comes to creating symmetry in the profit and loss statement), I will leave a few blanks and trust that the conclusions look appropriate when the figures are entered. We began 1967 on a traumatic note with January turning out to be one of the worst months we have experienced with a plus 3.3% for BPL versus a plus 8.5% for the Dow. Despite this sour start, we finished the half about plus 21% for an edge of 9.6 percentage points over the Dow. Again, as throughout 1966, the Dow was a relatively easy competitor (it won't be every year, prevailing thinking to the contrary notwithstanding) and a large majority of investment managers outdid this yardstick. The following table summarizes performance to date on the usual basis:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	-8.4%	10.4%	9.3%
1958	38.5%	40.9%	32.2%
1959	20.0%	25.9%	20.9%
1960	-6.2%	22.8%	18.6%
1961	22.4%	45.9%	35.9%
1962	-7.6%	13.9%	11.9%
1963	20.6%	38.7%	30.5%
1964	18.7%	27.8%	22.3%
1965	14.2%	47.2%	36.9%
1966	-15.6%	20.4%	16.8%
First half 1967	11.4%	21.0%	17.3%
Cumulative Results	**148.3%**	**1419.8%**	**843.3%**
Annual Compounded Rate	**9.1%**	**29.6%**	**23.8%**

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses but before distributions to partners or allocations to the general partner.

(3) For 1957-61 computed on the basis of the preceding column of partnership results allowing for allocation to the general partner based upon the present partnership agreement, but before monthly withdrawals by limited partners.

BPL's performance during the first hall reflects no change in valuation of our controlled companies and was thus achieved solely by the 63.3% of our net assets invested in marketable securities at the beginning of the year. 108 Any revaluation of Diversified Retailing Company (DRC) and Berkshire Hathaway Inc. (B-H) will be made in December prior to the time the commitment letters become final and will be based upon all relevant criteria (including current operating. market and credit conditions) at that time. Both DRC and B-H made important acquisitions during the first half. The overall progress of DRC (80% owned) and both of its subsidiaries (Hochschild Kohn and Associated Cotton Shops) is highly satisfactory.

However, B-H is experiencing and faces real difficulties in the textile business, while I don't presently foresee any loss in underlying values. I similarly see no prospect of a good return on the assets employed in the textile business. Therefore, this segment of our portfolio will be a substantial drag on our relative performance (as it has been during the first half) if the Dow continues to advance. Such relative performance with controlled companies is expected in a strongly advancing market, but is accentuated when the business is making no progress. As a friend of mine says. “Experience is what you find when you're looking for something else.”

Investment Companies

The usual comparison follows showing the results of the two largest open-end and two largest closed-end investment companies which pursue a policy of 95-100% investment in common stocks.

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont (2)	Dow	Limited Partners
1957	-11.4%	-12.4%	-11.4%	-2.4%	-8.4%	9.3%
1958	42.7%	47.5%	40.8%	33.2%	38.5%	32.2%
1959	9.0%	10.3%	8.1%	8.4%	20.0%	20.9%
1960	-1.0%	-0.6%	2.5%	2.8%	-6.2%	18.6%
1961	25.6%	24.9%	23.6%	22.5%	22.4%	35.9%
1962	-9.8%	-13.4%	-14.4%	-10.0%	-7.6%	11.9%
1963	20.0%	16.5%	23.7%	18.3%	20.6%	30.5%
1964	15.9%	14.3%	13.6%	12.6%	18.7%	22.3%
1965	10.2%	9.8%	19.0%	10.7%	14.2%	36.9%
1966	-7.7%	-10.0%	-2.6%	-6.9%	-15.6%	16.8%
First half 1967	11.3%	12.3%	19.3%	14.4%	11.4%	17.3%
Cumulative Results	**143.3%**	**126.4%**	**185.4%**	**156.8%**	**148.3%**	**843.3%**
Annual Compounded Rate	**8.9%**	**8.1%**	**10.5%**	**9.4%**	**9.1%**	**23.8%**

(1) Computed from changes in asset value plus any distributions to holders of record during year.

(2) From 1967 Moody's Bank & Finance Manual for 1957-1966. Estimated for first half of 1967.

The tide continues to be far more important than the swimmers.

Taxes

We entered 1967 with unrealized gains of $16,361,974. Through June 30 we have realized net capital gains of $7,084,104 so it appears likely that we will realize in 1967 a fairly substantial portion of the unrealized gain attributable to your interest at the beginning of the year. This amount was reported to you as Item 3 of our February 2, 1967 letter. A copy of that letter, along with a tax letter, will be mailed to you in November giving a rough idea of the tax situation at that time. 109 As I regularly suggest, the safe course to follow on interim estimates is to pay the same estimated tax for 1967 as your actual tax was for 1966. There can be no penalties if you follow this procedure. Whatever our final figure, it looks now as if it will be very largely long term capital gain with only minor amounts, if any, of short term gain and ordinary income. (I consider the whole Income-Principal Myth fair game for one of my soft-spoken gently worded critiques. As I told Susie in the early days of our marriage, “Don't worry about the income; just the outcome.”)

Miscellaneous

During the first half, Stan Perimeter resigned from the Dissolution Committee because of his present full-time involvement in investment management. Fred Stanback, Jr., a long-time partner and experienced investor, was elected by the remaining members to fill the vacancy. As in past years, we will have a report out about November 11 along with the Commitment Letter, and the rough estimate of the 1967 tax situation, etc. However, there will be a special letter (to focus your attention upon it) in October. The subject matter will not relate to change in the Partnership Agreement, but will involve some evolutionary changes in several "Ground Rules" which I want you to have ample time to contemplate before making your plans for 1968. Whereas the Partnership Agreement represents the legal understanding among us, the "Ground Rules" represent the personal understanding and in some ways is the more important document. I consider it essential that any changes be clearly set forth and explained prior to their effect on partnership activity or performance – hence, the October letter.

Cordially,

Warren E. Buffett

October 9, 1967

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

To My Partners:

Over the past eleven years, I have consistently set forth as the BPL investment goal an average advantage in our performance of ten percentage points per annum in comparison with the Dow Jones Industrial Average. Under the environment that existed during that period. I have considered such an objective difficult but obtainable. The following conditions now make a change in yardsticks appropriate:

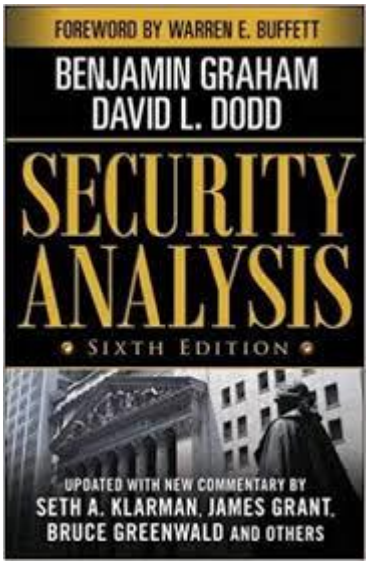
1. The market environment has changed progressively over the past decade, resulting in a sharp diminution in the number of obvious quantitatively based investment bargains available;

2. Mushrooming interest in investment performance (which has its ironical aspects since I was among a lonely few preaching the importance of this some years ago) has created a hyper-reactive pattern of market behavior against which my analytical techniques have limited value;

3. The enlargement of our capital base to about $65 million when applied against a diminishing trickle of good investment ideas has continued to present the problems mentioned in the January, 1967 letter;

4. My own personal interests dictate a less compulsive approach to superior investment results than when I was younger and leaner.

Let's look at each of these factors in more detail.



The evaluation of securities and businesses for investment purposes has always involved a mixture of qualitative and quantitative factors. At the one extreme, the analyst exclusively oriented to qualitative factors would say. "Buy the right company (with the right prospects, inherent industry conditions, management, etc.) and the price will take care of itself." On the other hand, the quantitative spokesman would say, "Buy at the right price and the company (and stock) will take care of itself." As is so often the pleasant result in the securities world, money can be made with either approach. And,

of course, any analyst combines the two to some extent - his classification in either school would depend on the relative weight he assigns to the various factors and not to his consideration of one group of factors to the exclusion of the other group. Interestingly enough, although I consider myself to be primarily in the quantitative school (and as I write this no one has come back from recess - I may be the only one left in the class), the really sensational ideas I have had over the years have been heavily weighted toward the qualitative side where I have had a "high-probability insight". This is what causes the cash register to really sing.

However, it is an infrequent occurrence, as insights usually are, and, of course, no insight is required on the quantitative side - the figures should hit you over the head with a baseball bat. So the really big money tends to be made by investors who are right on qualitative decisions but, at least in my opinion, the more sure money tends to be made on the obvious quantitative decisions. Such statistical bargains have tended to disappear over the years. This may be due to the constant combing and recombing of investments that has occurred during the past twenty years, without an economic convulsion such as that of the ‘30s to create a negative bias toward equities and spawn hundreds of new bargain securities. It may 111 be due to the new growing social acceptance, and therefore usage (or maybe it's vice versa - I'll let the behaviorists figure it out) of takeover bids which have a natural tendency to focus on bargain issues. It may be due to the exploding ranks of security analysts bringing forth an intensified scrutiny of issues far beyond what existed some years ago.

Whatever the cause, the result has been the virtual disappearance of the bargain issue as determined quantitatively - and thereby of our bread and butter. There still may be a few from time to time. There will also be the occasional security where I am really competent to make an important qualitative judgment. This will offer our best chance for large profits. Such instances will. however, be rare. Much of our good performance during the past three years has been due to a single idea of this sort. The next point of difficulty is the intensified interest in investment performance. For years I have preached the importance of measurement. Consistently I have told partners that unless our performance was better than average, the money should go elsewhere. In recent years this idea has gained momentum throughout the investment (or more importantly, the investing) community. In the last year or two it has started to look a bit like a tidal wave. I think we are witnessing the distortion of a sound idea. I have always cautioned partners that I considered three years a minimum in determining whether we were "performing".

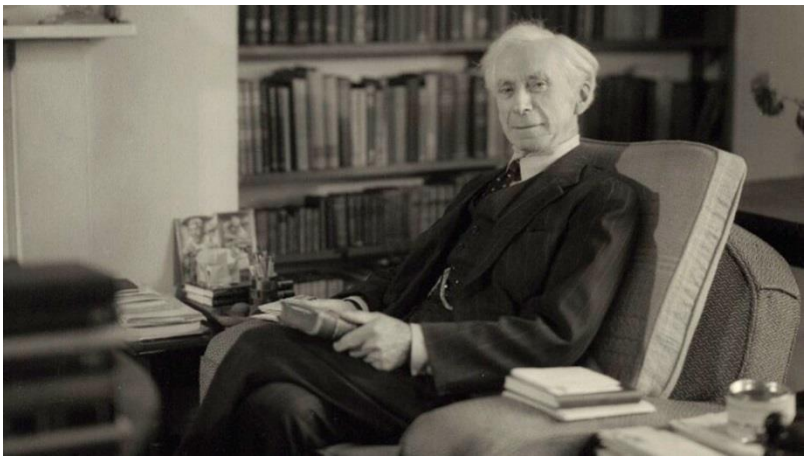
Naturally, as the investment public has taken the bit in its teeth, the time span of expectations has been consistently reduced to the point where investment performance by large aggregates of money is being measured yearly, quarterly, monthly, and perhaps sometimes even more frequently (leading to what is known as "instant research"). The payoff for superior short term performance has become enormous, not only in compensation for results actually achieved, but in the attraction of new money for the next round. Thus a self-generating type of activity has set in which leads to larger and larger amounts of money participating on a shorter and shorter time span. A disturbing corollary is that the vehicle for participation (the particular companies or stocks) becomes progressively less important - at times virtually incidental - as the activity accelerates. In my opinion what is resulting is speculation on an increasing scale. This is hardly a new phenomenon; however, a dimension has been added by the growing ranks of professional (in many cases formerly quite docile) investors who feel they must “get aboard”.

The game is dignified, of course, by appropriate ceremonies, personages and lexicon. To date it has been highly profitable. It may also be that this is going to be the standard nature of the market in the future. Nevertheless, it is an activity at which I am sure I would not do particularly well. As I said on page five of my last annual letter, "Furthermore, 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 (and currently as I write this in January). 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. I will not invest my own money based upon such an approach – hence, I will most certainly not do so with your money." Any form of hyper-activity with large amounts of money in securities markets can create problems for all participants. I make no attempt to guess the action of the stock market and haven't the foggiest notion as to whether the Dow will be at 600, 900 or 1200 a year from now. Even if there are serious consequences resulting from present and future speculative activity, experience suggests estimates of timing are meaningless.

However, I do believe certain conditions that now exist are likely to make activity in markets more difficult for us for the intermediate future. The above may simply be "old-fogeyism" (after all, I am 37). When the game is no longer being played your way, it is only human to say the new approach is all wrong, bound to lead to trouble, etc. I have been scornful of such behavior by others in the past. I have also seen the penalties incurred by those who evaluate conditions as 112 they were - not as they are. Essentially I am out of step with present conditions. On one point, however, I am clear. 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.

The third point of difficulty involves our much greater base of capital. For years my investment ideas were anywhere from 110% to 1000% of our capital. It was difficult for me to conceive that a different condition could ever exist. I promised to tell partners when it did and in my January 1967 letter had to make good on that promise. Largely because of the two conditions previously mentioned, our greater capital is now something of a drag on performance. I believe it is the least significant factor of the four mentioned, and that if we were operating with one-tenth of our present capital our performance would be little better. However, increased funds are presently a moderately negative factor.

The final, and most important, consideration concerns personal motivation. When I started the partnership I set the motor that regulated the treadmill at "ten points better than the DOW". I was younger, poorer and probably more competitive. Even without the three previously discussed external factors making for poorer performance. I would still feel that changed personal conditions make it advisable to reduce the speed of the treadmill. I have observed many cases of habit patterns in all activities of life, particularly business, continuing (and becoming accentuated as years pass) long after they ceased making sense.



Eminent British Philosopher Bertrand Russell

Bertrand Russell has related the story of two Lithuanian girls who lived at his manor subsequent to World War I. Regularly each evening after the house was dark, they would sneak out and steal vegetables from the neighbors for hoarding in their rooms; this despite the fact that food was bountiful at the Russell table. Lord Russell explained to the girls that while such behavior may have made a great deal of sense in Lithuania during the war, it was somewhat out of place in the English countryside. He received assenting nods and continued stealing. He finally contented himself with the observation that their behavior, strange as it might seem to the neighbors, was really not so different from that of the elder Rockefeller. Elementary self-analysis tells me that I will not be capable of less than all-out effort to achieve a publicly proclaimed goal to people who have entrusted their capital to me. All-out effort makes progressively less sense. I would like to have an economic goal which allows for considerable non-economic activity. This may mean activity outside the field of investments or it simply may mean pursuing lines within the investment field that do not promise the greatest economic reward.

An example of the latter might be the continued investment in a satisfactory (but far from spectacular) controlled business where I liked the people and the nature of the business even though alternative investments offered an expectable higher rate of return. More money would be made buying businesses at attractive prices, then reselling them. However, it may be more enjoyable (particularly

when the personal value of incremental capital is less) to continue to own them and hopefully improve their performance, usually in a minor way, through some decisions involving financial strategy.

Thus, I am likely to limit myself to things which are reasonably easy, safe, profitable and pleasant. This will not make our operation more conservative than in the past since I believe, undoubtedly with some bias, that we have always operated with considerable conservatism. The long-term downside risk will not be less; the upside potential will merely be less. Specifically, our longer term goal will be to achieve the lesser of 9% per annum or a five percentage point advantage over the Dow. Thus, if the Dow averages -2% over the next five years, I would hope to average +3% but if the Dow averages +12%, I will hope to achieve an average of only +9%. These may be limited objectives, but I consider it no more likely that we will achieve even these more modest results under present conditions than I formerly did that we would achieve our previous goal of a ten percentage point average annual edge over the Dow. Furthermore, I hope limited objectives will make for more limited effort (I'm quite sure the converse is 113 true). I will incorporate this new goal into the Ground Rules to be mailed you about November 1, along with the 1968 Commitment Letter.

I wanted to get this letter off to you prior to that mailing so you would have ample time to consider your personal situation, and if necessary get in touch with me to clear up some of the enclosed, before making a decision on 1968. As always, I intend to continue to leave virtually all of my capital (excluding Data Documents stock), along with that of my family, in BPL. What I consider satisfactory and achievable may well be different from what you consider so. Partners with attractive alternative investment opportunities may logically decide that their funds can be better employed elsewhere, and you can be sure I will be wholly in sympathy with such a decision. I have always found behavior most distasteful which publicly announces one set of goals and motivations when actually an entirely different set of factors prevails. Therefore, I have always tried to be l00% candid with you about my goals and personal feelings so you aren't making important decisions pursuant to phony proclamations (I've run into a few of these in our investment experience). Obviously all the conditions enumerated in this letter haven't appeared overnight. I have been thinking about some of the points involved for a long period of time. You can understand, I am sure, that I wanted to pick a time when past goals had been achieved to set forth a reduction in future goals. I would not want to reduce the speed of the treadmill unless I had fulfilled my objectives to this point. Please let me know if I can be of any help in deciphering any portion of this letter.

Cordially,

Warren E. Buffett

January 24, 1968

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

Our Performance in 1967

By most standards, we had a good year in 1967. Our overall performance was plus 35.9% compared to plus 19.0% for the Dow, thus surpassing our previous objective of performance ten points superior to the Dow. Our overall gain was $19,384,250 which, even under accelerating inflation, will buy a lot of Pepsi. And, due to the sale of some longstanding large positions in marketable securities, we had realized taxable income of $27,376,667 which has nothing to do with 1967 performance but should give all of you a feeling of vigorous participation in The Great Society on April 15th. The minor thrills described above are tempered by any close observation of what really took place in the stock market during 1967. Probably a greater percentage of participants in the securities markets did substantially better than the Dow last year than in virtually any year in history.

In 1967, for many, it rained gold and it paid to be out playing the bass tuba. I don't have a final tabulation at this time but my guess is that at least 95% of investment companies following a common stock program achieved better results than the Dow - in many cases by very substantial amounts. It was a year when profits achieved were in inverse proportion to age - and I am in the geriatric ward, philosophically. The following summarizes the year-by-year performance of the Dow, the Partnership before allocation (one quarter of the excess over 6%) to the general partner, and the results for limited partners:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	-8.4%	10.4%	9.3%
1958	38.5%	40.9%	32.2%
1959	20.0%	25.9%	20.9%
1960	-6.2%	22.8%	18.6%
1961	22.4%	45.9%	35.9%
1962	-7.6%	13.9%	11.9%
1963	20.6%	38.7%	30.5%
1964	18.7%	27.8%	22.3%
1965	14.2%	47.2%	36.9%
1966	-15.6%	20.4%	16.8%
1967	19.0%	35.9%	28.4%

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses, but before distributions to partners or allocations to the general partner.

(3) For 1957-61 computed on the basis of the preceding column of partnership results allowing for allocation to the general partner based upon the present partnership agreement, but before monthly withdrawals by limited partners.

On a cumulative or compounded basis, the results are:

Year	Overall Results From Dow	Partnership Results	Limited Partners' Results
1957	-8.4%	10.4%	9.3%
1957 – 58	26.9%	55.6%	44.5%
1957 – 59	52.3%	95.9%	74.7%
1957 – 60	42.9%	140.6%	107.2%
1957 – 61	74.9%	251.0%	181.6%
1957 – 62	61.6%	299.8%	215.1%
1957 – 63	95.1%	454.5%	311.2%
1957 – 64	131.3%	608.7%	402.9%
1957 – 65	164.1%	943.2%	588.5%
1957 – 66	122.9%	1156.0%	704.2%
1957 – 67	165.3%	1606.9%	932.6%
Annual Compounded Rate	**9.3%**	**29.4%**	**23.6%**

Investment Companies

On the following page is the usual tabulation showing the results of what were the two largest mutual funds (they have stood at the top in size since BPL was formed - this year, however, Dreyfus Fund overtook them) that follow a policy of being, typically, 95-100% invested in common stocks, and the two largest diversified closed end investment companies.

