Stock and berkshire hathaway

1. What is the possible meaning of the changes in stock price for Berkshire Hathaway and Scottish Power plc on the day of the acquisition announcement? Specifically, what does the $2. 17-billion gain in Berkshire's market value of equity imply about the intrinsic value of PacifiCorp? The significant change in stock prices for Berkshire Hathaway and Scottish Power plc is partially due to the wide variety of products produced under these names. The approval of these investments and products are indicated by the overall market because they are creating value for both the buyer and the seller.

Berkshire Hathaway is responsible for eight different types of product ranging from insurance and financial products to retail including wholesale distributing and apparel along with an array of smaller businesses. Warren Buffett's name goes a long way based on the type of work and success he has had in the past. His decision to run the company in the interests of the shareholders has proven to be successful. " In 1977, Berkshire Hathaway's year-end closing share price was $102; on May 24, 2005 the closing price on Class A shares reached $85, 500".

It seems that Warren Buffett refuses to ' split' the firm's share price in order to make it more accessible to everyday investors is because of the value of the company and the contribution that these investors have made to Berkshire Hathaway. They make risky decisions and expect a successful outcome which in turn results in a profitable project. The $2. 17-billion gain in Berkshire's market value implies that the intrinsic value of PacifiCorp is increasing as well.

The market value may be different than the intrinsic value however the intrinsic value is the actual value of the company including assets and the underlying perception of that value. Both tangible and intangible factors may be included. Therefore the intrinsic value of the PacifiCorp is on the rise with the amount of revenue they are generating. 1. Based on the multiples for comparable regulated utilities, what is the range of possible values for PacifiCorp? What questions might you have about this range? PacifiCorp | Revenue | EBIT | EBITDA | Net Income | EPS | Book Value | | Median |$6. 252B |$8. 775B |$9. 023B |$7. 96B |$4. 277B |$5. 904B | | Mean |$6. 584B |$9. 289B |$9. 076B |$7. 553B |$4. 308B |$5. 678B | | For the most part, the means are higher than the medians for the enterprise financial value of PacifiCorp. 2. Assess the bid for PacifiCorp. How does it compare with the firm's intrinsic value? As an alternative, the instructor could suggest that students perform a simple discounted cash flow (DCF) analysis. Warren Buffett and Berkshire Hathaway's bid of $5. 1 billion for PacifiCorp was a risky yet profitable move for the pair. With the average revenue earning of $6. 584 billion and an average net income of $7. 53 billion, the earnings seem to exceed the overall cost of purchasing this corporation. PacifiCorp had steady returns for numerous years as presented below. 5. 4 percent of their stock was preferred stock for two consecutive years with dividends of $1. 35 per share. With the wide range of businesses under their belt including, insurance, apparel, building products, financeand financial products, flight services, retail, grocery distribution and carpet and floor coverings along with an assortment of smaller businesses, PacifiCorp would just be another notch in the belt of Warren Buffet.

His investment strategies have proven to be profitable and his decisions have proven to be knowledgeable and successful. The intrinsic value of the corporation will definitely be of value to Warren Buffett and Berkshire Hathaway based on PacifiCorp's earnings, financial worth and the value of their assets in years prior to Warren Buffett's acquisition. [pic][pic] 3. How well has Berkshire Hathaway performed? How well has it performed in the aggregate? What about its investment in MidAmerican Energy Holdings? Berkshire Hathaway has become an investing empire.

Their enterprise value in 2005 was nearly $520 billion. Taking a look at their current value is no different. According to Berkshire Hathaway's most recent 10K report (2010), they had 1, 648, 000 outstanding shares of class A stock. At the end of 2010 the price of the class A stock was $120, 450 per share. If we use the formula for market capitalization we get: Market Capitalization = Outstanding shares * share price Market Capitalization = 1, 648, 000*120, 450 Market Capitalization = 198, 501, 600, 000 We then use the 10K to find their cash, cash equivalents and debt for 2010.

According to their annual report they had cash and cash equivalents of $2, 673, 000, 000 and a reported debt of $6, 621, 000, 000. We then use these numbers to find the current enterprise value: Enterprise value = 198, 501, 600, 000-2, 673, 000, 000+6, 621, 000, 000 Enterprise value = 202, 449, 600, 000 These estimates from 2005 and 2010 show us that Berkshire Hathaway did lose some value; however they still have an enterprise value of over $200 billion. This shows us that even through the last few years when the United States has been in an economic recession overall they have remained strong.

