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Berkshire Hathaway Intrinsic Value

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Full disclosure: I am long Berkshire Hathaway and look forward to the release of Mr. Buffett's annual letter each year.

Each year I do a mental calculation to estimate the intrinsic value of the firm, generally using a proxy of the "A" shares when doing the math. Occasionally I get asked what I think the current shares are worth by those who either own some shares already or are considering buying some.

As a sidebar, if someone tells you the shares are overvalued and that you should sell be sure to ask them when the last time they recommended buying BRK shares. Since at one time the shares were under \$20, and I can remember when they first passed \$300, generally the discussion stops at that point. There are perpetual bears on the stock who can always find something to be concerned about. Too high a price and mortality fears generally lead the pack. Two years ago mortality was more a fear than it is today. Adding Todd Combs and Ted Weschler to invest and Matt Rose (BNSF) has made the bench much deeper than it was when David Sokol was sent to fix every hiccup.

In the 2012 Berkshire Hathaway annual report there are a lot of clues to help you calculate the firm's intrinsic value. On page 6 there is even a section titled Intrinsic Business Value. In addition to that page, I pulled information from pages 7, 9, 15, and 26.

Per share investments \$113,786

Per share pretax earnings from non-insurance businesses \$8,085

Underwriting profit from insurance over 10 years (shows trend, conservative since float is growing) \$18.6 billion

Underwriting profit from insurance 2012 (comparable to average despite Sandy and other super-claims) \$1.625 billion

Total common stocks carried at market, cost basis \$49.796 billion

Total common stocks carried at market, market value \$87.662 billion

Class A equivalent common shares outstanding 1.643 million

Class A equivalent per share book value \$114,214

Acting as a floor, Mr. Buffett will consider share repurchases at 120% of book value. This results in a floor of about \$137,000 per share at year-end 2012. As this is written Berkshire Hathaway "A" shares are trading above \$150,000.

In my analysis there are three components of value for Berkshire Hathaway; investments, underwriting profit, and profit from non-insurance subsidiaries. Mr. Buffett shares the information I need to calculate using this view so I think this is similar to his analysis.

Investments

They tell us the amount of investments per share and the basis for a block of investments. This is actually not entirely clear to me as there are \$26 billion of investments held at book. I assume these are bonds, which in today's environment would be worth a lot more than they cost so this is conservative.

Investments per share – tax rate x (market value – basis)/number of shares = value from investments

$$\$113,786 - 35\% \times (87.662 \text{ B} - 49.796 \text{ B}) / 1.643 \text{ M} = \$105,720 \text{ value per share}$$

Underwriting Profit

Underwriting profit drives the float from insurance operations, and depends on competitive pressures. Buffett is known to drop out of the market periodically when he (or Ajit Jain) feels premiums are insufficient.

The sustainability factor estimates the ability to continue to earn this level (mean over 10 years) of underwriting profit over long periods of time. The P/E works from the future earnings so a growth factor is needed to project profits forward one year.

10-year average underwriting profit per share x (1-tax rate) x P/E x sustainability factor x 1 year growth rate = value from underwriting profit

$$1.86 \text{ B} / 1.643 \text{ M} \times (1 - 35\%) \times 10 \times 50\% \times (1 + 10\%) = \$4,047 \text{ value per share}$$

For most companies this value is negative, so this is a bonus due to BRK's efficiency, high rating and reputation. It can charge more for many types of insurance than others can. There are more arbitrary calculations here so results will vary by analyst, but the value is small relative to other components.

Profit from Non Insurance Subsidiaries

This is the most straightforward calculation.

Profit per share x (1 – tax rate) x P/E x (1 + growth rate) = value from non insurance subs

$$8,085 \times (1 - 35\%) \times 12 \times (1 + 10\%) = \$69,369$$

If you had done this calculation annually for many years this component would be seen to grow in both absolute and relative terms.

Totals

In total the value as calculated is \$179,136, well above the current price in late February 2013. While there is always uncertainty surrounding such a calculation, there is also conservatism built in so I feel this value is most likely lower than a true intrinsic value with insider information. Historically the actual market price rarely gets as high as my calculated value, so anything over 90% might be considered ripe for a correction.

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