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont (2)	Dow	Limited Partners
1957	-11.4%	-12.4%	-11.4%	-2.4%	-8.4%	9.3%
1958	42.7%	47.5%	40.8%	33.2%	38.5%	32.2%
1959	9.0%	10.3%	8.1%	8.4%	20.0%	20.9%
1960	-1.0%	-0.6%	2.5%	2.8%	-6.2%	18.6%
1961	25.6%	24.9%	23.6%	22.5%	22.4%	35.9%
1962	-9.8%	-13.4%	-14.4%	-10.0%	-7.6%	11.9%
1963	20.0%	16.5%	23.7%	18.3%	20.6%	30.5%
1964	15.9%	14.3%	13.6%	12.6%	18.7%	22.3%
1965	10.2%	9.8%	19.0%	10.7%	14.2%	36.9%
1966	-7.7%	-10.0%	-2.6%	-6.9%	-15.6%	16.8%
1967	20.0%	22.8%	28.0%	25.4%	19.0%	28.4%
Cumulative Results	**162.3%**	**147.6%**	**206.2%**	**181.5%**	**165.3%**	**932.6%**
Annual Compounded Rate	**9.2%**	**8.6%**	**10.7%**	**9.9%**	**9.3%**	**23.6%**

Last year I said: “A few mutual funds and some private investment operations have compiled records vastly superior to the Dow and, in some cases, substantially superior to Buffett Partnership, Ltd. Their investment techniques are usually very dissimilar to ours and not within my capabilities.” In 1967 this condition intensified. Many investment organizations performed substantially better than BPL, with gains ranging to over 100%. Because of these spectacular results, money, talent and energy are converging in a maximum effort for the achievement of large and quick stock market profits. It looks to me like greatly intensified speculation with concomitant risks -but many of the advocates insist otherwise. My mentor, Ben Graham, used to say, “Speculation is neither illegal, immoral nor fattening (financially).” During the past year, it was possible to become fiscally flabby through a steady diet of speculative bonbons. We continue to eat oatmeal but if indigestion should set in generally, it is unrealistic to expect that we won’t have some discomfort.

Analysis of 1967 Results

The overall figures given earlier conceal vast differences in profitability by portfolio category during 1967. We had our worst performance in history in the “Workout” section. In the 1965 letter, this category was defined as, “...securities with a timetable. They arise from corporate activity -- sell-outs, mergers, reorganizations, spin-offs, etc. In this category, we are not talking about rumors or inside information pertaining to such developments, but to publicly announced activities of this sort. We wait until we can read it in the paper. The risk does not pertain primarily to general market behavior (although that is sometimes tied in. to a degree). but instead to something upsetting the applecart so that the expected corporate development does not materialize.” The streets were filled with upset applecarts - our applecarts - during 1967. Thus, on an average investment of $17,246,879, our overall gain was $153,273. For those of you whose slide rule does not go to such insulting depths, this represents a return of .89 of 1%. While I don't have complete figures. I doubt that we have been below 10% in any past year.

As in other categories, we tend to concentrate our investments in the workout category in just a few situations per year. This technique gives more variation in yearly results than would be the case if we used an across-the-board approach. I believe our approach will result in as great (or greater) profitability on a long-term basis, but you can't prove it by 1967. Our investment in controlled companies was a similar drag on relative performance in 1967, but this is to be expected in strong markets. On an average investment of $20,192,776 we had an overall gain of $2,894,571. I am pleased with this sort of performance, even though this category will continue to underperform if the market continues strong during 1968. Through our two controlled companies (Diversified Retailing and Berkshire Hathaway), we acquired two new enterprises in 1967. Associated Cotton Shops and National Indemnity (along with National Fire & Marine, an affiliated company). These acquisitions couldn't be more gratifying. Everything was as advertised or better. The principal selling executives, Ben Rosner and Jack Ringwalt, have continued to do a superb job (the only kind they know), and in every respect have far more than lived up to their end of the bargain.

The satisfying nature of our activity in controlled companies is a minor reason for the moderated investment objectives discussed in the October 9th letter. When I am dealing with people I like, in businesses I find stimulating (what business isn't ?), and achieving worthwhile overall returns on capital employed (say, 10 -12%), it seems foolish to rush from situation to situation to earn a few more percentage points. It also does not seem sensible to me to trade known pleasant personal relationships with high grade people, at a decent rate of return, for possible irritation, aggravation or worse at potentially higher returns.

Hence, we will continue to keep a portion of our capital (but not over 40% because of the possible liquidity requirements arising from the nature of our partnership agreement) invested in controlled operating businesses at an expected rate of return below that inherent in an aggressive stock market operation. With a combined total of $37,439,655 in workouts and controls producing an overall gain of only $3,047,844, the more alert members of the class will have already concluded we had a whale of a year in the "Generals - Relatively Undervalued" category. On a net average investment of $19,487,996, we had an overall gain of $14,096,593, or 72%.

Last year I referred to one investment which substantially outperformed the general market in 1964, 1965 and 1966 and because of its size (the largest proportion we have ever had in anything - we hit our 40% limit) had a very material impact on our overall results and, even more so, this category. This excellent performance continued throughout 1967 and a large portion of total gain was again accounted for by this single security. Our holdings of this security have been very substantially reduced and we have nothing in this group remotely approaching the size or potential which formerly existed in this investment.

The "Generals - Private Owner" section produced good results last year ($1,297,215 on $5,141,710 average investment), and we have some mildly interesting possibilities in this area at present. Miscellaneous We begin the new year with net assets of $68,108,088. We had partners with capital of about $1,600,000 withdraw at yearend, primarily because of the reduced objectives announced in the October 9th letter. This makes good sense for them, since most of them have the ability and motivation to surpass our objectives and I am relieved from pushing for results that I probably can't attain under present conditions. Some of those who withdrew (and many who didn't) asked me, "What do you really mean?" after receiving the October 9th letter. This sort of a question is a little bruising to any author, but I assured them I meant exactly what I had said. I was also asked whether this was an initial stage in the phasing out of the partnership. The answer to this is, “Definitely, no”.

As long as partners want to put up their capital alongside of mine and the business is operationally pleasant (and it couldn't be better), I intend to continue to do business with those who have backed me since tennis shoes. Gladys Kaiser has joined us and is doing the same sort of top-notch job that we have long received from Donna, Bill and John. The office group, spouses and children have over $15 million invested in BPL on January 1, 1968, so we have not had a need for NoDoz during business hours. Within a few days, you will receive:

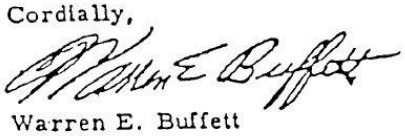
1. A tax letter giving you all BPL information needed for your 1967 federal income tax return. This letter is the only item that counts for tax purposes.

2. An audit from Peat, Marwick, Mitchell & Co. (they have again done an excellent job) for 1967, setting forth the operations and financial position of BPL, as well as your own capital account.

3. A letter signed by me setting forth the status of your BPL interest on January 1, 1968. This is identical with the figures developed in the audit.

Let me know if anything in this letter or that occurs during the year needs clarifying. My next letter will be about July 15th, summarizing the first half of this year.

Cordially,



Warren E. Buffett

July 11th, 1968

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

First Half Performance

During the first half of 1968, the Dow-Jones Industrial Average declined fractionally from 905 to 898. Ownership of the Dow would also have produced dividends of about $15 during the half, resulting in an overall gain of 0.9% for that Average. The Dow, once again, was an anemic competitor for most investment managers, although it was not surpassed by anything like the margins of 1967. Our own performance was unusually good during the first half, with an overall gain of 16% excluding any change in valuation for controlled companies (which represented slightly over one-third of net assets at the beginning of the year). However, any release of adrenalin is unwarranted. Our marketable security investments are heavily concentrated in a few situations, making relative performance potentially more volatile than in widely diversified investment vehicles. Our long term performance goals are as stated in the revised "Ground Rules" and I will be quite happy if we achieve those limited objectives over a period of years.

The following table summarizes performance to date on the usual basis:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	-8.4%	10.4%	9.3%
1958	38.5%	40.9%	32.2%
1959	20.0%	25.9%	20.9%
1960	-6.2%	22.8%	18.6%
1961	22.4%	45.9%	35.9%
1962	-7.6%	13.9%	11.9%
1963	20.6%	38.7%	30.5%
1964	18.7%	27.8%	22.3%
1965	14.2%	47.2%	36.9%
1966	-15.6%	20.4%	16.8%
1967	19.0%	35.9%	28.4%
First Half 1968	0.9%	16.0%	13.5%
Cumulative Results	167.7%	1880.0%	1072.0%
Annual Compounded Rate	8.9%	29.6%	23.8%

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses but before distributions to partners or allocations to the general partner.

(3) For 1957-61 computed on the basis of the preceding column of partnership results allowing for allocation to the general partner based upon the present partnership agreement, but before monthly withdrawals by limited partners.

Although we revise valuations of our controlled companies only at yearend, it presently appears that our share of their 1968 earnings will be something over $3 million. Those with primary responsibility

for their operations, Ken Chace at Berkshire Hathaway, Louis Kohn at Hochschild Kohn, Jack Ringwalt at National Indemnity and Ben Rosner at Associated Cotton Shops, continue to meld effort and ability into results.

This year, Diversified Retailing Company (owner of Hochschild Kohn and Associated Cotton Shops) issued its first published annual report. This was occasioned by the public sale of debentures to approximately 1,000 investors last December. Thus, DRC is in the rather unusual position of being a public company from a creditors' viewpoint, but a private one (there are three stockholders -BPL owns 80%) for ownership purposes. I am enclosing the DRC report with this letter (except where duplicates go to one house hold) and plan to continue to send them along with future mid-year letters.

As I have mentioned before, we cannot make the same sort of money out of permanent ownership of controlled businesses that can be made from buying and reselling such businesses, or from skilled investment in marketable securities. Nevertheless, they offer a pleasant long term form of activity (when conducted in conjunction with high grade, able people) at satisfactory rates of return.

Investment Companies

On the following page is the form sheet on the usual investment companies:

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont (2)	Dow	Limited Partners
1957	-11.4%	-12.4%	-11.4%	-2.4%	-8.4%	9.3%
1958	42.7%	47.5%	40.8%	33.2%	38.5%	32.2%
1959	9.0%	10.3%	8.1%	8.4%	20.0%	20.9%
1960	-1.0%	-0.6%	2.5%	2.8%	-6.2%	18.6%
1961	25.6%	24.9%	23.6%	22.5%	22.4%	35.9%
1962	-9.8%	-13.4%	-14.4%	-10.0%	-7.6%	11.9%
1963	20.0%	16.5%	23.7%	18.3%	20.6%	30.5%
1964	15.9%	14.3%	13.6%	12.6%	18.7%	22.3%
1965	10.2%	9.8%	19.0%	10.7%	14.2%	36.9%
1966	-7.7%	-10.0%	-2.6%	-6.9%	-15.6%	16.8%
1967	20.0%	22.8%	28.0%	25.4%	19.0%	28.4%
First Half 1968	5.1%	2.8%	4.4%	2.0%	0.9%	13.5%
Cumulative Results	**175.7%**	**154.5%**	**218.6%**	**186.7%**	**167.7%**	**1072.0%**
Annual Compounded Rate	**9.2%**	**8.5%**	**10.6%**	**9.6%**	**8.9%**	**23.8%**

(1) Computed from changes in asset value plus any distributions to holders of record during year.

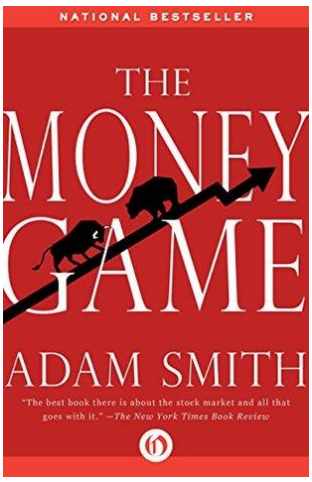
(2) From 1968 Moody's Bank & Finance Manual for 1957 -1967.

Estimated for first half of 1968.

Due to a sluggish performance by the Dow in the last few years, the four big funds now have, on average, about a one-half point per annum advantage over the Dow for the full period. The Present Environment I make no effort to predict the course of general business or the stock market. Period. However, currently there are practices snowballing in the security markets and business world which, while devoid of short term predictive value, bother me as to possible long term consequences. I know that some of you are not particularly interested (and shouldn't be) in what is taking place on the financial stage.

For those who are, I am enclosing a reprint of an unusually clear and simple article which lays bare just what is occurring on a mushrooming scale. Spectacular amounts of money are being made by those participating (whether as originators, top employees. professional advisors, investment bankers, stock speculators, etc.) in the chain-letter type stock-promotion vogue. The game is being played by the gullible, the self-hypnotized, and the cynical. To create the proper illusions, it frequently requires accounting distortions (one particularly progressive entrepreneur told me he believed in "bold, imaginative accounting"), tricks of capitalization and camouflage of the true nature of the operating businesses involved. The end product is popular, respectable and immensely profitable (I'll let the philosophers figure in which order those adjectives should be placed).

Quite candidly, our own performance has been substantially improved on an indirect basis because of the fallout from such activities. To create an ever widening circle of chain letters requires increasing amounts of corporate raw material and this has caused many intrinsically cheap (and not so cheap) stocks to come to life. When we have been the owners of such stocks, we have reaped market rewards much more promptly than might otherwise have been the case. The appetite for such companies, however, tends to substantially diminish the number of fundamentally attractive investments which remain. I believe the odds are good that, when the stock market and business history of this period is being written, the phenomenon described in Mr. May's article will be regarded as of major importance, and perhaps characterized as a mania. You should realize, however, that his "The Emperor Has No Clothes" approach is at odds (or dismissed with a “SO What?” or an "Enjoy, Enjoy”) with the views of most investment banking houses and currently successful investment managers. We live in an investment world, populated not by those who must be logically persuaded to believe, but by the hopeful, credulous and greedy, grasping for an excuse to believe.



Finally, for a magnificent account of the current financial scene, you should hurry out and get a copy of “The Money Game” by Adam Smith. It is loaded with insights and supreme wit. (Note: Despite my current “Support Your Local Postmaster” drive, I am not enclosing the book with this letter - it retails

for $6.95.) Taxes Several unusual factors make the tax figure even more difficult than usual to estimate this year. We will undoubtedly have an above average amount of ordinary income. The picture on short term and long term capital gain is subject to unusually substantial variance. At the beginning of the year, I suggested that you use an 8% ordinary income factor (it won't come in this manner but this figure embodies an adjustment for long term capital gain) applied to your BPL capital account on an interim basis to compute quarterly tax estimates. If a figure different from 8% seems more appropriate for your September 15th quarterly estimate. I will let you know by September 5th. If no change is necessary, you will next hear from me on November 1st with the Commitment Letter for 1969.

Cordially,

Warren E. Buffett

January 22nd, 1969

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

Our Performance in 1968

Everyone makes mistakes. At the beginning of 1968, I felt prospects for BPL performance looked poorer than at any time in our history. However, due in considerable measure to one simple but sound idea whose time had come (investment ideas, like women are often more exciting than punctual), we recorded an overall gain of $40,032,691. Naturally, you all possess sufficient intellectual purity to dismiss the dollar result and demand an accounting of performance relative to the Dow-Jones Industrial Average. We established a new mark at plus 58.8% versus an overall plus 7.7 % for the Dow, including dividends which would have been received through ownership of the Average throughout the year. This result should be treated as a freak like picking up thirteen spades in a bridge game. You bid the slam, make it look modest, pocket the money and then get back to work on the part scores. We will also have our share of hands when we go set.

The following summarizes the year-by-year performance of the Dow, the Partnership before allocation (one quarter of the excess over 6%) to the General Partner and the results for limited partners:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	-8.4%	10.4%	9.3%
1958	38.5%	40.9%	32.2%
1959	20.0%	25.9%	20.9%
1960	-6.2%	22.8%	18.6%
1961	22.4%	45.9%	35.9%
1962	-7.6%	13.9%	11.9%
1963	20.6%	38.7%	30.5%
1964	18.7%	27.8%	22.3%
1965	14.2%	47.2%	36.9%
1966	-15.6%	20.4%	16.8%
1967	19.0%	35.9%	28.4%
1968	7.7%	58.8%	45.6%

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of Partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses, but before distributions to partners or allocations to the General Partner.

(3) For 1957-61 computed on the basis of the preceding column of Partnership results allowing for allocation to the General Partner based upon the present Partnership Agreement, but before monthly withdrawals by limited partners.

On a cumulative or compounded basis, the results are:

Year	Overall Results From Dow	Partnership Results	Limited Partners' Results
1957	-8.4%	10.4%	9.3%
1957 – 58	26.9%	55.6%	44.5%
1957 – 59	52.3%	95.9%	74.7%
1957 – 60	42.9%	140.6%	107.2%
1957 – 61	74.9%	251.0%	181.6%
1957 – 62	61.6%	299.8%	215.1%
1957 – 63	95.1%	454.5%	311.2%
1957 – 64	131.3%	608.7%	402.9%
1957 – 65	164.1%	943.2%	588.5%
1957 – 66	122.9%	1156.0%	704.2%
1957 – 67	165.3%	1606.9%	932.6%
1957 – 68	185.7%	2610.6%	1403.5%
Annual Compounded Rate	**9.1%**	**31.6%**	**25.3%**

Investment Companies

On the following page is the usual tabulation showing the results of what were the two largest mutual funds (they stood at the top in size from 1957 through 1966 - they are still number two and three) that follow a policy of being, typically, 95 -100% invested in common stocks, and the two largest diversified closed-end investment companies.

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont (2)	Dow	Limited Partners
1957	-11.4%	-12.4%	-11.4%	-2.4%	-8.4%	9.3%
1958	42.7%	47.5%	40.8%	33.2%	38.5%	32.2%
1959	9.0%	10.3%	8.1%	8.4%	20.0%	20.9%
1960	-1.0%	-0.6%	2.5%	2.8%	-6.2%	18.6%
1961	25.6%	24.9%	23.6%	22.5%	22.4%	35.9%
1962	-9.8%	-13.4%	-14.4%	-10.0%	-7.6%	11.9%
1963	20.0%	16.5%	23.7%	18.3%	20.6%	30.5%
1964	15.9%	14.3%	13.6%	12.6%	18.7%	22.3%
1965	10.2%	9.8%	19.0%	10.7%	14.2%	36.9%
1966	-7.7%	-10.0%	-2.6%	-6.9%	-15.6%	16.8%
1967	20.0%	22.8%	28.0%	25.4%	19.0%	28.4%
1968	10.3%	8.1%	6.7%	6.8%	7.7%	45.6%
Cumulative Results	**189.3%**	**167.7%**	**225.6%**	**200.2%**	**185.7%**	**1403.5%**
Annual Compounded Rate	**9.3%**	**8.6%**	**10.3%**	**9.6%**	**9.1%**	**25.3%**

(1) Computed from changes in asset value plus any distributions to holders of record during year.

(2) From 1968 Moody's Bank & Finance Manual for 1957-1967. Estimated for 1968.

It is interesting that after twelve years these four funds (which presently aggregate well over $5 billion and account for over 10% of the investment company industry) have averaged only a fraction of one percentage point annually better than the Dow. Some of the so-called "go-go" funds have recently been re-christened "no-go" funds. For example, Gerald Tsai's Manhattan Fund, perhaps the world's best-known aggressive investment vehicle, came in at minus 6.9% for 1968. Many smaller investment entities continued to substantially outperform the general market in 1968, but in nothing like the quantities of 1966 and 1967.

