

## BERKSHIRE HATHAWAY INC.

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

Our per-share book value increased 14.3% during 1993. Over the last 29 years (that is, since present management took over) book value has grown from \$19 to \$8,854, or at a rate of 23.3% compounded annually.

During the year, Berkshire's net worth increased by \$1.5 billion, a figure affected by two negative and two positive non-operating items. For the sake of completeness, I'll explain them here. If you aren't thrilled by accounting, however, feel free to fast-forward through this discussion:

1. The first negative was produced by a change in Generally Accepted Accounting Principles (GAAP) having to do with the taxes we accrue against unrealized appreciation in the securities we carry at market value. The old rule said that the tax rate used should be the one in effect when the appreciation took place. Therefore, at the end of 1992, we were using a rate of 34% on the \$6.4 billion of gains generated after 1986 and 28% on the \$1.2 billion of gains generated before that. The new rule stipulates that the current tax rate should be applied to all gains. The rate in the first quarter of 1993, when this rule went into effect, was 34%. Applying that rate to our pre-1987 gains reduced net worth by \$70 million.
2. The second negative, related to the first, came about because the corporate tax rate was raised in the third quarter of 1993 to 35%. This change required us to make an additional charge of 1% against all of our unrealized gains, and that charge penalized net worth by \$75 million. Oddly, GAAP required both this charge and the one described above to be deducted from the earnings we report, even though the unrealized appreciation that gave rise to the charges was never included in earnings, but rather was credited directly to net worth.
3. Another 1993 change in GAAP affects the value at which we carry the securities that we own. In recent years, both the common stocks and certain common-equivalent securities held by our insurance companies have been valued at market, whereas equities held by our non-insurance subsidiaries or by the parent company were carried at their aggregate cost or market, whichever was lower. Now GAAP says that *all* common stocks should be carried at market, a rule we began following in the fourth quarter of 1993. This change produced a gain in Berkshire's reported net worth of about \$172 million.
4. Finally, we issued some stock last year. In a transaction described in last year's Annual Report, we issued 3,944 shares in early January, 1993 upon the conversion of \$46 million convertible debentures that we had

called for redemption. Additionally, we issued 25,203 shares when we acquired Dexter Shoe, a purchase discussed later in this report. The overall result was that our shares outstanding increased by 29,147 and our net worth by about \$478 million. Per-share book value also grew, because the shares issued in these transactions carried a price above their book value.

Of course, it's per-share intrinsic value, not book value, that counts. Book value is an accounting term that measures the capital, including retained earnings, that has been put into a business. Intrinsic value is a present-value estimate of the cash that can be taken out of a business during its remaining life. At most companies, the two values are unrelated. Berkshire, however, is an exception: Our book value, though significantly below our intrinsic value, serves as a useful device for tracking that key figure. In 1993, each measure grew by roughly 14%, advances that I would call satisfactory but unexciting.

These gains, however, were outstripped by a much larger gain - 39% - in Berkshire's market price. Over time, of course, market price and intrinsic value will arrive at about the same destination. But in the short run the two often diverge in a major way, a phenomenon I've discussed in the past. Two years ago, Coca-Cola and Gillette, both large holdings of ours, enjoyed market price increases that dramatically outpaced their earnings gains. In the 1991 Annual Report, I said that the stocks of these companies could not continuously overperform their businesses.

From 1991 to 1993, Coke and Gillette increased their annual operating earnings per share by 38% and 37% respectively, but their market prices moved up only 11% and 6%. In other words, the companies overperformed their stocks, a result that no doubt partly reflects Wall Street's new apprehension about brand names. Whatever the reason, what will count over time is the earnings performance of these companies. If they prosper, Berkshire will also prosper, though not in a lock-step manner.

Let me add a lesson from history: Coke went public in 1919 at \$40 per share. By the end of 1920 the market, coldly reevaluating Coke's future prospects, had battered the stock down by more than 50%, to \$19.50. At yearend 1993, that single share, with dividends reinvested, was worth more than \$2.1 million. As Ben Graham said: "In the short-run, the market is a voting machine - reflecting a voter-registration test that requires only money, not intelligence or emotional stability - but in the long-run, the market is a weighing machine."

So how should Berkshire's over-performance in the market last year be viewed? Clearly, Berkshire was selling at a higher percentage of intrinsic value at the end of 1993 than was the case at the beginning of the year. On the other hand, in a world of 6% or 7% long-term interest rates, Berkshire's market price was not inappropriate if - and you should understand that this is a huge if - Charlie Munger, Berkshire's Vice Chairman, and I can attain our long-standing goal of increasing Berkshire's per-share intrinsic value at an average annual rate of 15%. We have not retreated from this goal. But we again emphasize, as we have for many years, that the growth in our capital base makes 15% an ever-more difficult target to hit.

What we have going for us is a growing collection of good-sized operating businesses that possess economic characteristics ranging from good to terrific, run by managers whose performance ranges from terrific to terrific. You need have no worries about this group.

The capital-allocation work that Charlie and I do at the parent company, using the funds that our managers deliver to us, has a less certain outcome: It is not easy to find new businesses and managers comparable to those we have. Despite that difficulty, Charlie and I relish the search, and we are happy to report an important success in 1993.