Using Yahoo Finance we see that there was a slight drop in stock A prices in February of 2009 when it reached a low of about $78, 000 per share. But by the end of 2009, prices rose back to above $100, 000 per share and have remained, showing consistency and continuing to build shareholder confidence. Berkshire Hathaway has increased its interest in MidAmerican from 88. 6% to 89. 8% since 2005. By doing this it only adds even more value to Berkshire Hathaway as MidAmerican is a leading provider of natural gas for more than 2. 4 million customers.

The investment has surely paid off as the 2010 annual report showed 1. 13 billion dollars of earnings for Berkshire from MidAmerican. 4. What is your assessment of Berkshire's investments in Buffett's " Big Four": American Express, Coca-Cola, Gillette (now part of Procter and Gamble), and Wells Fargo? With a little more than 150, 000, 000 shares of American Express, Berkshire Hathaway owns about 12. 6% of the company. It initially cost about $1, 300, 000, 000 to invest in these shares. As of today the market value is right around $7, 500, 000, 000.

As you can see, Investing in American Express has turned out to be a smart move for Buffet as they have seen over $6. 2 Billion in profit. American Express shows a consistent trend year after year of making a profit and continues to be a safe and attractive purchase. Berkshire owns around 200, 000, 000 shares of Coca-Cola coming out to be about 8. 6% ownership of the company. The cost of these shares was about $1, 300, 000, 000 and the market value of the shares today has grown to be almost $13, 400, 000, 000. Again we see a smart investment, with Coca-Cola producing a $12. billion dollar profit for Berkshire. Coca-Cola continues to be a leader in effectively

running their finances as it seems their stock prices rises every year. They carry low debt and our consistent fitting perfect into the Berkshire mold. Berkshire Hathaway owns close to 73, 000, 000 shares of Procter and Gamble. These shares are equal to a 2. 6% ownership of Procter and Gamble. When they invested this cost them $464, 000, 000. Today these shares are worth around $4, 800, 000, 000. Again we see that this investment has worked out in favor of Buffet and Berkshire Hathaway.

Proctor and Gamble carries a low amount of debt and produces a high net income and continues to grow year in and year out making Buffet and other investor’s very happy shareholders. The last company Wells Fargo, Berkshire has about a 6. 8% ownership of or roughly holds around 360, 000, 000 shares. The cost of the Wells Fargo stock to Berkshire was estimated at around $8, 000, 000, 000. In today’s market these shares hold a value of about $10, 600, 000, 000. Even though this is a profit of about $2. 6 billion I’m not sure if Buffett is extremely happy with this investment.

Proctor and Gambles stock price is relatively low giving it much room to grow however over the last couple of years it has fluctuated quite a bit. Out of the four investments this is definitely the least effective and efficient. 5. From Warren Buffett’s perspective, what is the intrinsic value? Why is it accorded such importance? How is it estimated? What are the alternatives to intrinsic value? Why does Buffett reject them? As I already stated, intrinsic value is found by using a company’s stock price and their earnings per share.

People tend to buy the stocks that they feel are worth more than what the market claims they are worth adding to the notion of a company’s intrinsic

value. Warren Buffet obviously does much more than the average person when he chooses stocks to invest in as we can see from the amount ofmoneyhe and Berkshire Hathaway have. When deciding whether or not to invest in a company he looks at the return on equity of a company to see the consistency of a company's performance and how much equity they are able to generate for their shareholders. Buffet performs this calculation year after year to be sure that the company is consistent.

Next, he looks at the company's debt to equity ratio to be sure that the company is avoiding large amounts of debt. None of the companies he invests in have higher liabilities than assets as he believes that debt in large amounts is a bad thing. In order for him to be willing to invest he must see that the company is or will be highly profitable for years to come. If the company hasn't been publically traded for at least 10 years more times than not, he won't even consider investing. He does not believe in short-term success; he claims that " in the short-term, the market is a popularity contest. He chooses stocks by looking at the overall ability and potential of a company rather than how they perform in the short-term ignoring the supply/demand attraction. When Buffet considers companies for the long-term, he looks at them more as an owner than a shareholder concerned with receiving capital gains. He is concerned with the individual company and their ability to make money over the long-term. He prefers to act as almost an owner and less of a shareholder concerned with receiving capital gains. 6. Critically assess Buffett's investmentphilosophy. Be prepared to identify points where you agree and disagree with him. . Economic reality, not accounting reality. When looking at a business, Warren Buffet looks at the

economic reality as opposed to the accounting reality. Accounting reality looks at a company using the generally accepted accounting principles (GAAP) to determine the value of the company. GAAP covers revenue recognition, balance sheet item classification, and outstanding share measurements. Economic reality is broader than accounting reality and includes intangible assets, such as patents, trademarks, special managerial expertise, and reputation of the company.