The investment management business, which I used to severely chastise in this section for excessive lethargy, has now swung in many quarters to acute hypertension. One investment manager, representing an organization (with an old established name you would recognize) handling mutual funds aggregating well over $1 billion, said upon launching a new advisory service in 1968: "The complexities of national and international economics make money management a full-time job. A good money 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." Wow! This sort of stuff makes me feel guilty when I go out for a Pepsi. When practiced by large and increasing numbers of highly motivated people with huge amounts of money on a limited quantity of suitable securities, the result becomes highly unpredictable. In some ways it is fascinating to watch and in other ways it is appalling.

Analysis of 1968 Results

All four main categories of our investment operation worked out well in 1968. Our total overall gain of $40,032,691 was divided as follows:

Category	Average Investment	Overall Gain
Controls	$24,996,998	$5,886,109
Generals – Private Owner	$16,363,100	$21,994,736
Generals – Relatively Undervalued	$8,766,878	$4,271,825
Workouts	$18,980,602	$7,317,128
Miscellaneous, primarily US Treasury Bills	$12,744,973	$839,496
Total Income		$40,309,294
Less – General Expense, including Interest		$276,603
Overall Gain		$40,032,691

A few caveats, as mentioned in my letter two years ago, are again in order (non-doctoral candidates may proceed to next section):

1. An explanation of the various categories listed above was made in the January 18, 1965 letter. If your memory needs refreshing and your favorite newsstand does not have the pocketbook edition. We'll be glad to give you a copy.

2. The classifications are not iron clad. Nothing is changed retroactively, but the initial decision as to category is sometimes arbitrary. Sometimes later classification proves difficult; e.g. a workout that falls through but that I continue to hold for reasons unrelated or only partially related to the original decision (like stubbornness).

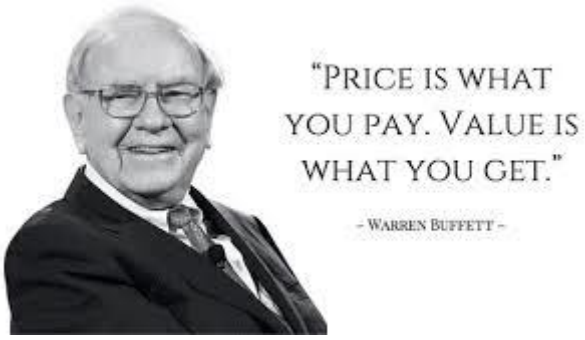
3. Percentage returns calculated on the average investment base by category would be significantly understated relative to Partnership percentage returns which are calculated on a beginning investment base. In the foregoing figures, a security purchased by us at 100 on January 1 which appreciated at an even rate to 200 on December 31 would have an average investment of 150 producing a 66-2/3% result contrasted to a 100% result by the customary approach. In other words, the foregoing figures use a monthly average of market values in calculating the average investment.

4. All results are based on a 100% ownership, non-leverage basis. Interest and other general expenses are deducted from total performance and not segregated by category. Expenses directly related to specific investment operations, such as dividends paid on short stock, are deducted by category. When securities are borrowed directly and sold short, the net investment (longs minus shorts) is shown for the applicable category's average investment.

5. The foregoing table has only limited use. The results applicable to each category are dominated by one or two investments. They do not represent a collection of great quantities of stable data (mortality rates of all American males or something of the sort) from which conclusions can be drawn and projections made. Instead, they represent infrequent, non-homogeneous phenomena leading to very tentative suggestions regarding various courses of action and are so used by us. 6. Finally, these calculations are not made with the same loving care we apply to counting the money and are subject to possible clerical or mathematical error since they are not entirely self-checking.

Controls

Overall, the controlled companies turned in a decent performance during 1968. Diversified Retailing Company Inc. (80% owned) and Berkshire Hathaway Inc. (70% owned) had combined after-tax earnings of over $5 million. Particularly outstanding performances were turned in by Associated Cotton Shops, a subsidiary of DRC run by Ben Rosner, and National Indemnity Company, a subsidiary of B-H run by Jack Ringwalt. Both of these companies earned about 20% on capital employed in their businesses. Among Fortune's “500” (the largest manufacturing entities in the country, starting with General Motors), only 37 companies achieved this figure in 1967, and our boys outshone such mildly better-known (but not better appreciated) companies as IBM, General Electric, General Motors, Procter & Gamble, DuPont, Control Data, Hewlett-Packard, etc...



I still sometimes get comments from partners like: "Say, Berkshire is up four points - that's great!" or "What's happening to us, Berkshire was down three last week?" Market price is irrelevant to us in the valuation of our controlling interests. We valued B-H at 25 at yearend 1967 when the market was about 20 and 31 at yearend 1968 when the market was about 37. We would have done the same thing if the markets had been 15 and 50 respectively. ("**Price** is what you pay. **Value** is what you get"). We will prosper or suffer in controlled investments in relation to the operating performances of our businesses - we will not attempt to profit by playing various games in the securities markets.

Generals -Private Owner

Over the years this has been our best category, measured by average return, and has also maintained by far the best percentage of profitable transactions. This approach was the way I was taught the business, and it formerly 126 accounted for a large proportion of all our investment ideas. Our total individual profits in this category during the twelve year BPL history are probably fifty times or more our total losses. The cash register really rang on one simple industry idea (implemented in several ways) in this area in 1968. We even received a substantial fee (included in Other Income in the audit) for some work in this field. Our total investment in this category (which is where I feel by far the greatest certainty regarding consistently decent results) is presently under $2 million and I have nothing at all in the hopper to bolster this. What came through like the Johnstown flood in 1968 looks more like a leaky faucet in Altoona for 1969.

Generals - Relatively Undervalued

This category produced about two-thirds of the overall gain in 1966 and 1967 combined. I mentioned last year that the great two-year performance here had largely come from one idea. I also said, "We have nothing in this group remotely approaching the size or potential which formerly existed in this investment." It gives me great pleasure to announce that this statement was absolutely correct. It gives me somewhat less pleasure to announce that it must be repeated this year.

Workouts

This category, which was a disaster in 1967, did well during 1968. Our relatively heavy concentration in just a few situations per year (some of the large arbitrage houses may become involved in fifty or more workouts per annum) gives more variation in yearly results than an across-the-board approach. I feel the average profitability will be as good with our policy and 1968 makes me feel better about that conclusion than 1967 did. It should again be stated that our results in the Workout area (as well as in other categories) are somewhat understated compared to the more common method of determining results computed on an initial base figure and utilizing borrowed money (which is often a sensible part of the Workout business).

****

I can't emphasize too strongly that the quality and quantity of ideas is presently at an all time low - the product of the factors mentioned in my October 9th, 1967 letter, which have largely been intensified since then. Sometimes I feel we should have a plaque in our office like the one at the headquarters of Texas Instruments in Dallas which reads: "We don't believe in miracles, we rely on them." It is possible for an old, overweight ball player, whose legs and batting eye are gone, to tag a fast ball on the nose for a pinch-hit home run, but you don't change your line-up because of it. We have a number of important negatives operating on our future and, while they shouldn't add up to futility, they certainly don't add up to more than an average of quite moderate profitability.

Memorabilia

As one of my older friends says, "Nostalgia just isn't what it used to be." Let's take a stab at it, anyway. Buffett Associates, Ltd., the initial predecessor partnership, was formed May 5, 1956 with seven limited partners (four family, three close friends), contributing $105,000, and the General Partner putting his money where his mouth was by investing $100. Two additional single-family limited partnerships were formed during 1956, so that on January 1, 1957 combined net assets were

$303,726. During 1957, we had a gain of $31,615.97, leading to the 10.4% figure shown on page one. During 1968 I would guess that the New York Stock Exchange was open around 1,200 hours, giving us a gain of about $33,000 per hour (sort of makes you wish they had stayed with the 5-1/2 hour, 5 day week, doesn't it), or roughly the same as the full year gain in 1957. On January 1, 1962 we consolidated the predecessor limited partnerships moved out of the bedroom and hired our first full-time employees. Net assets at that time were $7,178,500.

From that point to our present net assets of $104,429,431 we have added one person to the payroll. Since 1963 (Assets $9,405,400) rent has gone from $3,947 to $5,823 (Ben Rosner would never have forgiven me if I had signed a percentage lease) travel from $3,206 to $3,603, and dues and subscriptions from $900 to $994. If one of Parkinson's Laws is operating, at least the situation hasn't gotten completely out of control. In making our retrospective survey of our financial assets, our conclusion need not parallel that of Gypsy Rose Lee who opined, when reviewing her physical assets on her fifty-fifth birthday: “I have everything I had twenty years ago - it's just that it's all lower.”

Miscellaneous

Although the investment environment is difficult, the office environment is superb. With Donna, Gladys, Bill and John, we have an organization that functions speedily, efficiently and pleasantly. They are the best. The office group, along with spouses (one apiece - I still haven't figured out how I should handle that plural) and children have over $27 million invested in BPL on January 1, 1969. Assorted sizes and shapes of aunts, uncles, parents, in-laws, brothers, sisters and cousins make the BPL membership list read like “Our Crowd” - which, so far as I am concerned, is exactly what it is. Within a few days, you will receive:

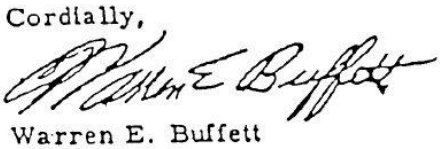
1. A tax letter giving you all BPL information needed for your 1968 federal income tax return. This letter is the only item that counts for tax purposes.

2. An audit from Peat Marwick. Mitchell & Co. (they have again done an excellent job) for 1968, setting forth the operations and financial position of BPL, as well as your own capital account.

3. A letter signed by me setting forth the status of your BPL interest on January 1, 1969. This is identical with the figures developed in the audit.

Let me know if anything in this letter or that occurs during the year needs clarifying. My next letter will be about July 10th, summarizing the first half of this year.

Cordially,



Warren E. Buffett

May 29th, 1969

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

To My Partners:

About eighteen months ago I wrote to you regarding changed environmental and personal factors causing me to modify our future performance objectives. The investing environment I discussed at that time (and on which I have commented in various other letters has generally become more negative and frustrating as time has passed. Maybe I am merely suffering from a lack of mental flexibility. (One observer commenting on security analysts over forty stated: “They know too many things that are no longer true.”) However, it seems to me that:

(1) opportunities for investment that are open to the analyst who stresses 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.

The October 9th, 1967 letter stated that personal considerations were the most important factor among those causing me to modify our objectives. I expressed a desire to be relieved of the (self-imposed) necessity of focusing 100% on BPL. I have flunked this test completely during the last eighteen months. The letter said: I hope limited objectives will make for more limited effort. It hasn't worked out that way. As long as I am “on stage”, publishing a regular record and assuming responsibility for management of what amounts to virtually 100% of the net worth of many partners, I will never be able to put sustained effort into any non-BPL activity. If I am going to participate publicly. I can't help being competitive. I know I don't want to be totally occupied with out-pacing an investment rabbit all my life. The only way to slow down is to stop.

Therefore, before yearend. I intend to give all limited partners the required formal notice of my intention to retire. There are, of course, a number of tax and legal problems in connection with liquidating the Partnership, but overall, I am concerned with working out a plan that attains the following objectives:

1. The most important item is that I have an alternative regarding money management to suggest to the many partners who do not want to handle this themselves. Some partners of course, have alternatives of their own in which they have confidence and find quite acceptable.

To the others, however, I will not hand over their money with a "good luck". I intend to suggest an alternative money manager to whom I will entrust funds of my relatives and others for whom I have lifetime financial responsibility. This manager has integrity and ability and will probably perform as well or better than I would in the future (although nowhere close to what he or I have achieved in the past). He will be available to any partner, so that no minimum size for accounts will cause any of you a problem. I intend, in the future, to keep in general touch with what he is doing, but only on an infrequent basis with any advice on my part largely limited to a negative type.

2. I want all partners to have the option of receiving cash and possibly readily marketable securities (there will probably be only one where this will apply) where I like both the prospects and price but which 129 partners will be able to freely convert to cash if they wish.

3. However, I also want all partners to have the option of maintaining their proportional interests in our two controlled companies (Diversified Retailing Company Inc. and Berkshire Hathaway Inc.) and one other small "restricted" holding. Because these securities will be valued unilaterally by me at fair value, I feel it is essential that, if you wish, you can maintain your proportionate interest at such valuation. However, these securities are not freely marketable (various SEC restrictions apply to “control” stock and non-registered stock) and they will probably be both non-transferable and non-income -producing for a considerable period of time. Therefore, I want you to be able to go either way in our liquidation - either stick with the restricted securities or take cash equivalent.

I strongly like all of the people running our controlled businesses (joined now by the Illinois National Bank and Trust Company of Rockford, Illinois, a $100 million plus, extremely well-run bank, purchased by Berkshire Hathaway earlier this year), and want the relationship to be life long. I certainly have no desire to sell a good controlled business run by people I like and admire, merely to obtain a fancy price. However, specific conditions may cause the sale of one operating unit at some point. I believe we will have a liquidation program which will accomplish the above objectives. Our activities in this regard should cause no change in your tax planning for 1969.

One final objective, I would like very much to achieve (but which just isn't going to happen) is to go out with a bang. I hate to end with a poor year, but we are going to have one in 1969. My best guess is that at yearend, allowing for a substantial increase in value of controlled companies (against which all partners except me will have the option of taking cash), we will show a breakeven result for 1969 before any monthly payments to partners. This will be true even if the market should advance substantially between now and yearend, since we will not be in any important position which will expose us to much upside potential.

Our experience in workouts this year has been atrocious - during this period I have felt like the bird that inadvertently flew into the middle of a badminton game. We are not alone in such experience, but it came at a time when we were toward the upper limit of what has been our historical range of percentage commitment in this category. Documenting one's boners is unpleasant business. I find "selective reporting" even more distasteful. Our poor experience this year is 100% my fault. It did not reflect bad luck, but rather an improper assessment of a very fast-developing governmental trend.

Paradoxically, I have long believed the government should have been doing (in terms of the problem attacked – not necessarily the means utilized) what it finally did - in other words, on an overall basis, I believe the general goal of the activity which has cost us substantial money is socially desirable and

have so preached for some time. Nevertheless, I didn't think it would happen. I never believe in mixing what I think should happen (socially) with what I think will happen in making decisions - in this case, we would be some millions better off if I had. Quite frankly, in spite of any factors set forth on the earlier pages. I would continue to operate the Partnership in 1970, or even 1971, if I had some really first class ideas. Not because I want to, but simply because I would so much rather end with a good year than a poor one.

However, I just don't see anything available that gives any reasonable hope of delivering such a good year and I have no desire to grope around, hoping to "get lucky" with other people's money. I am not attuned to this market environment and I don't want to spoil a decent record by trying to play a game I don't understand just so I can go out a hero. Therefore, we will be liquidating holdings throughout the year, working toward a residual of the controlled companies, the one "investment letter" security, the one marketable security with favorable long-term prospects, and the miscellaneous "stubs", etc. of small total value which will take several years to clean up in the Workout category.

I have written this letter a little early in lieu of the mid-year letter. Once I made a decision, I wanted you to know. I also wanted to be available in Omaha for a period after you received this letter to clear up anything that may be confusing in it. In July, I expect to be in California. Some of you are going to ask, "What do you plan to do?" I don't have an answer to that question. I do know that when I am 60, I should be attempting to achieve different personal goals than those which had priority at age 20. Therefore, unless I now divorce myself from the activity that has consumed virtually all of my time and energies during the first eighteen years of my adult life, I am unlikely to develop activities that will be appropriate to new circumstances in subsequent years. We will have a letter out in the Fall, probably October, elaborating on the liquidation procedure, the investment advisor suggestion, etc…

Cordially,

Warren E. Buffett

October 9th, 1969

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

To My Partners:

Here is my present estimate of the BPL calendar for the months to come:

(1) This letter - to tell you something of Bill Ruane, the money manager within my knowledge who ranks the highest when combining the factors of integrity, ability and continued availability to all partners. I also want to comment upon the present range of expectations involved in deciding on a bond-stock mix.

(2) Late November - the required thirty days formal notice of my intent to retire from the Partnership at the end of the year.

(3) Early December - a package of publicly available material, as well as some general comments by me relating to our controlled companies. Berkshire Hathaway Inc. (owning the textile business, Illinois National Bank and Trust Company of Rockford, Illinois, National Indemnity Company and National Fire and Marine Insurance Company and Sun Newspapers) and Diversified Retailing Company (owning Hochschild, Kohn & Co. and Associated Cotton Shops). I want you to have ample time to study the material relating to such companies before you make any decision to hold, sell or buy such securities after distribution to you in early January. I will solicit written questions from partners (I don't want to talk to you individually about such companies, as I want all partners to obtain exactly the same information) and then have a further mailing late in December, giving all questions received relating to these companies along with my answers, if possible. I still anticipate having a plan enabling partners to promptly convert such controlled company holdings to cash, if they wish.

(4) About January 5th –

> (a) a cash distribution amounting to at least 56% (probably more - depending upon what percentage of our remaining holdings are sold before yearend) of your January 1, 1969 capital, less any distributions (the regular monthly payments many of you receive) or borrowings by you during 1969,
>
> (b) your proportional share of our holdings in Diversified Retailing Company Inc. and Berkshire Hathaway Inc. I which, if you dispose of them, will bring 30% - 35% (my estimate of value will be made at yearend) of your January 1, 1969 capital. We may make substantial additional sales before yearend - if so, the early January cash distribution will be somewhat larger than the 56% mentioned above. If we don't, such sales will be made during the first half of 1970 and an interim distribution made. Residual assets will be sold at appropriate times and I believe not more than 10% of our present asset value will remain after June 30th, 1970 pending a final distribution when all assets and liabilities have been cleaned up.

Unless there is a further substantial decline in the market. I still expect about a breakeven performance before any monthly payments for 1969. We were lucky - if we had not been in liquidation this year, our results would have been significantly worse. Ideas that looked potentially interesting on a "continuing" basis have on balance performed poorly to date. We have only two items of real size left - one we are selling as I write this and the other is a holding of limited marketability representing about 7-1/2% of the outstanding stock of Blue Chip Stamps which we may sell via a registered public offering around yearend, depending upon market conditions and other factors.

(5) March 1st. 1970 - John Harding expects to leave Buffett Partnership. Ltd. and open a branch office in Omaha for Ruane, Cunniff & Stires. Bill Scott and I will be available at BPL offices to help any partners who are desirous of purchasing bonds, tax-free or taxable. We will set aside the month of March to make our services available without cost to those who want to acquire bonds. Because of some experience we have in analysis and purchasing, as well as the access we have to wholesale markets. I think it is likely we can save material elements of cost as well as help select better relative values for those of you who wish to invest in bonds. After April 1st, however, we want to be out of any form of personal advisory activity.

(6) After March, 1970 - Bill and I will continue to office in Kiewit Plaza, spending a very minor portion of our time completing the wind-up of BPL. This will mean filing tax returns for 1970 and probably 1971 resolving minor assets and liabilities etc.

Bill Ruane

Now, to Bill Ruane - we met in Ben Graham's class at Columbia University in 1951 and I have had considerable opportunity to observe his qualities of character, temperament and intellect since that time. If Susie and I were to die while our children are minors, he is one of three trustees who have carte blanche on investment matters - the other two are not available for continuous investment management for all partners, large or small. There is no way to eliminate the possibility of error when judging humans particularly in regard to future behavior 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.

Bill has recently formed a New York Stock Exchange firm, Ruane, Cunniff & Stires, Inc., 85 Broad Street, New York, N.Y. 10004, telephone number (212) 344-6700. John Harding presently plans to establish an office for the firm in Omaha about March 1st, 1970. Bill manages accounts individually on a fee

basis and also executes brokerage for the accounts - presently with some portion of the brokerage commissions used to offset a portion of the investment advisory fee. His method of operation allows monthly withdrawals on a basis similar to BPL - as a percentage of capital and unrelated to realized or unrealized gain or loss. It is possible he may form some sort of pooled account but such determinations will be made between him and those of you who elect to go with him. I, of course, will not be involved with his operation.

