

## 巴菲特致股东的信 1976

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

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:

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 do identify as attractive. Our intention usually is to maintain equity positions for a long time, but sometimes we will make a purchase with a shorter expected time horizon such as Kaiser Industries. Here a distribution of securities and cash from the parent company is expected to be initiated in 1977. Purchases were made in 1976 after the announcement of the distribution plan by Kaiser management.

### 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 even 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 sold plus U. S. 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 very 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 still 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 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.

Warren E. Buffett, Chairman

March 21, 1977