## **Dexter Shoe**

What we did last year was build on our 1991 purchase of H. H. Brown, a superbly-run manufacturer of work shoes, boots and other footwear. Brown has been a real winner: Though we had high hopes to begin with, these expectations have been considerably exceeded thanks to Frank Rooney, Jim Issler and the talented managers who work with them. Because of our confidence in Frank's team, we next acquired Lowell Shoe, at the end of 1992. Lowell was a long-established manufacturer of women's and nurses' shoes, but its business needed some fixing. Again, results have surpassed our expectations. So we promptly jumped at the chance last year to acquire Dexter Shoe of Dexter, Maine, which manufactures popular-priced men's and women's shoes. Dexter, I can assure you, needs no fixing: It is one of the best-managed companies Charlie and I have seen in our business lifetimes.

Harold Alfond, who started working in a shoe factory at 25 cents an hour when he was 20, founded Dexter in 1956 with \$10,000 of capital. He was joined in 1958 by Peter Lunder, his nephew. The two of them have since built a business that now produces over 7.5 million pairs of shoes annually, most of them made in Maine and the balance in Puerto Rico. As you probably know, the domestic shoe industry is generally thought to be unable to compete with imports from low-wage countries. But someone forgot to tell this to the ingenious managements of Dexter and H. H. Brown and to their skilled labor forces, which together make the U.S. plants of both companies highly competitive against all comers.

Dexter's business includes 77 retail outlets, located primarily in the Northeast. The company is also a major manufacturer of golf shoes, producing about 15% of U.S. output. Its bread and butter, though, is the manufacture of traditional shoes for traditional retailers, a job at which it excels: Last year both Nordstrom and J.C. Penney bestowed special awards upon Dexter for its performance as a supplier during 1992.

Our 1993 results include Dexter only from our date of merger, November 7th. In 1994, we expect Berkshire's shoe operations to have more than \$550 million in sales, and we would not be surprised if the combined pre-tax earnings of these businesses topped \$85 million. Five years ago we had no thought of getting into shoes. Now we have 7,200 employees in that industry, and I sing "There's No Business Like Shoe Business" as I drive to work. So much for strategic plans.

At Berkshire, we have no view of the future that dictates what businesses or industries we will enter. Indeed, we think it's usually poison for a corporate giant's shareholders if it embarks upon new ventures pursuant to some grand vision. We prefer instead to focus on the economic characteristics of businesses that we wish to own and the personal characteristics of managers with whom we wish to associate - and then to hope we get lucky in finding the two in combination. At Dexter, we did.

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And now we pause for a short commercial: Though they owned a business jewel, we believe that Harold and Peter (who were not

interested in cash) made a sound decision in exchanging their Dexter stock for shares of Berkshire. What they did, in effect, was trade a 100% interest in a single terrific business for a smaller interest in a large group of terrific businesses. They incurred no tax on this exchange and now own a security that can be easily used for charitable or personal gifts, or that can be converted to cash in amounts, and at times, of their own choosing. Should members of their families desire to, they can pursue varying financial paths without running into the complications that often arise when assets are concentrated in a private business.

For tax and other reasons, private companies also often find it difficult to diversify outside their industries. Berkshire, in contrast, can diversify with ease. So in shifting their ownership to Berkshire, Dexter's shareholders solved a reinvestment problem. Moreover, though Harold and Peter now have non-controlling shares in Berkshire, rather than controlling shares in Dexter, they know they will be treated as partners and that we will follow owner-oriented practices. If they elect to retain their Berkshire shares, their investment result from the merger date forward will exactly parallel my own result. Since I have a huge percentage of my net worth committed for life to Berkshire shares - and since the company will issue me neither restricted shares nor stock options - my gain-loss equation will always match that of all other owners.

Additionally, Harold and Peter know that at Berkshire we can keep our promises: There will be no changes of control or culture at Berkshire for many decades to come. Finally, and of paramount importance, Harold and Peter can be sure that they will get to run their business - an activity they dearly love - exactly as they did before the merger. At Berkshire, we do not tell .400 hitters how to swing.

What made sense for Harold and Peter probably makes sense for a few other owners of large private businesses. So, if you have a business that might fit, let me hear from you. Our acquisition criteria are set forth in the appendix on page 22.

### Sources of Reported Earnings

The table below shows the major sources of Berkshire's reported earnings. In this presentation, amortization of Goodwill and other major purchase-price accounting adjustments are not charged against the specific businesses to which they apply, but are instead aggregated and shown separately. This procedure lets you view the earnings of our businesses as they would have been reported had we not purchased them. I've explained in past reports why this form of presentation seems to us to be more useful to investors and managers than one utilizing GAAP, which requires purchase-price adjustments to be made on a business-by-business basis. The total net earnings we show in the table are, of course, identical to the GAAP total in our audited financial statements.

(000s omitted)

		<i>Berkshire's Share of Net Earnings (after taxes and minority interests)</i>	
<i>Pre-Tax Earnings</i>			
<i>1993</i>	<i>1992</i>	<i>1993</i>	<i>1992</i>

### Operating Earnings:

#### Insurance Group:

Underwriting .....	\$ 30,876	\$(108,961)	\$ 20,156	\$(71,141)
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Net Investment Income .....	375,946	355,067	321,321	305,763
H. H. Brown, Lowell, and Dexter .....	44,025*	27,883	28,829	17,340
Buffalo News .....	50,962	47,863	29,696	28,163
Commercial & Consumer Finance	22,695	19,836	14,161	12,664
Fechheimer .....	13,442	13,698	6,931	7,267
Kirby				