I am making my list of partners available to him and he will be writing you fairly soon regarding a trip he plans to make before yearend to Omaha, Los Angeles and Chicago, so that those of you who wish to meet him may do so. Any of you who are going to be in New York during the next few months can contact him directly. Bill's overall record has been very good-averaging fairly close to BPL's, but with considerably greater variation. From 1956-1961 and from 1964-1968, a composite of his individual accounts averaged over 40% per annum. However, in 1962, undoubtedly somewhat as a product of the euphoric experience of the earlier years, he was down about 50%. As he re-oriented his thinking, 1963 was about breakeven. While two years may sound like a short time when included in a table of performance, it may feel like a long time when your net worth is down 50%.

I think you run this sort of short-term risk with virtually any money manager operating in stocks and it is a factor to consider in deciding the portion of your capital to commit to equities. To date in 1969, Bill is down about 15%, which I believe to be fairly typical of most money managers. Bill, of course, has not been in control situations or workouts, which have usually tended to moderate the swings in BPL year-to-year performance. Even excluding these factors, I believe his performance would have been somewhat more volatile (but not necessarily poorer by any means) than mine - his style is different, and while his typical portfolio (under most conditions) would tend to have a mild overlap with mine, there would always be very significant differences. Bill has achieved his results working with an average of $5 to $10 million.

I consider the three most likely negative factors in his future to be:

(1) the probability of managing significantly larger sums - this is a problem you are going to have rather quickly with any successful money manager, and it will tend to moderate performance; I believe Bill's firm is now managing $20 -$30 million and, of course, they will continue to add accounts;

(2) the possibility of Bill's becoming too involved in the detail of his operation rather than spending all of his time simply thinking about money management. The problems of being the principal factor in a NYSE firm as well as handling many individual accounts can mean that he, like most investment advisors, will be subject to pressures to spend much of his time in activities that do nothing to lead to superior investment performance. In this connection, I have asked Bill to make his services available to all BPL partners - large or small and he will, but I have also told him he is completely a free agent if he finds particular clients diverting him from his main job;

(3) the high probability that even excellent investment management during the next decade will only produce limited advantages over passive management. I will comment on this below.

The final point regarding the negatives listed above is that they are not the sort of drawbacks leading to horrible performance, but more likely the sort of things that lead to average performance. I think this is the main risk you run with Bill - and average performance is just not that terrible a risk. In recommending Bill, I am engaging in the sort of activity I have tried to avoid in BPL portfolio activities - a decision where there is nothing to gain (personally) and considerable to lose. Some of my friends who are not in the Partnership have suggested that I make no recommendation since, if results were excellent it would do me no good and, if something went wrong, I might well get a portion of the

blame. If you and I had just had a normal commercial relationship, such reasoning might be sound. However, the degree of trust partners have extended to me and the cooperation manifested in various ways precludes such a "hands off" policy. Many of you are professional investors or close thereto and need no advice from me on managers - you may well do better yourself. For those partners who are financially inexperienced. I feel it would be totally unfair for me to assume a passive position and deliver you to the most persuasive salesman who happened to contact you early in 1970.

Finally, a word about expectations. A decade or so ago was quite willing to set a target of ten percentage points per annum better than the Dow, with the expectation that the Dow would average about 7%. This meant an expectancy for us of around 17%, with wide variations and no guarantees, of course - but, nevertheless, an expectancy. Tax-free bonds at the time yielded about 3%. While stocks had the disadvantage of irregular performance, overall they seemed much the more desirable option. I also stressed this preference for stocks in teaching classes, participating in panel discussions, etc…

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. If correct. this view has important implications. Let me briefly (and in somewhat oversimplified form) set out the situation as I see it:

(1) I am talking about the situation for, say, a taxpayer in a 40% Federal Income Tax bracket who also has some State Income Tax to pay. Various changes are being proposed in the tax laws, which may adversely affect net results from presently tax-exempt income, capital gains, and perhaps other types of investment income. More proposals will probably come in the future. Overall, I feel such changes over the years will not negate my relative expectations about after-tax income from presently tax-free bonds versus common stocks, and may well even mildly reinforce them.

(2) I am talking about expectations over the next ten years - not the next weeks or months. I find it much easier to think about what should develop over a relatively long period of time than what is likely in any short period. As 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 weights dictated by fundamentals than votes dictated by psychology.

(3) Purely passive investment in tax-free bonds will now bring about 6-1/2%. This yield can be achieved with excellent quality and locked up for just about any period for which the investor wishes to contract. Such conditions may not exist in March when Bill and I will be available to assist you in bond purchases, but they exist today.

(4) The ten year expectation for corporate stocks as a group is probably not better than 9% overall. say 3% dividends and 6% gain in value. I would doubt that Gross National Product grows more than 6% per annum - I don't believe corporate profits are likely to grow significantly as a percentage of GNP - and if earnings multipliers don't change (and with these assumptions and present interest rates they shouldn't) the aggregate valuation of American corporate enterprise should not grow at a long-term compounded rate above 6% per annum. This typical experience in stocks might produce (for the taxpayer described earlier) 1-3/4% after tax from dividends and 4-3/4% after tax from capital gain, for a total after-tax return of about 6-1/2%. The pre-tax mix between dividends and capital gains might be more like 4% and 5%, giving a slightly lower aftertax result. This is not far from historical experience and overall, I believe future tax rules on capital gains are likely to be stiffer than in the past.

(5) Finally, probably half the money invested in stocks over the next decade will be professionally managed. Thus, by definition virtually, the total investor experience with professionally managed money will be average results (or 6-1/2% after tax if my assumptions above are correct). My judgment would be that less than 10% of professionally managed money (which might imply an average of $40 billion just for this superior segment) handled consistently for the decade would average 2 points per annum over group expectancy. So-called "aggressively run" money is unlikely to do significantly better than the general run of professionally managed money.

There is probably $50 billion in various gradations of this "aggressive" category now - maybe 100 times that of a decade ago - and $50 billion just can't "perform". If you are extremely fortunate and select advisors who achieve results in the top 1% to 2% of the country (but who will be working with material sums of money because they are that good), I think it is unlikely you will do much more than 4 points per annum better than the group expectancy. I think the odds are good that Bill Ruane is in this select category. My estimate, therefore, is that over the next decade the results of really excellent management for our "typical taxpayer" after tax might be 1-3/4% from dividends and 7-3/4% from capital gain. or 9 –1.2% overall.

(6) The rather startling conclusion is that under today's historically unusual conditions, passive investment in tax-free bonds is likely to be fully the equivalent of expectations from professionally managed money in stocks, and only modestly inferior to extremely well-managed equity money.

(7) A word about inflation - it has very little to do with the above calculation except that it enters into the 6% assumed growth rate in GNP and contributes to the causes producing 6-1/2% on tax-free bonds. If stocks should produce 8% after tax and bonds 4%, stocks are better to own than bonds, regardless of whether prices go up, down or sidewise. The converse is true if bonds produce 6-1/2% after tax. and stocks 6%. The simple truth, of course, is that the best expectable after-tax rate of return makes the most sense - given a rising, declining or stable dollar.

All of the above should be viewed with all the suspicion properly accorded to assessments of the future. It does seem to me to be the most realistic evaluation of what is always an uncertain future - I present it with no great feeling regarding its approximate accuracy, but only so you will know what I think at this time. You will have to make your own decision as between bonds and stocks and, if the latter, who advises you on 135 such stocks. In many cases, I think the decision should largely reflect your tangible and intangible (temperamental) needs for regularity of income and absence of large principal fluctuation, perhaps balanced against psychic needs for some excitement and the fun associated with contemplating and perhaps enjoying really juicy results. If you would like to talk over the problem with me, I will be very happy to help.

Cordially,

Warren E. Buffett

December 5th, 1969

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

To My Partners:

This letter is to supply you with some published information relating to our two controlled companies (and their four principal operating components), as well as to give you my general views regarding their operations. My comments are not designed to give you loads of detailed information prospectus-style, but only my general "slant" as I see the businesses at this time.

Hochschild, Kohn & Company

At yearend, BPL will own 800,000 of 1,000,000 shares outstanding of Diversified Retailing Company. First Manhattan Company and Wheeler, Munger & Company will each own 100,000 shares. DRC previously owned 100% of Hochschild, Kohn & Company of Baltimore, and currently owns 100% of Associated Retail Stores (formerly named Associated Cotton Shops). On December 1st, DRC sold its entire interest in H-K to Supermarkets General Corp. for $5,045,205 of cash plus non-interest bearing SGC notes for $2 million due 2-1- 70, and $4,540,000 due 2-1-71. The present value of these notes approximates $6.0 million so, effectively, DRC received about $11 million on the sale. Various warranties were made by DRC in connection with the sale, and, while we expect no claims pursuant to the contract, a remote contingent liability always exists while warranties are in force. Associated Retail Stores has a net worth of about $7.5 million. It is an excellent business with a strong financial position, good operating margins and a record of increasing sales and earnings in recent years. Last year, sales were about $37.5 million and net income about $1 million.

This year should see new records in sales and earnings, with my guess on the latter to be in the area of $1.1 million after full taxes. DRC has $6.6 million in debentures outstanding (prospectus with full description of the business as of December 18th, 1967 and the debenture terms will be sent you upon request) which have one unusual feature in that if I, or an entity controlled by me, is not the largest shareholder of DRC, the debenture holders have the right to present their debentures for payment by the company at par. Thus, DRC has tangible net assets of about $11.50 - $12.00 per share, an excellent operating business and substantial funds available for reinvestment in other operating businesses. On an interim basis, such funds will be employed in marketable securities.

Berkshire Hathaway Inc. has 983,582 shares outstanding, of which BPL owns 691,441. B-H has three main operating businesses, the textile operation, the insurance operation (conducted by National Indemnity Company and National Fire & Marine Insurance Company, which will be collectively called the insurance company) and the Illinois National Bank and Trust Company of Rockford, Illinois. It also owns Sun Newspapers Inc, Blacker Printing Company and 70% of Gateway Underwriters, but these operations are not financially significant relative to the total. The textile operation presently employs about $16 per share in capital and, while I think it has made some progress relative to the textile industry generally, cannot be judged 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 the business that existed when we purchased control four and one-half years ago. Capital from the 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 return, we expect to continue the textile operation as long as it produces near current levels.

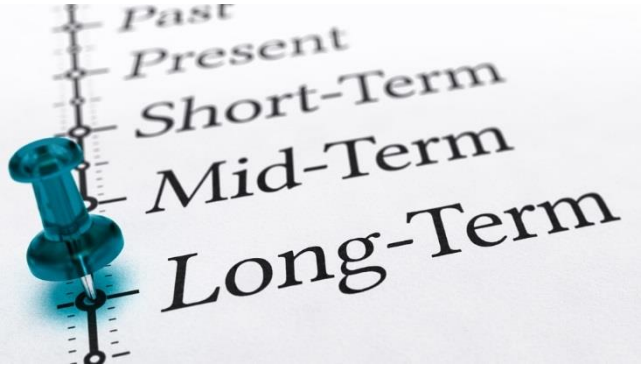
The insurance operation (of which B-H owns virtually 100%) and the bank (where B-H owns 97.7%) present a much happier picture. Both are first-class businesses, earning good returns on capital and stacking up well on any absolute or comparative analysis of operating statistics. The bank has about $17 per share of net tangible assets applicable to B-H, and the insurance company approximately $15. I would estimate their normal current earning power to be about $4 per share (compared to about $3.40 from operations pro-forma in 1968), with good prospects for future growth on the combined $32 of tangible net assets in the bank and insurance company.

Adding in the textile business and miscellaneous assets, and subtracting parent company bank debt of about $7 million, gives a tangible net asset value of about $43 per share for B-H, or about $45 stated book value, allowing for the premium over tangible assets paid for the bank. One caveat - when I talk above of tangible net assets. I am valuing the $75 million of bonds held by the insurance company and bank at amortized cost. This is in accord with standard accounting procedures used in those industries and also in accord with the realities of their business operations where it is quite unlikely that bonds will have to be sold before maturity. At today's historically low bond prices, however, our bonds have a market value substantially below carrying value, probably on the order of $10 per share of B-H stock.

Between DRC and B-H, we have four main operating businesses with three of them in my opinion, definitely first class by any of the usual standards of evaluation. The three excellent businesses are all run by men over sixty who are largely responsible for building each operation from scratch. These men are hardworking, wealthy, and good – extraordinarily good. Their age is a negative, but it is the only negative applicable to them.

One of the reasons I am happy to have a large segment of my capital in B-H and DRC is because we have such excellent men in charge of the operating businesses. We have various annual reports, audits, interim reports, proxy materials prospectuses, etc… applicable to our control holdings and we will be glad to supply you with any item you request. I also solicit your written questions and will send to all partners the questions and answers shortly before yearend. Don't hesitate to ask any question at all that comes to mind - if it isn't clear to you, it probably isn't clear to others - and there is no reason for any of you to be wondering about something that I might clear up. DRC and B-H presently pay no dividends and will probably pay either no dividends or very modest dividends for some years to come.

There are a number of reasons for this. Both parent companies have borrowed money - we want to maintain a good level of protection for depositors at the bank and policyholders at the insurance company - some of the operating companies have very satisfactory ways to utilize additional capital - and we are hopeful of finding new businesses to both diversify and augment our earning power. My personal opinion is that the intrinsic value of DRC and B-H will grow substantially over the years. While no one knows the future, I would be disappointed if such growth wasn't at a rate of approximately 10% per annum. Market prices for stocks fluctuate at great amplitudes around intrinsic value but, over the long term, intrinsic value is virtually always reflected at some point in market price.



Thus, I think both securities should be very decent long-term holdings and I am happy to have a substantial portion of my net worth invested in them. You should be unconcerned about short-term price action when you own the securities directly, just as you were unconcerned when you owned them indirectly through BPL. I think about them as businesses, not “stocks”, and if the business does all right over the long term, so will the stock. I want to stress that I will not be in a managerial or partnership status with you regarding your future holdings of such securities. You will be free to do what you wish with your stock in the future and so, of course, will I.

I think that there is a very high probability that I will maintain my investment in DRC and B-H for a very long period, but I want no implied moral commitment to do so nor do so nor do I wish to advise others over an indefinite future period regarding their holdings. The companies, of course, will keep all shareholders advised of their activities and you will receive reports as issued by them, probably on a semi-annual basis. Should I continue to hold the securities, as I fully expect to do, my degree of involvement in their activities may vary depending upon my other interests. The odds are that I will take an important position on matters of policy, but I want no moral obligation to be other than a passive shareholder, should my interests develop elsewhere.

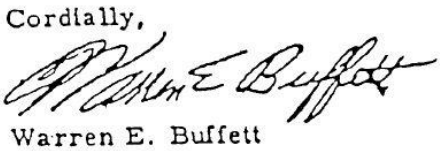
We presently plan to make the initial BPL cash distribution on January 5th, which will now come to at least 64% of January 1, 1969 capital less any distributions (including monthly payments) you have received from us since January 1, 1969. There is now pending a public offering, headed by Merrill, Lynch, Pierce, Fenner & Smith, of our Blue Chip Stamps holdings which, if completed this month as

expected, should bring the figure to at least 70%. If you wish Bill and me to give you our ideas regarding bonds in March, you should purchase U.S. Treasury Bills maturing in late March with the applicable portion of the January 5th distribution. Then advise us in the last week of February of the amount you wish to invest in bonds and we will let you know our thoughts.

About the middle of January (as soon as the exact amounts are figured and shares are received from the Transfer Agent after having been registered in your name) we will distribute the DRC and B-H stock applicable to your partnership interest and subsequently advise you of your tax basis and acquisition date attributable to the stock. Such shares will be "legended" as described in the enclosed letter from Monen, Seidler & Ryan. These stock certificates are valuable and should be kept in a safe place. In past letters I had expressed the hope that BPL could supply a mechanism whereby you could, if you wished, automatically convert your DRC and B-H to cash. I have had two law firms consider extensively the status of these shares in your hands following the liquidation and the accompanying letters (which should be saved and kept with the shares) give their conclusions. As you can see, it is not an area that produces simple, clear-cut guidelines. I see no prudent way to implement the alternatives I had previously been considering.

Therefore, you must follow the guidelines they set forth if you wish to dispose of your shares. As you probably realize, the restrictions on subsequent sale apply more severely to Susie and me (because of my continued "insider" position) than they probably do to you. Substantial quantities of securities often are sold via the "private sale" option described in paragraph (3) of the opinion. If the rules become clearer or more simplified in the future, I will be sure to let you know. At the time of distribution of DRC and B-H, I will advise you of the values applied to such shares at 1969 yearend. You will receive our audit and tax letter about the end of January. It presently appears that sale of our Blue Chip shares and a substantial increase in value of DRC and B- H will bring our overall gain for the year to slightly over 6%. My next letter will be in late December, summarizing the questions and answers regarding DRC and B-H. and also supplying a final estimate on the January 5th cash distribution.

Cordially,



Warren E. Buffett

Enclosures:

Legal opinion. Monen, Seidler & Ryan Concurring opinion, Munger, Tolles. Hills & Rickershauser 1968 Annual Report. Berkshire Hathaway. Inc. 1969 Semi-Annual Report. Berkshire Hathaway. Inc. April 3. 1969 letter to Shareholders. Berkshire Hathaway. Inc. 1968 Annual Report. Diversified Retailing 139 Company. Inc. Financial information regarding Associated Retail Stores. Inc. Financial information regarding Illinois National Bank & Trust Co. 1969 Best's Report. National Indemnity Company 1969 Best's Report. National Fire & Marine Insurance Company

December 26, 1969

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

To My Partners:

Our plans regarding the initial cash distribution have been finalized and we expect to mail to you on January 3rd a check dated January 5th, 1970 for approximately 64% of your January 1st. 1969 capital, less any distributions made to you (including monthly payments) since January 1st. 1969. If you have taken no monthly payments during 1969, there will be a small interest adjustment in your favor; if you have had loans from BPL, there will be an interest charge. I couldn't be more delighted about the action of the bond and stock markets from the standpoint of the timing of our liquidation. I believe practically all partners - whether they would have invested in bonds or stocks - will be far better off receiving the cash now than if we had liquidated at the end of last year. Those seeking income will receive about 40% more after tax on the same principal investment than they would have achieved only a year ago at what then seemed like generous yields. Our tax picture is virtually complete and it appears that you will have ordinary income (dividends plus interest income less ordinary loss) for Federal tax purposes of about 3 –3/4% of your January 1st. 1969 capital (item 1 in enclosed letter), no significant long-term capital gain or loss, and a short-term capital loss of about 8-1/2% of your January 1st, 1969 unrealized appreciation (item 3).

These estimates are just rough approximations - definitive figures will reach you in early February. The sale of our 371,400 shares of Blue Chip Stamps was not completed in 1969. When the stock went into registration, it was selling at about $24 per share. The underwriters indicated a range where they expected to offer our shares (along with others) with heavy weight placed on a comparison with Sperry & Hutchinson. Shortly before the stock was to be offered, with the Dow-Jones Industrials much lower but S & H virtually unchanged, they indicated a price below their former range. We reluctantly agreed and felt we had a deal but, on the next business day, they stated that our agreed price was not feasible. We then withdrew and a much smaller offering was done. I intend to hold our block of Blue Chip Stamps in BPL for a more advantageous disposal or eventual distribution to our partners. The odds are decent that we will do better in this manner -even if it takes a year or two - than if we had participated in a very large sale into a somewhat distressed market. Unless there is a material change in the market in the next few days, I plan to value our Blue Chip holdings at yearend at the price received by selling shareholders on the public offering after underwriting discount and expenses.

Various questions have been asked pursuant to the last letter:

1. If we are not getting a good return on the textile business of Berkshire Hathaway Inc., why do we continue to operate it? Pretty much for the reasons outlined in my letter. 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 severe 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.

2. How large is our investment in Sun Newspapers, etc., and do we intend to expand in the newspaper, radio and TV business? The combined investment in Sun, Blacker Printing and Gateway Underwriters is a little over $1 per share of Berkshire Hathaway, and earns something less than 10 cent per share. We have no particular plans to expand in the communication field.

3. What does Gateway Underwriters do? Gateway Underwriters serves primarily as a General Agent for National Indemnity Company in the State of Missouri.

4. Are there good "second men" to take over from the men running the three excellent operating businesses? In any company where the founder and chief driving force behind the enterprise is still active, it is very difficult to evaluate "second men". The only real way to see how someone is going to do when running a company is to let him run it. Some of our businesses have certainly been more "one-man shows" than the typical corporation. Subject to the foregoing caveat, I think that we do have some good “second men” coming along.

5. In what area do you plan to invest the cash in Diversified Retailing Company and do you intend to stick primarily to the retailing field? While we prefer the retailing field, we do not preclude anything that will make sense. We have been looking without success for two years for an intelligent acquisition for DRC, so we are not about to rule out any industry, if the business looks good. Pending such time as we find one or more operating businesses to buy, the money will be invested in marketable securities.

6. Why didn't DRC payout the money it received on the sale of Hochschild, Kohn & Company? In addition to the fact that such a payment would constitute a dividend, taxable in significant part as ordinary income, there are restrictions in the bond indenture which prevent such a pay-out without turning over control of the company to the bondholders.

7. Will distribution of the DRC stock cause the DRC debentures to be called? After distribution of the stock, I will be the largest stockholder in DRC and, hence, the call provision will not apply.

8. How would we know if the DRC debentures were called? All stockholders and debenture holders would find out directly from the company through regular or special reports that the company issues to its security holders. There is no intention at all of calling the debentures.

9. Why did you not register our Berkshire Hathaway and Diversified Retailing shares so that the stock, when received by the partners, would be freely marketable? We considered this possibility but rejected it for both practical and legal considerations. I will just discuss the practicalities, since they would independently dictate the decision we made. There is presently no existing market for Diversified Retailing, and our holdings of Berkshire Hathaway are probably four or five times the present floating supply of this stock. An attempt to quickly buy or sell a few thousand shares can easily move BH stock several points or more.

We own 691,441 shares. Were we to distribute these stocks to you via a registration without an underwriting, and with the possibility that a substantial portion would be offered for sale by many sellers operating individually but virtually simultaneously, there is a real likelihood, particularly in a stock market environment such as we have seen recently, that the market for these two stocks would be little short of chaotic. It has not seemed to me that this was the kind of situation with which I should leave you, both from the standpoint of the price level which might prevail, as well as for the reason that different partners might well have to liquidate at widely varying price levels. The more sophisticated partners might have an important edge on the less sophisticated ones, and I believe many partners might have no chance to realize the prices I anticipate using for yearend valuation.

This would rightly seem most unfair to you, since I would have received some allocation of 1969 BPL profits based upon these yearend valuations. If the markets were to become distressed, I would probably come in for criticism, whether I personally bought at lower prices or, perhaps more so, if I refrained from buying. Were we to attempt to sponsor an underwriting in connection with a

registration for those partners who might wish to sell, there would be, in my opinion, the likelihood that the result would still be far less than satisfactory. We have just been around this track with our holdings of Blue Chip Stamps, where we watched the price of our stock go from 24 to 16-1/2 after announcement of the underwriting, of which we originally were to be a part. I did not want this sort of result for the partners with respect to their holdings of Berkshire and Diversified. It is my belief that, by confining sales to private placements, those partners who wish to sell will realize more for their stock (with the sophisticated partners having no marketing edge on the less knowledgeable) than would be achieved, through an underwriting at this time. Also, the stock should be more likely to find its way into the hands of long-term investment-minded holders, which should mean less volatile markets in the future.

We have had several phone calls from persons indicating that they wish to make private sales - we anticipate there will be no difficulty in effectuating such sales at prices related to our yearend valuations. Those partners who would prefer an underwritten distribution always have the option of having a registration of their own. I will be glad to facilitate this by placing all partners in touch with each other who indicate to me their desire to sell via a registered underwriting, at their expense and through an underwriter of their choice. In this way the expense of an underwriting, which can be considerable, would be borne by the selling partners and not by the partners as a whole. I have also had partners ask if they could participate in a registered offering in the future if I should sell shares in this manner. I think it is almost certain I will never sell stock via public offering but, should it ever happen, I will be glad to let any of you participate in any underwritten offering in which I might be involved. In all probability, if it ever did happen, your stock would already be “free”, although mine would still be restricted. I cannot make the same commitment to you regarding any private sale I might make in the future, just as I can't expect you to restrict any sale options you might have in order to include me.

10. Will you let us know if you sell your holdings of BH or DRC? You would undoubtedly know from corporate communications, reports in the press and reports to Government agencies if I disposed of my holdings. I have no intention at all of doing so in the foreseeable future - I merely make no commitment not to. However, former BPL partners will have no priority over other BH or DRC security holders in obtaining information relating to their corporate activities.

11. Should I hold my BH or DRC stock? I can’t give you the answer on this one. All I can say is that I’m going to do so and I plan to buy more. I am very happy to have a material portion of my net worth invested in these companies on a long term basis. Obviously, I think they will be worth significantly more money five or ten years hence. Compared to most stocks, I think there is a low risk of loss. I hope their price patterns follow a rather moderate range related to business results rather than behaving in a volatile manner related to speculative enthusiasm or depression. Obviously, I cannot control the latter phenomena, but there is no intent to "promote" the stocks a la much of the distasteful general financial market activity of recent years.

12. Can I give either BH or DRC shares to my wife or children? We are advised by counsel that this is permissible but, of course the same restrictions on transfer that applied to you would apply to the donee of the gift. 13. Why are you waiting until March to give us your suggestions regarding bonds? January and February promise to be very busy months. Many partners may want to talk to me about their questions and objectives regarding bonds. I want to have all important BPL matters out of the way before I talk with any of them on an individual basis. I make no forecasts regarding the bond market (or stock market) - it may be higher or lower in March than now. After my October letter, several partners became very eager to buy bonds immediately - to date they are much better off by

waiting. The excellent quality taxfree bonds I talked about at that time with yields of 6 -1/2% can now be bought to yield about 7%.

Cordially,

Warren E. Buffett

February 25th, 1970

BUFFETT PARTNERSHIP. LTD. 610 KIEWIT PLAZA OMAHA, NEBRASKA 68131 TELEPHONE 042-4110

To My Partners:

This letter will attempt to provide a very elementary education regarding tax-exempt bonds with emphasis on the types and maturities of bonds which we expect to help partners in purchasing next month. If you expect to use our help in the purchase of bonds, it is important that you carefully read (and, if necessary, reread) this letter as it will serve as background for the specific purchases I suggest. If you disagree with me as to conclusions regarding types of bonds or maturities (and you would have been right and I would have been wrong if you had disagreed with me on the latter point either one or two years ago), you may well be correct, but we cannot be of assistance to you in the purchase of bonds outside our area. We will simply have our hands full concentrating in our recommended area, so will be unavailable to assist or advise in the purchase of convertible bonds, corporate bonds or short term issues. I have tried to boil this letter down as much as possible. Some of it will be a little weighty - some a little oversimplified. I apologize for the shortcomings in advance. I have a feeling I am trying to put all the meat of a 100 page book in 10 pages - and have it read like the funny papers.

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I am sure you understand that our aid in the purchase of bonds will involve no future assistance regarding either these specific bonds or general investment decisions. I want to be available at this time to be of help because of the unusual amount of cash you have received in one distribution from us. I have no desire to be in the investment counseling business, directly or indirectly, and will not be available for discussion of financial matters after March 31st.

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The mechanics of Tax-Free Bonds

For those who wish our help, we will arrange the purchase of bonds directly from municipal bond dealers throughout the country and have them confirm sale of the bonds directly to you. The confirmation should be saved as a basic document for tax purposes. You should not send a check to the bond dealer since he will deliver the bonds to your bank, along with a draft which the bank will pay by charging your account with them. In the case of bonds purchased in the secondary market (issues already outstanding), this settlement date will usually be about a week after confirmation date whereas, on new issues, the settlement date may be as much as a month later. The settlement date is shown plainly on the confirmation ticket (in the case of new issues this will be the second and final ticket rather than the preliminary "when issued" ticket), and you should have the funds at your bank ready to pay for the bonds on the settlement date.

If you presently own Treasury Bills, they can be sold on a couple of days' notice by your bank upon your instructions, so you should experience no problems in having the money available on time. Interest begins to accrue to you on the settlement date, even if the bond dealer is late in getting them delivered to your bank. Bonds will be delivered in negotiable form (so-called "bearer" form which makes them like currency) with 145 coupons attached. Usually the bonds are in $5,000 denominations and frequently they can be exchanged for registered bonds (sometimes at considerable expense and sometimes free-it depends upon the terms). Bonds in registered form are nonnegotiable without assignment by you, since you are the registered owner on the Transfer Agent's books. Bonds trade almost exclusively on a bearer basis and it is virtually impossible to sell registered bonds without converting them back into bearer form.

Thus, unless you are going to own great physical quantities of bonds, I recommend keeping bonds in bearer form. This means keeping them in a very safe place and clipping the coupons every six months. Such coupons, when clipped, can be deposited in your bank account just like checks. If you have $250,000 in bonds, this probably means about fifty separate pieces of paper ($5,000 denominations) and perhaps six or eight trips a year to the safe deposit section to cut and deposit coupons. It is also possible to open a custody account with a bank where, for a fairly nominal cost, they will keep the bonds, collect the interest and preserve your records for you. For example, a bank will probably perform the custodial service for you for about $200 a year on a $250,000 portfolio. If you are interested in a custodial account, you should talk to a Trust Officer at your commercial bank as to the nature of their services and cost. Otherwise, you should have a safe deposit box.

Taxation

The interest received upon the deposit of coupons from tax-free bonds is, of course, free from Federal Income Taxes. This means if you are at a 30% top Federal Income Tax bracket, a 6% return from tax-free bonds is equivalent to about 8-1/2% from taxable bonds. Thus, for most of our partners, excluding minors or some retired people, tax-free bonds will be more attractive than taxable bonds. For people with little or no income from wages or dividends, but with substantial capital, it is possible that a combination of taxable bonds (to bring taxable income up to about the 25% or 30% bracket) plus tax-free bonds will bring the highest total after-tax income. Where appropriate, we will work with you to achieve such a balance.

The situation in respect to State Income Taxes is more complicated. In Nebraska. where the State Income Tax is computed as a percentage of the Federal Income Tax, the effect is that there is no state tax on interest from taxfree bonds. My understanding of both the New York and California law is that tax-free bonds of entities within the home state are not subject to State Income Tax, but tax-free bonds from other states are subject to the local State Income Tax. I also believe that the New York City Income Tax exempts tax-free bonds of entities based within the State of New York, but taxes those

from other states. I am no expert on state income taxes and make no attempt to post myself on changes taking place within the various states or cities. Therefore, I defer to your local tax advisor, but simply mention these few general impressions so that you will be alert to the existence of a potential problem.

In Nebraska there is no need to have any local considerations enter into the after-tax calculation. Where out-of-state issues are subject to local taxation, the effective cost of your State or Municipal Income Tax is reduced by the benefit received from deducting it on your Federal Income Tax return. This, of course, varies with the individual. Additionally, in some states there are various taxes on intangible property which may apply to all tax-free bonds or just those of out-of-state entities. There are none of these in Nebraska, but I cannot advise on the other states. When bonds are bought at a discount from par and later are sold or mature (come due and get paid), the difference between the proceeds and cost is subject to capital gain or loss treatment. (There are minor exceptions to this statement as, unfortunately, there are to most general statements on investments and taxes but they will be pointed out to you should they affect any securities we recommend). This reduces the net after-tax yield by a factor involving the general rate of future capital gains taxes and the specific future tax position of the individual. Later on, we will discuss the impact of such capital gains taxes in calculating the relative attractiveness of discount bonds versus "full coupon" bonds.

Finally, one most important point. Although the law is not completely clear, you should probably not contemplate owning tax-free bonds if you have, or expect to have, general purpose bank or other indebtedness. The law excludes the deductibility of interest on loans incurred or continued to purchase or carry tax-free bonds, and the interpretation of this statute will probably tend to be broadened as the years pass. For example, my impression is that you have no problem if you have a mortgage against real property (unless the debt was incurred in order to acquire municipal bonds) in deducting the mortgage interest on your Federal Tax return, even though you own tax-free bonds at the same time. However, I believe that if you have a general bank loan, even though the proceeds were directly used to purchase stocks, a handball court, etc. and the tax-free bonds are not used for security for the loan, you are asking for trouble if you deduct the interest and, at the same time, are the owner of tax-free bonds. Therefore, I would pay off bank loans before owning tax-free bonds, but I leave detailed examination of this question to you and your tax advisor. I merely mention it to make you aware of the potential problem.

Marketability

Tax-free bonds are materially different from common stocks or corporate bonds in that there are literally hundreds of thousands of issues, with the great majority having very few holders. This substantially inhibits the development of close, active markets. Whenever the City of New York or Philadelphia wants to raise money it sells perhaps twenty, thirty or forty non-identical securities, since it will offer an issue with that many different maturities. A 6% bond of New York coming due in 1980 is a different animal from a 6% bond of New York coming due in 1981. One cannot be exchanged for the other, and a seller has to find a buyer for the specific item he holds. When you consider that New York may offer bonds several times a year, it is easy to see why just this one city may have somewhere in the neighborhood of 1,000 issues outstanding. Grand Island, Nebraska may have 75 issues outstanding. The average amount of each issue might be $100,000 and the average number of holders may be six or eight per issue. Thus, it is absolutely impossible to have quoted markets at all times for all issues and spreads between bids and offers may be very wide. You can't set forth in the morning to buy a specific Grand Island issue of your choosing. It may not be offered at any price, anywhere,

and if you do find one seller, there is no reason why he has to be realistic compared to other offerings of similar quality.

On the other hand, there are single issues such as those of the Ohio Turnpike, Illinois Turnpike, etc. that amount to $200 million or more and have thousands of bondholders owning a single entirely homogeneous and interchangeable issue. Obviously, here you get a high degree of marketability. My impression is that marketability is generally a function of the following three items, in descending order of importance: (1) the size of the particular issue; (2) the size of the issuer (a $100,000 issue of the State of Ohio will be more marketable than a $100,000 issue of Podunk, Ohio); and (3) the quality of the issuer. By far the most sales effort goes into the selling of new issues of bonds. An average of over $200 million per week of new issues comes up for sale, and the machinery of bond distribution is geared to get them sold, large or small.

In my opinion, there is frequently insufficient differential in yield at time of issue for the marketability differences that will exist once the initial sales push is terminated. We have frequently run into markets in bonds where the spread between bid and asked prices may get to 15%. There is no need to buy bonds with the potential for such grotesque markets (although the profit spread to the dealer who originally offers them is frequently wider than on more marketable bonds) and we will not be buying them for you. The bonds we expect to buy will usually tend to have spreads (reflecting the difference between what you would pay net for such bonds on purchase and receive net on sale at the same point in time) of from 2% to 5%. Such a spread would be devastating if you attempted to trade in such bonds, but I don't believe it should be a deterrent for a long-term investor. The real necessity is to stay away from bonds of very limited marketability - which frequently are the type local bond dealers have the greatest monetary incentive to push.

Specific Areas of Purchase

We will probably concentrate our purchases in the following general areas:

(1) Large revenue-producing public entities such as toll roads, electric power districts, water districts, etc. Many of these issues possess high marketability, are subject to quantitative analysis, and sometimes have favorable sinking fund or other factors which tend not to receive full valuation in the market place.

(2) Industrial Development Authority bonds which arise when a public entity holds title to property leased to a private corporation. For example, Lorain, Ohio holds title to an $80 million project for U.S. Steel Corp. The Development Authority Board issued bonds to pay for the project and has executed a net and absolute lease with U.S. Steel to cover the bond payments. The credit of the city or state is not behind the bonds and they are only as good as the company that is on the lease. Many top-grade corporations stand behind an aggregate of several billion dollars of these obligations, although new ones are being issued only in small amounts ($5 million per project or less) because of changes in the tax laws. For a period of time there was a very substantial prejudice against such issues, causing them to sell at yields considerably higher than those commensurate with their inherent credit standing. This prejudice has tended to diminish, reducing the premium yields available, but I still consider it a most attractive field. Our insurance company owns a majority of its bonds in this category.

(3) Public Housing Authority Issues for those of you who wish the very highest grade of tax-free bonds. In effect, these bonds bear the guarantee of the U.S. Government, so they are all rated AAA. In states where local taxes put a premium on buying in-state issues, and I can’t fill your needs from (1) and (2), my tendency would be to put you into Housing Authority issues rather than try to select from among credits that I don't understand. If you direct me to buy obligations of your home state, you should

expect substantial quantities of Housing Authority issues. There is no need to diversify among such issues, as they all represent the top credit available.

(4) State obligations of a direct or indirect nature. You will notice I am not buying issues of large cities. I don't have the faintest idea how to analyze a New York City, Chicago, Philadelphia, etc. (a friend mentioned the other day when Newark was trying to sell bonds at a very fancy rate that the Mafia was getting very upset because Newark was giving them a bad name). Your analysis of a New York City - and I admit it is hard to imagine them not paying their bills for any extended period of time - would be as good as mine.

My approach to bonds is pretty much like my approach to stocks. If I can't understand something, I tend to forget it. Passing an opportunity which I don't understand - even if someone else is perceptive enough to analyze it and get paid well for doing it - doesn't bother me. All I want to be sure of is that I get paid well for the things I do feel capable of handling - and that I am right when I make affirmative decisions. We will probably tend to purchase somewhere between five and ten issues for most of you. However, if you wish to limit me to your home state, it may be fewer issues - and perhaps those will only be Housing Authorities. We will try not to buy in smaller than $25,000 pieces and will prefer larger amounts where appropriate. Smaller lots of bonds are usually penalized upon resale, sometimes substantially. The bond salesman doesn't usually explain this to you when you buy the $10,000 of bonds from him, but it gets explained when you later try to sell the $10,000 to him. We may make exceptions where we are buying secondary market issues in smaller pieces - but only if we are getting an especially good price on the buy side because of the small size of the offering.

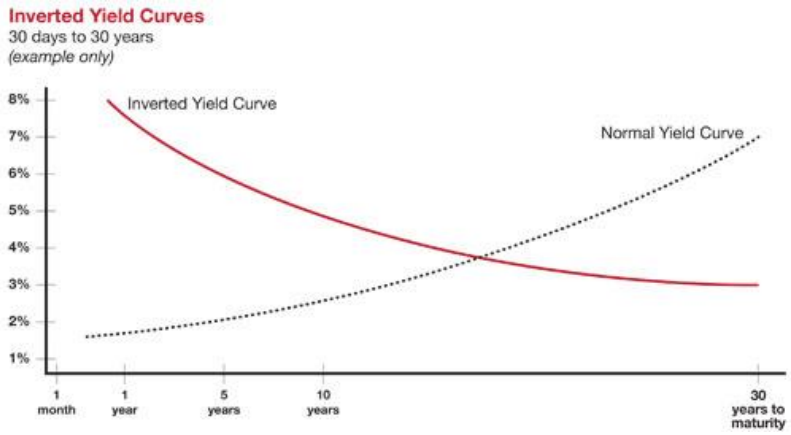
Callable Bonds

We will not buy bonds where the issuer of the bonds has a right to call (retire) the bonds on a basis which substantially loads the contract in his favor. It is amazing to me to see people buy bonds which are due in forty years, but where the issuer has the right to call the bonds at a tiny premium in five or ten years. Such a contract essentially means that you have made a forty year deal if it is advantageous to the issuer (and disadvantageous to you) and a five year deal if the initial contract turns out to be advantageous to you (and disadvantageous to the 148 issuer). Such contracts are really outrageous and exist because bond investors can't think through the implications of such a contract form and bond dealers don't insist on better terms for their customers. One extremely interesting fact is that bonds with very unattractive call features sell at virtually the same yield as otherwise identical bonds which are noncallable. It should be pointed out that most Nebraska bonds carry highly unfair call provisions. Despite this severe contractual disadvantage, they do not offer higher yields than bonds with more equitable terms. One way to avoid this problem is to buy bonds which are totally noncallable.

Another way is to buy discount bonds where the right of the issuer to call the bond is at a price so far above your cost as to render the possible call inconsequential. If you buy a bond at 60 which is callable at 103, the effective cost to you of granting the issuer the right to prematurely terminate the contract (which is a right you never have) is insignificant. But to buy a bond of the Los Angeles Department of Water and Power at 100 to come due at 100 in 1999 or to come due at 104 in 1974, depending on which is to the advantage of the issuer and to your disadvantage, is the height of foolishness when comparable yields are available on similar credits without such an unfair contract. Nevertheless, just such a bond was issued in October, 1969 and similar bonds continue to be issued every day. I only write at such length about an obvious point, since it is apparent from the continual sale of such bonds that many investors haven't the faintest notion how this loads the dice against them and many bond salesmen aren't about to tell them.

Maturity and the Mathematics of Bonds

Many people, in buying bonds, select maturities based on how long they think they are going to want to hold bonds, how long they are going to live, etc. While this is not a silly approach, it is not necessarily the most logical. The primary determinants in selection of maturity should probably be (1) the shape of the yield curve; (2) your expectations regarding future levels of interest rates and (3) the degree of quotational fluctuation you are willing to endure or hope to possibly profit from. Of course, (2) is the most important but by far the most difficult upon which to comment intelligently. Let's tackle the yield curve first. When other aspects of quality are identical, there will be a difference in interest rates paid based upon the length of the bond being offered. For example, a top grade bond being offered now might have a yield of 4.75% if it came due in six or nine months, 5.00% in two years, 5.25% in five years, 5.50% in ten years and 6.25% in twenty years.



When long rates are substantially higher than short rates, the curve is said to be strongly positive. In the U. S. Government bond market, rates recently have tended to produce a negative yield curve; that is, a long term Government bond over the last year or so has consistently yielded less than a short term one. Sometimes the yield curve has been very flat, and sometimes it is positive out to a given point, such as ten years, and then flattens out. What you should understand is that it varies, often very substantially, and that on an historical basis the present slope tends to be in the high positive range. This doesn't mean that long bonds are going to be worth more but it does mean that you are being paid more to extend maturity than in many periods. If yields remained constant for several years, you would do better with longer bonds than shorter bonds, regardless of how long you intended to hold them.

The second factor in determining maturity selection is expectations regarding future rate levels. Anyone who has done much predicting in this field has tended to look very foolish very fast. I did not regard rates as unattractive one year ago, and I was proved very wrong almost immediately. I believe present rates are not unattractive and I may look foolish again. Nevertheless, a decision has to be made and you can make just as great a mistake if you buy short term securities now and rates available on reinvestment in a few years are much lower.

The final factor involves your tolerance for quotational fluctuation. This involves the mathematics of bond investment and may be a little difficult for you to understand. Nevertheless, it is important that you get a general 149 grasp of the principles. Let's assume for the moment a perfectly flat yield curve and a non-callable bond. Further assume present rates are 5% and that you buy two bonds, one due in two years and one due in twenty years. Now assume one year later that yields on new issues have gone to 3% and that you wish to sell your bonds. Forgetting about market spreads, commissions, etc., you will receive $1,019.60 for the original two year $1,000 bond (now with one year to run) and $1,288.10 for the nineteen year bond (originally twenty years). At these prices, a purchaser will get exactly 3% on his money after amortizing the premium he has paid and cashing the stream of 5% coupons attached to each bond. It is a matter of indifference to him whether to buy your nineteen year 5% bond at $1,288.10 or a new 3% bond (which we have assumed is the rate current - one year later) at $1,000.00.

On the other hand, let's assume rates went to 7%. Again we will ignore commissions, capital gains taxes on the discount, etc. Now the buyer will only pay $981.00 for the bond with one year remaining until maturity and $791.60 for the bond with nineteen years left. Since he can get 7% on new issues, he is only willing to buy your bond at a discount sufficient so that accrual of this discount will give him the same economic benefits from your 5% coupon that a 7% coupon at $1,000.00 would give him. The principle is simple. The wider the swings in interest rates and the longer the bond, the more the value of a bond can go up or down on an interim basis before maturity. It should be pointed out in the first example where rates went to 3%, our long term bond would only have appreciated to about $1,070.00 if it had been callable in five years at par, although it would have gone down just as much if 7% rates had occurred. This just illustrates the inherent unfairness of call provisions.

For over two decades, interest rates on tax-free bonds have almost continuously gone higher and buyers of long term bonds have continuously suffered. This does not mean it is bad now to buy long term bonds - it simply means that the illustration in the above paragraph has worked in only one direction for a long period of time and people are much more conscious of the downside risks from higher rates than the upside potential from lower ones. If it is a 50-50 chance as to the future general level of interest rates and the yield curve is substantially positive, then the odds are better in buying long term non-callable bonds than shorter term ones. This reflects my current conclusion and, therefore, I intend to buy bonds within the 10 to 25 year range. If you have any preferences within that range, we will try to select bonds reflecting such preferences, but if you are interested in shorter term bonds, we will not be able to help you as we are not searching out bonds in this area.

Before you decide to buy a 20 year bond, go back and read the paragraph showing how prices change based upon changes in interest rates. Of course, if you hold the bond straight through, you are going to get the contracted rate of interest, but if you sell earlier, you are going to be subject to the

mathematical forces described in that paragraph, for better or for worse. Bond prices also change because of changes in quality over the years but, in the tax-free area, this has tended to be - and probably will continue to be - a relatively minor factor compared to the impact of changes in the general structure of interest rates.

Discount Versus Full Coupon Bonds

You will have noticed in the above discussion that if you now wanted to buy a 7% return on a nineteen year bond, you had a choice between buying a new nineteen year bond with a 7% coupon rate or buying a bond with a 5% coupon at $791.60, which would pay you $1,000.00 in nineteen years. Either purchase would have yielded exactly 7% compounded semi-annually to you. Mathematically, they are the same. In the case of tax-free bonds the equation is complicated, however, by the fact that the $70.00 coupon is entirely tax-free to you, whereas the bond purchased at a discount gives you tax-free income of $50.00 per year but a capital gain at the end of the nineteenth year of $208.40. Under the present tax law, you would owe anything from a nominal tax, if the gain from realization of the discount was your only taxable income in the nineteenth year, up to a tax of over $70.00 if it came on top of very large amounts of capital gain at that time (the new tax law provides for capital gain rates of 35%, and even slightly higher on an indirect basis in 1972 and thereafter for those realizing very large 150 gains.)

In addition to this, you might have some state taxes to pay on the capital gain. Obviously, under these circumstances you are not going to pay the $791.60 for the 5% coupon and feel you are equally as well off as with the 7% coupon at $1,000.00. Neither is anyone else. Therefore, identical quality securities with identical maturities sell at considerably higher gross yields when they have low coupons and are priced at discounts than if they bear current high coupons. Interestingly enough, for most taxpayers, such higher gross yields over-compensate for the probable tax to be paid. This is due to several factors.

First, no one knows what the tax law will be when the bonds mature and it is both natural and probably correct to assume the tax rate will be stiffer at that time than now. Second, even though a 5% coupon on a $1,000.00 bond purchased at $791.60 due in nineteen years is the equivalent of a 7% coupon on a $1,000.00 bond purchased at par with the same maturity, people prefer to get the higher current return in their pocket. The owner of the 5% coupon bond is only getting around 6.3% current yield on his $791.60 with the balance necessary to get him up to 7% coming from the extra $208.40 he picks up at the end.

Finally, the most important factor affecting prices currently on discount bonds (and which will keep affecting them) is that banks have been taken out of the market as buyers of discount tax-free bonds by changes brought about in bank tax treatment through the 1969 Tax Reform Act. Banks have historically been the largest purchasers and owners of tax-free bonds and anything that precludes them from one segment of the market has dramatic effects on the supply-demand situation in that segment. This may tend to give some edge to individuals in the discount tax-free market, particularly those who are not likely to be in a high tax bracket when the bonds mature or are sold. If I can get a significantly higher effective after-tax yield (allowing for sensible estimates of your particular future tax rate possibilities), I intend to purchase discount bonds for you. I know some partners prefer full coupon bonds, even though their effective yield is less, since they prefer to maximize the current cash yield and if they will so advise me, we will stick to full coupon issues (or very close thereto) in their cases.

Procedure

I intend to be in the office solidly through March (including every Saturday except March 7th) and will be glad to see any partner or talk with him by phone. To aid in scheduling, please make an appointment with Gladys (or me). The only request I make is that you absorb as much as possible of this letter before we talk. As you can see, it would be an enormous problem if I had to explain each item to all of you. If you decide you want us to help you in buying bonds, you should let us know:

(1) Whether you want to restrict purchases to your home state for local tax reasons;

(2) Whether you want to restrict us to full coupon issues or let us use our judgment as to where you get the best value;

(3) Your preference as to maturity in the ten to twenty-five year range or if you prefer to let us use our judgment in that area;

(4) How much you want to invest - we may end up several per cent short of the figure you name, but we will never go over;

(5) On what bank the bonds should be drafted. We will advise you by phone or letter as we buy bonds. Bill and John will be doing much of the mechanical work.

Needless to say, none of us will have any financial interest in any transaction. Should you have any questions regarding the mechanics, please direct them to John or Bill as I will probably be swamped and they will be more familiar with specific transactions.

After March 31st, I don't expect to be around the office for several months. Therefore, if you want to talk things over, come in by then. The completion of all purchases may go into April, but Bill will be taking care of this and the mechanics will all be set up. You should realize that because of the enormous diversity of issues mentioned earlier, it is impossible to say just what will be bought. Sometimes the tax-free bond market has more similarities to real estate than to stocks. There are hundreds of thousands of items of varying comparability, some with no sellers, some with reluctant sellers and some with eager sellers. Which may be the best buy depends on the quality of what is being offered, how well it fits your needs and the eagerness of the seller. The standard of comparison is always new issues where an average of several hundred million dollars worth have to be sold each week - however, specific secondary market opportunities (issues already outstanding) may be more attractive than new issues and we can only find out how attractive they are when we are ready to make bids. Although markets can change, it looks as if we will have no difficulty in getting in the area of 6-1/2% after tax (except from Housing Authority issues) on bonds in the twenty-year maturity range.

Cordially,

Warren E. Buffett

April 3, 1970

To the Stockholders of Berkshire Hathaway Inc.:

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 businesses meeting our investment and management criteria. This policy has proved reasonably successful—particularly when contrasted with results achieved by firms which have continued to commit large sums to textile expansion in the face of totally inadequate returns.

We have been able to conclude two major purchases of operating businesses, and their successful operations enabled Berkshire Hathaway to achieve an over-all return of more than 10% on average stockholders' equity last year in the face of less than a 5% return from the portion of our capital employed in the textile business. We have liquidated our entire holdings of marketable securities over the last two years at a profit of more than $5 million after taxes. These gains provided important funds to facilitate our major purchase of 1969, when borrowed money to finance acquisitions was generally most difficult to obtain.

We anticipate no further purchases of marketable securities, but our search for desirable acquisitions continues. Any acquisition will, of course, be dependent upon obtaining appropriate financing.

Textile Operations

Dollar sales volume in 1969 was approximately 12% below 1968. Net earnings were slightly higher despite substantial operating losses incurred in the termination of our Box Loom Division. Earnings on capital employed improved modestly but still remain unsatisfactory despite strenuous efforts toward improvement. We are presently in the midst of a textile recession of greater intensity than we have seen for some years. There is an over-all lack of demand for textile products in a great many end uses. This lack of demand has required curtailment of production to avoid inventory build-up. Both our Menswear Lining Division and Home Fabrics Division have been forced to schedule two- week shutdowns during the first quarter of 1970, but inventories remain on the high side. The slowdown in demand appears even greater than that normally occurring in the cyclical textile market.

Recovery from this cycle will probably be dependent upon Federal Government action on economic factors they can control. We have concentrated our textile operations in those areas that appear, from historical performance and from our market projections, to be potentially satisfactory businesses. Improvements have been made in our mill operations which, under better industry conditions, should produce substantial cost reductions. However, the present picture is for lower profits in this business during 1970.

Insurance Operations

Jack Ringwalt and his outstanding management group turned in new records in just about every department during 1969. During another year in which the fire and casualty insurance industry experienced substantial underwriting losses, our insurance subsidiaries achieved significant adjusted underwriting profits. Since establishment of the business in 1941, Mr. Ringwalt has held to the principle of underwriting for a profit—a policy which is frequently talked about within the industry but much less frequently achieved. Our new surety department, although small, made good progress during the year. We are entering the workmen's compensation market in California through the establishment of a branch office in Los Angeles.

Our new reinsurance division seems to be off to a strong start, although the nature of this business is such that it takes at least several years to render an intelligent verdict as to operating results. We also have interesting plans for a new "home state" insurance operation. Phil Liesche—over 20 years a major contributor to outstanding results in the production and underwriting departments—was elected Executive Vice President early this year. Expectations are for continued growth in our insurance operations.

Banking Operations

The most significant event of 1969 for Berkshire Hathaway was the acquisition of 97.7% of the stock of The Illinois National Bank and Trust Co. of Rockford, Illinois. This bank had been built by Eugene Abegg, without addition of outside capital, from $250,000 of net worth and $400,000 of deposits in 1931 to $17 million of net worth and $100 million of deposits in 1969. Mr. Abegg has continued as Chairman and produced record operating earnings (before security losses) of approximately $2 million in 1969. Such earnings, as a percentage of either deposits or total assets, are close to the top among larger commercial banks in the country which are not primarily trust department operations. It will not be easy to achieve greater earnings in 1970 because (1) our bank is already a highly efficient business, and (2) the unit banking law of Illinois makes more than modest deposit growth difficult for a major downtown bank. After almost a year of ownership, we are delighted with our investment in Illinois National Bank, and our association with Mr. Abegg.

Kenneth V. Chace

President

1971 Letter

Letter To the Stockholders of Berkshire Hathaway Inc.:

It is a pleasure to report that operating earnings in 1971, excluding capital gains, amounted to more than 14% of beginning shareholders' equity. This result—considerably above the average of American industry—was achieved in the face of inadequate earnings in our textile operation, making clear the benefits of redeployment of capital inaugurated five years ago. It will continue to be the objective of management to improve return on total capitalization (long term debt plus equity), as well as the return on equity capital. However, it should be realized that merely maintaining the present relatively high rate of return may well prove more difficult than was improvement from the very low levels of return which prevailed throughout most of the 1960's.

Textile Operations

We in common with most of the textile industry, continued to struggle throughout 1971 with inadequate gross margins. Strong efforts to hammer down costs and a continuous search for less price-sensitive fabrics produced only marginal profits. However, without these efforts we would have operated substantially in the red. Employment was more stable throughout the year as our program to improve control of inventories achieved reasonable success. As mentioned last year, Ken Chace and his management group have been swimming against a strong industry tide. This negative environment has only caused them to intensify their efforts. Currently we are witnessing a mild industry pickup which we intend to maximize with our greatly strengthened sales force. With the improvement now seen in volume and mix of business, we would expect better profitability—although not of a dramatic nature—from our textile operation in 1972.

Insurance Operations

An unusual combination of factors—reduced auto accident frequency, sharply higher effective rates in large volume lines, and the absence of major catastrophes—produced an extraordinarily good year for the property and casualty insurance industry. We shared in these benefits, although they are not without their negative connotations. Our traditional business—and still our largest segment—is in the specialized policy or non- standard insured. When standard markets become tight because of unprofitable industry underwriting, we experience substantial volume increases as producers look to us. This was the condition several years ago, and largely accounts for the surge of direct volume experienced in 1970 and 1971. Now that underwriting has turned very profitable on an industry-wide basis, more companies are seeking the insureds they were rejecting a short while back and rates are being cut in some areas. We continue to have underwriting profitability as our primary goal and this may well mean a substantial decrease in National Indemnity's direct volume during 1972.

Jack Ringwalt and Phil Liesche continue to guide this operation in a manner matched by very few in the business. Our reinsurance business, which has been developed to a substantial operation in just two years by the outstanding efforts of George Young, faces much the same situation. We entered the reinsurance business late in 1969 at a time when rates had risen substantially and capacity was tight. The reinsurance industry was exceptionally profitable in 1971, and we are now seeing rate-cutting as well as the formation of well-capitalized aggressive new competitors. These lower rates are frequently accompanied by greater exposure. Against this background we expect to see our business curtailed somewhat in 1972. We set no volume goals in our insurance business generally—and certainly not in reinsurance—as virtually any volume can be achieved if profitability standards are ignored.

When catastrophes occur and underwriting experience sours, we plan to have the resources available to handle the increasing volume which we will then expect to be available at proper prices. We inaugurated our "home-state" insurance operation in 1970 by the formation of Cornhusker Casualty Company. To date, this has worked well from both a marketing and an underwriting standpoint. We have therefore further developed this approach by the formation of Lakeland Fire & Casualty Company in Minnesota during 1971, and Texas United Insurance in 1972. Each of these companies will devote its entire efforts to a single state seeking to bring the agents and insureds of its area a combination of large company capability and small company accessibility and sensitivity. John Ringwalt has been in overall charge of this operation since inception. Combining hard work with imagination and intelligence, he has transformed an idea into a well- organized business. The "home-state" companies are still very small, accounting for a little over $1.5 million in premium volume during 1971. It looks as though this volume will more than double in 1972 and we will develop a more creditable base upon which to evaluate underwriting performance.

A highlight of 1971 was the acquisition of Home & Automobile Insurance Company, located in Chicago. This company was built by Victor Raab from a small initial investment into a major auto insurer in Cook County, writing about $7.5 million in premium volume during 1971. Vic is cut from the same cloth as Jack Ringwalt and Gene Abegg, with a talent for operating profitably accompanied by enthusiasm for his business. These three men have built their companies from scratch and, after selling their ownership position for cash, retain every bit of the proprietary interest and pride that they have always had. While Vic has multiplied the original equity of Home & Auto many times since its founding, his ideas and talents have always been circumscribed by his capital base. We have added capital funds to the company, which will enable it to establish branch operations extending its highly-concentrated and on-the-spot marketing and claims approach to other densely populated areas. All in all, it is questionable whether volume added by Home & Auto, plus the "home-state" business in 1972, will offset possible declines in direct and reinsurance business of National Indemnity Company. However, our large volume gains in 1970 and 1971 brought in additional funds for investment at a time of high interest rates, which will be of continuing benefit in future years. Thus, despite the unimpressive prospects regarding premium volume, the outlook for investment income and overall earnings from insurance in 1972 is reasonably good.

Banking Operations

Our banking subsidiary, The Illinois National Bank & Trust Company, continued to lead its industry as measured by earnings as a percentage of deposits. In 1971, Illinois National earned well over 2% after tax on average deposits while (1) not using borrowed funds except for very occasional reserve balancing transactions; (2) maintaining a liquidity position far above average; (3) recording loan losses far below average; and (4) utilizing a mix of over 50% time deposits with all consumer savings accounts receiving maximum permitted interest rates throughout the year. This reflects a superb management job by Gene Abegg and Bob Kline. Interest rates received on loans and investments were down

substantially throughout the banking industry during 1971. In the last few years, Illinois National's mix of deposits has moved considerably more than the industry average away from demand money to much more expensive time money. For example, interest paid on deposits has gone from under $1.7 million in 1969 to over $2.7 million in 1971.

Nevertheless, the unusual profitability of the Bank has been maintained. Marketing efforts were intensified during the year, with excellent results. With interest rates even lower now than in 1971, the banking industry is going to have trouble achieving gains in earnings during 1972. Our deposit gains at Illinois National continue to come in the time money area, which produces only very marginal incremental income at present. It will take very close cost control to enable Illinois National to maintain its 1971 level of earnings during 1972. Financial Because of the volume gains being experienced by our insurance subsidiaries early in 1971, we re-cast Berkshire Hathaway's bank loan so as to provide those companies with additional capital funds. This financing turned out to be particularly propitious when the opportunity to purchase Home & Auto occurred later in the year. Our insurance and banking subsidiaries possess a fiduciary relationship with the public. We retain a fundamental belief in operating from a very strongly financed position so as to be in a position to unquestionably fulfill our responsibilities. Thus, we will continue to map our financial future for maximum financial strength in our subsidiaries as well as at the parent company level.

Cordially,

Warren E. Buffett

1972 Letter

To the Stockholders of Berkshire Hathaway Inc.:

Operating earnings of Berkshire Hathaway during 1972 amounted to a highly satisfactory 19.8% of beginning shareholders' equity. Significant improvement was recorded in all of our major lines of business, but the most dramatic gains were in insurance underwriting profit. Due to an unusual convergence of favorable factors—diminishing auto accident frequency, moderating accident severity, and an absence of major catastrophes—underwriting profit margins achieved a level far above averages of the past or expectations of the future. While we anticipate a modest decrease in operating earnings during 1973, it seems clear that our diversification moves of recent years have established a significantly higher base of normal earning power. Your present management assumed policy control of the company in May, 1965.

Eight years later, our 1972 operating earnings of $11,116,256 represent a return many-fold higher than would have been produced had we continued to devote our resources entirely to the textile business. At the end of the 1964 fiscal year, shareholders' equity totaled $22,138,753. Since that time, no additional equity capital has been introduced into the business, either through cash sale or through merger. On the contrary, some stock has been reacquired, reducing outstanding shares by 14%. The increase in book value per share from $19.46 at fiscal year-end 1964 to $69.72 at 1972 year-end amounts to about 16.5% compounded annually.

Our three major acquisitions of recent years have all worked out exceptionally well—from both the financial and human standpoints. In all three cases, the founders were major sellers and received significant proceeds in cash—and, in all three cases, the same individuals, Jack Ringwalt, Gene Abegg and Vic Raab, have continued to run the businesses with undiminished energy and imagination which have resulted in further improvement of the fine records previously established. We will continue to search for logical extensions of our present operations, and also for new operations which will allow us to continue to employ our capital effectively.

Textile Operations

As predicted in last year's annual report, the textile industry experienced a pickup in 1972. In recent years, Ken Chace and Ralph Rigby have developed an outstanding sales organization enjoying a growing reputation for service and reliability. Manufacturing capabilities have been restructured to complement our sales strengths. Helped by the industry recovery, we experienced some payoff from these efforts in 1972. Inventories were controlled, minimizing close-out losses in addition to minimizing capital requirements; product mix was greatly improved. While the general level of profitability of the industry will always be the primary factor in determining the level of our textile earnings, we believe that our relative position within the industry has noticeably improved. The outlook for 1973 is good.

Insurance Underwriting

Our exceptional underwriting profits during 1972 in the large traditional area of our insurance business at National Indemnity present a paradox. They served to swell substantially total corporate profits for 1972, but the factors which produced such profits induced exceptional amounts of new competition at what we believe to be a non-compensatory level of rates. Overall, we probably would have retained better prospects for the next five years if profits had not risen so dramatically this year. Substantial new competition was forecast in our annual report for last year and we experienced in 1972 the decline in premium volume that we stated such competition implied.

Our belief is that industry underwriting profit margins will narrow substantially in 1973 or 1974 and, in time, this may produce an environment in which our historical growth can be resumed. Unfortunately, there is a lag between deterioration of underwriting results and tempering of competition. During this period we expect to continue to have negative volume comparisons in our traditional operation. Our seasoned management, headed by Jack Ringwalt and Phil Liesche, will continue to underwrite to produce a profit, although not at the level of 1972, and base our rates on long-term expectations rather than short-term hopes.

Although this approach has meant dips in volume from time to time in the past, it has produced excellent long-term results. Also as predicted in last year's report, our reinsurance division experienced many of the same competitive factors in 1972. A multitude of new organizations entered what has historically been a rather small field, and rates were often cut substantially, and we believe unsoundly, particularly in the catastrophe area. The past year turned out to be unusually free of catastrophes and our underwriting experience was good. George Young has built a substantial and profitable reinsurance operation in just a few years. In the longer term we plan to be a very major factor in the reinsurance field, but an immediate expansion of volume is not sensible against a background of deteriorating rates.

In our view, underwriting exposures are greater than ever. When the loss potential inherent in such exposures becomes an actuality, repricing will take place which should give us a chance to expand significantly. In the "home state" operation, our oldest and largest such company, Cornhusker

Casualty Company, operating in Nebraska only, achieved good underwriting results. In the second full year, the home state marketing appeal has been proven with the attainment of volume on the order of one-third of that achieved by "old line" giants who have operated in the state for many decades. Our two smaller companies, in Minnesota and Texas, had unsatisfactory loss ratios on very small volume. The home state managements understand that underwriting profitably is the yardstick of success and that operations can only be expanded significantly when it is clear that we are doing the right job in the underwriting area. Expense ratios at the new companies are also high, but that is to be expected when they are in the development stage.

John Ringwalt has done an excellent job of launching this operation, and plans to expand into at least one additional state during 1973. While there is much work yet to be done, the home state operation appears to have major long-range potential. Last year it was reported that we had acquired Home and Automobile Insurance Company of Chicago. We felt good about the acquisition at the time, and we feel even better now. Led by Vic Raab, this company continued its excellent record in 1972. During 1973 we expect to enter the Florida (Dade County) and California (Los Angeles) markets with the same sort of specialized urban auto coverage which Home and Auto has practiced so successfully in Cook County. Vic has the managerial capacity to run a much larger operation. Our expectation is that Home and Auto will expand significantly within a few years.

Insurance Investment Results

We were most fortunate to experience dramatic gains in premium volume from 1969 to 1971 coincidental with virtually record-high interest rates. Large amounts of investable funds were thus received at a time when they could be put to highly advantageous use. Most of these funds were placed in tax-exempt bonds and our investment income, which has increased from $2,025,201 in 1969 to $6,755,242 in 1972, is subject to a low effective tax rate. Our bond portfolio possesses unusually good call protection, and we will benefit for many years to come from the high average yield of the present portfolio. The lack of current premium growth, however, will moderate substantially the growth in investment income during the next several years.

Banking Operations

Our banking subsidiary, The Illinois Bank and Trust Co. of Rockford, maintained its position of industry leadership in profitability. After-tax earnings of 2.2% on average deposits in 1972 are the more remarkable when evaluated against such moderating factors as: (1) a mix of 50% time deposits heavily weighted toward consumer savings instruments, all paying the maximum rates permitted by law; (2) an unvaryingly strong liquid position and avoidance of money-market borrowings; (3) a loan policy which has produced a net charge-off ratio in the last two years of about 5% of that of the average commercial bank. This record is a direct tribute to the leadership of Gene Abegg and Bob Kline who run a bank where the owners and the depositors can both eat well and sleep well.

During 1972, interest paid to depositors was double the amount paid in 1969. We have aggressively sought consumer time deposits, but have not pushed for large "money market" certificates of deposit although, during the past several years, they have generally been a less costly source of time funds. During the past year, loans to our customers expanded approximately 38%. This is considerably more than indicated by the enclosed balance sheet which includes $10.9 million in short-term commercial paper in the 1971 loan total, but which has no such paper included at the end of 1972. Our position as "Rockford's Leading Bank" was enhanced during 1972. Present rate structures, a decrease in investable funds due to new Federal Reserve collection procedures, and a probable

increase in already substantial non-federal taxes make it unlikely that Illinois National will be able to increase its earnings during 1973.

Financial On March 15, 1973, Berkshire Hathaway borrowed $20 million at 8% from twenty institutional lenders. This loan is due March 1, 1993, with principal repayments beginning March 1, 1979. From the proceeds, $9 million was used to repay our bank loan and the balance is being invested in insurance subsidiaries. Periodically, we expect that there will be opportunities to achieve significant expansion in our insurance business and we intend to have the financial resources available to maximize such opportunities. Our subsidiaries in banking and insurance have major fiduciary responsibilities to their customers. In these operations we maintain capital strength far above industry norms, but still achieve a good level of profitability on such capital. We will continue to adhere to the former objective and make every effort to continue to maintain the latter.

Cordially,

Warren E. Buffett

1973 Letter

Letter 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 capital 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.

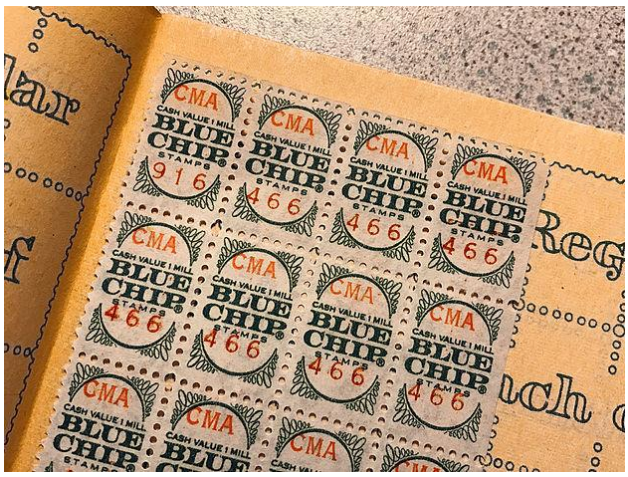
Our specialized urban auto operation, Home and Automobile Insurance Company, experienced very poor underwriting in Chicago during 1973. It would appear that rates are inadequate in our primary Cook County marketing area, although the current energy situation confuses the picture. The question is whether 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. 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., though subsidiaries, operates a chain of popular-priced women's apparel stores and also conducts a reinsurance business.



In the opinion of 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 22.5%: implementation of the proposed merger with Diversified Retailing Company, Inc. would increase this figure to about 38.5%. 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 3, 1973 with regard to the 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 Stamps to achieve satisfactory earnings in future years related to capital employed, although certainly at a much lower level than would have been achieved if the trading stamp business had been maintained at anything close to former levels. Your Chairman is on the Board of Directors of Blue Chip Stamps, as well as Wesco Financial Corporation, and is Chairman of the Board of See's Candy Shops Incorporated. Operating management of all three entities is in the hands of first-class, able, experienced executives. Sun Newspapers, Inc. In the 1969 annual report we commented on the purchase of Sun Newspapers Inc., a group of weekly papers published in the

metropolitan Omaha area. Since that time we have not commented on their operations in the text of our annual reports, nor have we consolidated their financial results since the operation, because of the small investment involved, has been "financially insignificant." During 1973 it was made quite apparent that such insignificance did not extend to publishing quality.

On May 7th Sun Newspapers was awarded a Pulitzer Prize for local investigative reporting (the first time in history that a weekly had won in this category) for its special section of March 30,1972 relating to Boys Town. We reported the extraordinary contrast between decreasing services and mounting wealth that had taken place since Father Flanagan's death in 1948. In addition to the Pulitzer Prize, the reporting job also won the Public Service Award of Sigma Delta Chi, the national society of professional journalists, as well as seven other national awards. Our congratulations go to Paul Williams, Editor, and Stan Lipsey, Publisher, as well as the entire editorial staff of Sun Newspapers for their achievement, which vividly illustrated that size need not be equated with significance in publishing.

Cordially,

Warren E. Buffett

1974 Letter

Letter to the Stockholders of Berkshire Hathaway Inc.:

Operating results for 1974 overall were unsatisfactory due to the poor performance of our insurance business. In last year's annual report some decline in profitability was predicted but the extent of this decline, which accelerated during the year, was a surprise. Operating earnings for 1974 were $8,383,576, or $8.56 per share, for a return on beginning shareholders' equity of 10.3%. This is the lowest return on equity realized since 1970. Our textile division and our bank both performed very well, turning in improved results against the already good figures of 1973. However, insurance underwriting, which has been mentioned in the last several annual reports as running at levels of unsustainable profitability, turned dramatically worse as the year progressed.

The outlook for 1975 is not encouraging. We undoubtedly will have sharply negative comparisons in our textile operation and probably a moderate decline in banking earnings. Insurance underwriting is a large question mark at this time—it certainly won't be a satisfactory year in this area, and could be an extremely poor one. Prospects are reasonably good for an improvement in both insurance investment income and our equity in earnings of Blue Chip Stamps. During this period we plan to continue to build financial strength and liquidity, preparing for the time when insurance rates become adequate and we can once again aggressively pursue opportunities for growth in this area.

Textile Operations

During the first nine months of 1974 textile demand was exceptionally strong, resulting in very firm prices. However, in the fourth quarter significant weaknesses began to appear, which have continued into 1975. We currently are operating at about one-third of capacity. Obviously, at such levels operating losses must result. As shipments have fallen, we continuously have adjusted our level of operations downward so as to avoid building inventory. Our products are largely in the curtain goods area. During a period of consumer uncertainty, curtains may well be high on the list of deferrable purchases. Very low levels of housing starts also serve to dampen demand. In addition, retailers have been pressing to cut inventories generally, and we probably are feeling some effect from these efforts. These negative trends should reverse in due course, and we are attempting to minimize losses until that time comes.

Insurance Underwriting

In the last few years we consistently have commented on the unusual profitability in insurance underwriting. This seemed certain eventually to attract unintelligent competition with consequent inadequate rates. It also has been apparent that many insurance organizations, major as well as minor, have been guilty of significant underreserving of losses, which inevitably produces faulty information as to the true cost of the product being sold. In 1974, these factors, along with a high rate of inflation, combined to produce a rapid erosion in underwriting results. The costs of the product we deliver (auto repair, medical payments, compensation benefits, etc.) are increasing at a rate we estimate to be in the area of 1% per month. Of course, this increase doesn't proceed in an even flow but, inexorably, inflation grinds very heavily at the repair services—to humans and to property—that we provide. However, rates virtually have been unchanged in the property and casualty field for the last few years. With costs moving forward rapidly and prices remaining unchanged, it was not hard to predict what would happen to profit margins.

Best's, the authoritative voice of the insurance industry, estimates that in 1974 all auto insurance premiums in the United States increased only about 2%. Such a growth in the pool of dollars available

to pay insured losses and expenses was woefully inadequate. Obviously, medical costs applicable to people injured during the year, jury awards for pain and suffering, and body shop charges for repairing damaged cars increased at a dramatically greater rate during the year. Since premiums represent the sales dollar and the latter items represent the cost of goods sold, profit margins turned sharply negative.

As this report is being written, such deterioration continues. Loss reserves for many giant companies still appear to be understated by significant amounts, which means that these competitors continue to underestimate their true costs. Not only must rates be increased sufficiently to match the month-by-month increase in cost levels, but the existed expense- revenue gap must be overcome. At this time, it appears that insurers must experience even more devastating underwriting results before they take appropriate pricing action. All major areas of insurance operations, except for the "home state" companies, experienced significantly poorer results for the year. The direct business of National Indemnity Company, our largest area of insurance activity, produced an underwriting loss of approximately 4% after several years of high profitability. Volume increased somewhat, but we are not encouraging such increases until rates are more adequate. At some point in the cycle, after major insurance companies have had their fill of red ink, history indicates that we will experience an inflow of business at compensatory rates.

This operation, headed by Phil Liesche, a most able underwriter, is staffed by highly profit-oriented people and we believe it will provide excellent earnings in most future years, as it has in the past. Intense competition in the reinsurance business has produced major losses for practically every company operating in the area. We have been no exception. Our underwriting loss was something over 12%—a horrendous figure, but probably little different from the average of the industry. What is even more frightening is that, while about the usual number of insurance catastrophes occurred during 1974, there really was no "super disaster" which might have accounted for the poor figures of the industry. Rather, a condition of inadequate rates prevails, particularly in the casualty area where we have significant exposure.

Our reinsurance department is run by George Young, an exceptionally competent and hardworking manager. He has cancelled a great many contracts where prices are totally inadequate, and is making no attempt to increase volume except in areas where premiums are commensurate with risk. Based upon present rate levels, it seems highly unlikely that the reinsurance industry generally, or we, specifically, will have a profitable year in 1975. Our "home state" companies, under the leadership of John Ringwalt, made good progress in 1974. We appear to be developing a sound agency group, capable of producing business with acceptable loss ratios. Our expense ratios still are much too high, but will come down as the operation develops into units of economic size. The Texas problem which was commented upon in last year's report seems to be improving. We consider the "home state" operation one of our most promising areas for the future.

Our efforts to expand Home and Automobile Insurance Company into Florida proved disastrous. The underwriting loss from operations in that market will come to over $2 million, a very large portion of which was realized in 1974. We made the decision to drop out of the Florida market in the middle of 1974, but losses in substantial amounts have continued since that time because of the term nature of insurance contracts, as well as adverse development of outstanding claims. We can't blame external insurance industry conditions for this mistake. In retrospect, it is apparent that our management simply did not have the underwriting information and the pricing knowledge necessary to be operating in the area. In Cook County, where Home and Auto's volume traditionally has been concentrated, evidence also became quite clear during 1974 that rates were inadequate. Therefore, rates were

increased during the middle of the year but competition did not follow; consequently, our volume has dropped significantly in this area as competitors take business from us at prices that we regard as totally unrealistic.

While the tone of this section is pessimistic as to 1974 and 1975, we consider the insurance business to be inherently attractive. Our overall return on capital employed in this area—even including the poor results of 1974—remains high. We have made every effort to be realistic in the calculation of loss and administrative expense. Because of accruals, this had a double effect at both the bank and corporate level in 1974. Under present money market conditions, we expect bank earnings to be down somewhat in 1975 although we believe they still are likely to compare favorably with those of practically any banking institution in the country. Blue Chip Stamps During 1974 we increased our holdings of Blue Chip Stamps to approximately 25.5% of the outstanding shares of that company. Overall, we are quite happy about the results of Blue Chip and its prospects for the future. Stamp sales continue at a greatly reduced level, but the Blue Chip management has done an excellent job of adjusting operating costs.

The See's Candy Shops, Inc. subsidiary had an outstanding year, and has excellent prospects for the future. Your Chairman is on the Board of Directors of Blue Chip Stamps, as well as Wesco Financial Corporation, a 64% owned subsidiary, and is Chairman of the Board of See's Candy Shops, Inc. We expect Blue Chip Stamps to be a source of continued substantial earning power for Berkshire Hathaway Inc. The annual report of Blue Chip Stamps, which will contain financial statements for the year ended March 1, 1975 audited by Price, Waterhouse and Company, will be available in May. Any shareholder of Berkshire Hathaway Inc. who desires an annual report of Blue Chip Stamps may obtain it at any time by writing Mr. Robert H. Bird, Secretary, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Merger with Diversified Retailing Company, Inc

As you previously have been informed, the proposed merger with Diversified Retailing Company, Inc. was terminated by the respective Boards of Directors on January 28, 1975. We continue to view such a merger as eventually desirable, and hope to reopen the subject at some future time.

Cordially,

Warren E. Buffett

1975 Letter

Letter to the Stockholders of Berkshire Hathaway Inc.:

Last year, when discussing the prospects for 1975, we stated "the outlook for 1975 is not encouraging." This forecast proved to be distressingly accurate. Our operating earnings for 1975 were $6,713,592, or $6.85 per share, producing a return on beginning shareholders' equity of 7.6%. This is the lowest return on equity experienced since 1967. Furthermore, as explained later in this letter, a large segment of these earnings resulted from Federal income tax refunds which will not be available to assist performance in 1976.

On balance, however, current trends indicate a somewhat brighter 1976. Operations and prospects will be discussed in greater detail below, under specific industry titles. Our expectation is that significantly better results in textiles, earnings added from recent acquisitions, an increase in equity in earnings of Blue Chip Stamps resulting from an enlarged ownership interest, and at least a moderate improvement in insurance underwriting results will more than offset other possible negatives to produce greater earnings in 1976.

The major variable—and by far the most difficult to predict with any feeling of confidence—is the insurance underwriting result. Present very tentative indications are that underwriting improvement is in prospect. If such improvement is moderate, our overall gain in earnings in 1976 likewise will prove moderate. More significant underwriting improvement could give us a major gain in earnings.

Textile Operations

During the first half of 1975 sales of textile products were extremely depressed, resulting in major production curtailments. Operations ran at a significant loss, with employment down as much as 53% from a year earlier. In contrast with previous cyclical slumps, however, most textile producers quickly reduced production to match incoming orders, thus preventing massive industry-wide accumulation of inventories. Such cutbacks caused quite prompt reflection at the mill operating level when demand revived at retail. As a result, beginning about midyear business rebounded at a fairly rapid rate. This "V" shaped textile depression, while one of the sharpest on record, also became one of the shortest ones in our experience. The fourth quarter produced an excellent profit for our textile division, bringing results for the year into the black.

On April 28, 1975 we acquired Waumbec Mills Incorporated and Waumbec Dyeing and Finishing Co., Inc. located in Manchester, New Hampshire. These companies have long sold woven goods into the drapery and apparel trade. Such drapery materials complement and extend the line already marketed through the Home Fabrics Division of Berkshire Hathaway. In the period prior to our acquisition, the company had run at a very substantial loss, with only about 55% of looms in operation and the finishing plant operating at about 50% of capacity. Losses continued on a reduced basis for a few months after

acquisition. Outstanding efforts by our manufacturing, administrative and sales people now have produced major improvements, which, coupled with the general revival in textiles, have moved Waumbec into a significant profit position. We expect a good level of profits from textiles in 1976.

Continued progress is being made in the movement of Waumbec goods into areas of traditional marketing strength of Berkshire Hathaway, productivity should improve in both the weaving and finishing areas at Manchester, and textile demand continues to firm at decent prices. We have great confidence in the ability of Ken Chace and his team to maximize our strengths in textiles. Therefore, we continue to look for ways to increase further our scale of operations while avoiding major capital investment in new fixed assets which we consider unwise, considering the relatively low returns historically earned on large scale investment in new textile equipment.

Insurance Underwriting

The property and casualty insurance industry had its worst year in history during 1975. We did our share—unfortunately, even somewhat more. Really disastrous results were concentrated in auto and long-tail (contracts where settlement of loss usually occurs long after the loss event) lines. Economic inflation, with the increase in cost of repairing humans and property far outstripping the general rate of inflation, produced ultimate loss costs which soared beyond premium levels established in a different cost environment. "Social" inflation caused the liability concept to be expanded continuously, far beyond limits contemplated when rates were established—in effect, adding coverage beyond what was paid for. Such social inflation increased significantly both the propensity to sue and the possibility of collecting mammoth jury awards for events not previously considered statistically significant in the establishment of rates.

Furthermore, losses to policyholders which otherwise would result from mushrooming insolvencies of companies inadequately reacting to these problems are divided through Guaranty Funds among remaining solvent insurers. These trends will continue, and should moderate any optimism which otherwise might be justified by the sharply increased rates now taking effect. Berkshire Hathaway's insurance subsidiaries have a disproportionate concentration of business in precisely the lines which produced the worst underwriting results in 1975. Such lines produce unusually high investment income and, therefore, have been particularly attractive to us under previous underwriting conditions.

However, our "mix" has been very disadvantageous during the past two years and it well may be that we will remain positioned in the more difficult part of the insurance spectrum during the inflationary years ahead. The only segment to show improved results for us during 1975 was the "home state" operation, which has made continuous progress under the leadership of John Ringwalt. Although still operating at a significant underwriting loss, the combined ratio improved from 1974. Adjusted for excess costs attributable to operations still in the start-up phase, underwriting results are satisfactory.

Texas United Insurance Company, a major problem a few years ago, has made outstanding progress since George Billing has assumed command. With an almost totally new agency force, Texas United was the winner of the "Chairman's Cup" for achievement of the lowest loss ratio among the home state companies. Cornhusker Casualty Company, oldest and largest of the home state companies, continues its outstanding operation with major gains in premium volume and a combined ratio slightly under 100. Substantial premium growth is expected at the home state operation during 1976; the measurement of success, however, will continue to be the achievement of a low combined ratio.

Our traditional business at National Indemnity Company, representing well over half of our insurance volume, had an extraordinarily bad underwriting year in 1975. Although rates were increased frequently and significantly, they continually lagged loss experience throughout the year. Several special programs instituted in the early 1970s have caused significant losses, as well as a heavy drain on managerial time and energies. Present indications are that premium volume will show a major increase in 1976, and we hope that underwriting results will improve.

Reinsurance suffered the same problems as our direct business during 1975. The same remedial efforts were attempted. Because reinsurance contract settlements lag those of direct business, it well may be that any upturn in results from our direct insurance business will precede those of the reinsurance segment. At our Home and Automobile Insurance Company subsidiary, now writing auto business only in the Cook County area of Illinois, experience continued very bad in 1975 resulting in a management change in October. John Seward was made President at that time, and has energetically and imaginatively implemented a completely revamped underwriting approach.

Overall, our insurance operation will produce a substantial gain in premium volume during 1976. Much of this will reflect increased rates rather than more policies. Under normal circumstances such a gain in volume would be welcome, but our emotions are mixed at present. Underwriting experience should improve—and we expect it to—but our confidence level is not high. While our efforts will be devoted to obtaining a combined ratio below 100, it is unlikely to be attained during 1976. Insurance Investments Gains in investment income were moderate during 1975 because premium volume remained flat and underwriting losses reduced funds available for investment. Invested assets, measured at cost at yearend, were close to identical with the level at the beginning of the year.

At the end of 1974 the net unrealized loss in the stock section of our portfolio amounted to about $17 million, but we expressed the opinion, nevertheless, that this portfolio overall represented good value at its carrying value of cost. During 1975 a net capital loss of $2,888,000 before tax credits was realized, but our present expectation is that 1976 will be a year of realized capital gain. On March 31, 1976 our net unrealized gains applicable to equities amounted to about $15 million. Our equity investments are heavily concentrated in a few companies which are selected based on favorable economic characteristics, competent and honest management, and a purchase price attractive when measured against the yardstick of value to a private owner. When such criteria are maintained, our intention is to hold for a long time; indeed, our largest equity investment is 467,150 shares of Washington Post "B" stock with a cost of $10.6 million, which we expect to hold permanently. With this approach, stock market fluctuations are of little importance to us—except as they may provide buying opportunities—but business performance is of major importance. On this score we have been delighted with progress made by practically all of the companies in which we now have significant investments. We have continued to maintain a strong liquid position in our insurance companies. In last year's annual report we explained how variations of 1/10 of 1% in interest rates result in million dollar swings in market value of our bonds. We consider such market fluctuation of minor importance as our liquidity and general financial strength make it highly improbable that bonds will have to be sold at times other than those of our choice.

Banking

It is difficult to find adjectives to describe the performance of Eugene Abegg, Chief Executive of Illinois National Bank and Trust of Rockford, Illinois, our banking subsidiary. In a year when many banking operations experienced major troubles, Illinois National continued its outstanding record. Against average loans of about $65 million, net loan losses were $24,000, or .04%. Unusually high liquidity is maintained with obligations of the U. S. Government and its agencies, all due within one year, at yearend amounting to about 75% of demand deposits. Maximum rates of interest are paid on all consumer savings instruments which make up more than $2 million, it consistently has generated favorable earnings. Positioned as we now are with respect to income taxes, the addition of a solid source of taxable income is particularly welcome.

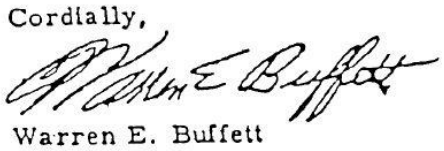
General Review

Your present management assumed responsibility at Berkshire Hathaway in May, 1965. At the end of the prior fiscal year (September, 1964) the net worth of the Company was $22.1 million, and 1,137,778 common shares were outstanding, with a resulting book value of $19.46 per share. Ten years earlier, Berkshire Hathaway's net worth had been $53.4 million. Dividends and stock repurchases accounted for over $21 million of the decline in company net worth, but aggregate net losses of $9.8 million had been incurred on sales of $595 million during the decade.

In 1965, two New England textile mills were the company's only sources of earning power and, before Ken Chace assumed responsibility for the operation, textile earnings had been erratic and, cumulatively, something less than zero subsequent to the merger of Berkshire Fine Spinning and Hathaway Manufacturing. Since 1964, net worth has been built to $92.9 million, or $94.92 per share. We have acquired total, or virtually total ownership of six businesses through negotiated purchases for cash (or cash and notes) from private owners, started four others, purchased a 31.5% interest in a large affiliate enterprise and reduced the number of outstanding shares of Berkshire Hathaway to 979,569.

Overall, equity per share has compounded at an annual rate of slightly over 15%. While 1975 was a major disappointment, efforts will continue to develop growing and diversified sources of earnings. Our objective is a conservatively financed and highly liquid business—possessing extra margins of balance sheet strength consistent with the fiduciary obligations inherent in the banking and insurance industries—which will produce a long term rate of return on equity capital exceeding that of American industry as a whole.

Cordially,



Warren E. Buffett

1976 Letter

Letter To the Stockholders of Berkshire Hathaway Inc.:

After two dismal years, operating results in 1976 improved significantly. Last year we said the degree of progress in insurance underwriting would determine whether our gain in earnings would be "moderate" or "major." As it turned out, earnings exceeded even the high end of our expectations. In large part, this was due to the outstanding efforts of Phil Liesche's managerial group at National Indemnity Company. In dollar terms, operating earnings came to $16,073,000, or $16.47 per share. While this is a record figure, we consider return on shareholders' equity to be a much more significant yardstick of economic performance. Here our result was 17.3%, moderately above our long- term average and even further above the average of American industry, but well below our record level of 19.8% achieved in 1972. Our present estimate, subject to all the caveats implicit in forecasting, is that dollar operating earnings are likely to improve somewhat in 1977, but that return on equity may decline a bit from the 1976 figure.

Textile Operations

Our textile division was a significant disappointment during 1976. Earnings, measured either by return on sales or by return on capital employed, were inadequate. In part, this was due to industry conditions which did not measure up to expectations of a year ago. But equally important were our own shortcomings. Marketing efforts and mill capabilities were not properly matched in our new Waumbec operation. Unfavorable manufacturing cost variances were produced by improper evaluation of machinery and personnel capabilities. Ken Chace, as always, has been candid in reporting problems and has worked diligently to correct them. He is a pleasure to work with—even under difficult operating conditions.

While the first quarter outlook is for red ink, our quite tentative belief is that textile earnings in 1977 will equal, or exceed modestly, those of 1976. Despite disappointing current results, we continue to look for ways to build our textile operation and presently have one moderate-size acquisition under consideration. It should be recognized that the textile business does not offer the expectation of high returns on investment. Nevertheless, we maintain a commitment to this division—a very important source of employment in New Bedford and Manchester—and believe reasonable returns on average are possible.

Insurance Underwriting

Icon for Casualty Insurance

Casualty insurers enjoyed some rebound from the disaster levels of 1975 as rate increases finally outstripped relentless cost increases. Preliminary figures indicate that the stockholder owned portion of the property and casualty industry had a combined ratio of 103.0 in 1976, compared to 108.3 in

1975. (100 represents a break-even position on underwriting—and higher figures represent underwriting losses.) We are unusually concentrated in auto lines where stock companies had an improvement from 113.5 to 107.4. Our own overall improvement was even more dramatic, from 115.4 to 98.7. Our major insurance sector in insurance, the traditional auto and general liability business of National Indemnity Company, had an outstanding year, achieving profit levels significantly better than the industry generally. Credit for this performance must be given to Phil Liesche, aided particularly by Roland Miller in Underwriting and Bill Lyons in Claims. Volume at National Indemnity Company grew rapidly during 1976 as competitors finally reacted to the inadequacy of past rates. But, as mentioned in last year's annual report, we are concentrated heavily in lines that are particularly susceptible to both economic and social inflation. Thus present rates, which are adequate for today, will not be adequate tomorrow.

Our opinion is that before long, perhaps in 1978, the industry will fall behind on rates as temporary prosperity produces unwise competition. If this happens, we must be prepared to meet the next wave of inadequate pricing by a significant reduction in volume. Reinsurance underwriting has lagged the improvement in direct business. When mistakes are made in the pricing of reinsurance, the effects continue for even longer than when similar mistakes are made in direct underwriting. George Young, an outstanding manager, has worked tirelessly to achieve his goal of profitable underwriting, and has cancelled a great many contracts where appropriate rate adjustments were not obtainable. Here, as in the direct business, we have had a concentration in casualty lines which have been particularly hard hit by inflationary conditions.

The near term outlook still is not good for our reinsurance business. Our "home state" operation continues to make substantial progress under the management of John Ringwalt. The combined ratio improved from 108.4 in 1975 to 102.7 in 1976. There still are some excess costs reflected in the combined ratio which result from the small size of several operations. Cornhusker Casualty Company, oldest and largest of the home state companies, was the winner of the Chairman's Cup in 1976 for achievement of the lowest loss ratio among the home state companies. Cornhusker also achieved the lowest combined ratio in its history at 94.4, marking the fifth time in its six full years of existence that a ratio below 100 has been recorded. Premium growth was 78% at the home state companies in 1976, as market position improved significantly. We presently plan a new home state operation later this year.

Our Home and Automobile Insurance Company subsidiary, writing primarily automobile business in the Cook County area of Illinois, experienced a strong recovery in 1976. This is directly attributable to John Seward who, in his first full year, has revamped significantly both rating methods and marketing. The auto business has been shifted to a six month direct bill policy, which permits a faster reaction time to underwriting trends. Our general liability business at Home and Automobile has been expanded significantly with good results. While it remains to be proven that we can achieve sustained underwriting profitability at Home and Auto, we are delighted with the progress John Seward has achieved. Overall, we expect a good year in insurance in 1977. Volume is high and present rate levels should allow profitable underwriting. Longer term, however, there are significant negatives in the insurance picture. Auto lines, in particular, seem highly vulnerable to pricing and regulatory problems produced by political and social factors beyond the control of individual companies.

Insurance Investments

Pre-tax investment income in 1976 improved to $10,820,000 from $8,918,000 as invested assets built up substantially, both from better levels of profitability and from gains in premium volume. In recent reports we have noted the unrealized depreciation in our bond account, but stated that we considered

such market fluctuations of minor importance as our liquidity and general financial strength made it improbable that bonds would have to be sold at times other than those of our choice. The bond market rallied substantially in 1976, giving us moderate net unrealized gains at yearend in the bond portfolios of both our bank and insurance companies. This, too, is of minor importance since our intention is to hold a large portion of our bonds to maturity. The corollary to higher bond prices is that lower earnings are produced by the new funds generated for investment. On balance, we prefer a situation where our bond portfolio has a current market value less than carrying value, but more attractive rates are available on issues purchased with newly-generated funds.

Last year we stated that we expected 1976 to be a year of realized capital gains and, indeed, gains of $9,962,000 before tax, primarily from stocks, were realized during the year. It presently appears that 1977 also will be a year of net realized capital gains. We now have a substantial unrealized gain in our stock portfolio as compared to a substantial unrealized loss several years ago. Here again we consider such market fluctuations from year to year relatively unimportant; unrealized appreciation in our equity holdings, which amounted to $45.7 million at yearend, has declined by about $5 million as this is written on March 21st. However, we consider the yearly business progress of the companies in which we own stocks to be very important.

And here, we have been delighted by the 1976 business performance achieved by most of our portfolio companies. If the business results continue excellent over a period of years, we are certain eventually to achieve good financial results from our stock holdings, regardless of wide year-to-year fluctuations in market values. Our equity holdings with a market value of over $3 million on December 31, 1976 were as follows:

No of Shares	Company Name	Cost
141,987	California Water Service Company……	$ 3,608,711
1,986,953	Government Employees Insurance Company Convertible Preferred	19,416,635
1,294,308	Government Employees Insurance Company Common Stock……..	4,115,670
395,100	Interpublic Group of Companies…….	4,530,615
562,900	Kaiser Industries, Inc……	8,270,871
188,900	Munsingwear, Inc…….	3,398,404
83,400	National Presto Industries, Inc…….	1,689,896
170,800	Ogilvy & Mather International…….	2,762,433
934,300	The Washington Post Company Class B…….	10,627,604
	Total……	$58,420,839
	All Other Holdings…….	16,974,375
	Total Equities……	$75,395,214

You will notice that our major equity holdings are relatively few. We select such investments on a long term basis, weighing the same factors as would be involved in the purchase of 100% of an operating business: (1) favorable long term economic characteristics; (2) competent and honest management; (3) purchase price attractive when measured against the yardstick of value to a private owner; and (4) an industry with which we are familiar and whose long term business characteristics we feel competent to judge. It is difficult to find investments meeting such a test and that is one reason for our concentration of holdings. We simply can't find one hundred different securities that conform to our investment requirements. However, we feel quite comfortable concentrating our holdings in the much smaller number that we identify as attractive.

Banking

Eugene Abegg, Chief Executive of Illinois National Bank and Trust Company of Rockford, Illinois, our banking subsidiary, continues to lead the parade among bankers – just as he has ever since he opened the bank in 1931.

Recently, National City Corp. of Cleveland, truly an outstandingly well-managed bank, ran an ad stating "the ratio of earnings to average assets was 1.34% in 1976 which we believe to be the best percentage for any major banking company." Among the really large banks, this was the best earnings achievement but, at the Illinois National Bank, earnings were close to 50% better than those of National City, or approximately 2% of average assets.

This outstanding earnings record again was achieved while:

1) Paying maximum rates of interest on all consumer savings instruments (time deposits now make up well over two-thirds of the deposit base at the Illinois National Bank),
2) Maintaining an outstanding liquidity position (Federal funds rate plus US Government and Agency issues of under six months' duration presently are approximately equal to demand deposits), and
3) Avoiding high yield but second class loans (net loan losses in 1976 came to about $12,000 or .02% of outstanding loans, a tiny fraction of the ratio prevailing in 1976 in the banking industry).

Cost control is an important factor in the bank's success. Employment is stil at about the level existing at the time of purchase in 1969 despite growth in consumer time deposits from $30 million to $90 million and considerable expansion in other activities such as trust, travel and data processing.

Blue Chip Stamps

During 1976 we increased our interest in Blue Chip Stamps, and by yearend we held about 33% of that company's outstanding shares. Our interest in Blue Chip Stamps is of growing importance to us. Summary financial reports of Blue Chip Stamps are contained in the footnotes to our attached financial statements. Moreover, shareholders of Berkshire Hathaway Inc are urged to obtain the current and subsequent annual reports of Blue Chip Stamps by requesting them from Mr Robert H Bird, Secretary, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Miscellaneous

K&W Products has performed well in its first year as a subsidiary of Berkshire Hathaway Inc. Both sales and Earnings were up moderately over 1975.

We have less than four years remaining to comply with the requirement that our bank be divested by December 31, 1980. We intend to accomplish such a divestiture in a manner that minimizes disruption to the bank and produces good results for our shareholders. Most probably this will involve a spin-off of bank shares in 1980.

We also hope at some point to merge with Diversified Retailing Company, Inc. Both corporate simplification and enhanced ownership position in Blue Chip Stamps would be benefits of such a merger. However, it is unlikely that anything will be proposed in this regard during 1977.

Cordially,

Warren E. Buffett

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About Us

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We at Smart Sync Investment Advisory Services (SSIAS) are guided by the words of wisdom from the father of Investment Management, Benjamin Graham —

"An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return."

We are aware of the prospects of exponential returns in the stock market, but we firmly believe that Return of Capital is more important than Return on Capital. Thus, while we look for avenues providing adequate return, we don't compromise on the protection of our clients' capital.

We intend to make all the relevant materials available on our website, free of cost. We would also write on matters involving finance and stock market investing. Any student of investment could derive a good value out of those blog posts.

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