When looking at the value of a company looking at the economic reality makes more sense because it includes intangible assets that can't be computed, but are an important factor for the value of a company. For example, the reputation of a company cannot be quantified, but reputation is valuable in the sense that a company with a good reputation will draw more favor from customers and investors while a company with a bad reputation will drive away customers and potential investors. 2. The cost of lost opportunity. This compares an investment opportunity against the next best alternative.

What this means is that when making a decision as to whether to invest in one company or the other, choices are made as either/or decisions rather than yes/no. By looking at companies this way, Buffet is able to see how investing in one company would compare by looking at the potential returns on common stock from investing in another company. 3. Value creation: time is money. In terms of value creation, Buffet believes that intrinsic value is a better indicator of future expected performance as opposed to using book value.

Intrinsic value is the discounted value of the cash that can be taken out of a business during its remaining life while, book value is the number of total assets a company has minus intangible assets and liabilities. What makes the intrinsic value a better indicator of future expected performance is the fact that book value may not reflect the economic reality because depending on the relationship between expected returns and the discount rate; value can either be gained or lost. What this means is that the estimates of the return on equity can drastically change whether or not a company is seen as valuable. . Measure performance by gain in intrinsic value. Performance is measured by gain in intrinsic value as opposed to accounting profit. Warren Buffet says that Berkshire's performance is not measured by the size of the company, but by the companies per share progress. The gain of intrinsic value is modeled as the value added by a business compared to the cost for the use of capital in that business. Other forms of measuring performance look at the ability to earn returns in excess of the cost of capital.

By looking at per share progress, it is easier to see growth in a company than by looking at how large it is because a large company does not mean that it is a profitable company or that their growth is related to an increase in profit, if anything their growth could just be related to a large number of acquisitions. 5. Risk and discount rates. When looking at risk and discount rates, instead of using the traditional capital asset pricing model (CAPM) to estimate discount rates, Buffet chooses to use the rate of return on the long term treasury bond to discount cash flows.

The CAPM model of estimating discount rates adds in a risk premium to the long term risk free rate of return, while Buffet's method avoids risk

altogether and uses a risk-free discount rate. The reason behind this is that Buffet likes to invest in companies with predictable and stable earnings and avoid financing his firm with debt. Overall this is a smart strategy because if there was ever an economic crisis, like there was a few years ago, a company not financed with debt and low risk would pull through better than a company who had many high risk investments and was financed by debt. . Diversification. Buffet's view on diversification is that it is an unnecessary precaution, and that instead of inventing in many stocks to avoid risk, it would be more profitable to wait for one exceptional company to invest in. The logic behind this makes sense, but the execution is difficult because of the fact that the stock market is so volatile and investors do not have all of the information necessary to make an informed decision with 100% confidence that there investment will pay off.

There is also the fact that some investment opportunities may be missed if companies wait too long to find that one exceptional company to invest in. 7. Investing behavior should be driven by information, analysis, and self-discipline, not by emotion or " hunch". Buffet believes that stock prices have become unreliable measure of intrinsic value of a company because they are influenced by the fear and greed of investors. He also doesn't believe in the efficient markets hypothesis (EMH), which states that stock prices are fair in reflecting what was known about a company.

Buffet disapproves of this theory because he believes that stock prices do not accurately portray the intrinsic value of the company and believing in this theory prevents investors from seeing the bigger picture on how the stock market really works. It is important to use information and analysis of

companies when making an investment decision because you can't always trust the information that is given and the information given may not give the whole picture on the value of a company. 8. Alignment of agents and owners. When it comes to investing Buffet believes that an alignment of agents and owners is important.

This means that the needs of the company are that of the needs of the shareholders. Keeping the needs of the shareholders first is important to having a successful business. If shareholders are happy, businesses can expect to receive a good supply of cash flow from investments. Shareholder wealth can also lead to more profits in the company as well as the company will be focused on long term profit maximization and not just the short term. 7. Should Berkshire Hathaway's shareholders endorse the acquisition of PacifiCorp?

While looking at PacifiCorp's ConsolidatedFinancial Statement(Exhibit 7) PacifiCorp's income from operations before tax fits the criteria 1 presented in Berkshire Hathaway's acquisition criteria (Exhibit 8) by having more than $75 million in pretax earnings, (PacifiCorp has $4. 2 billion.) However, they do carry about $3. 92 billion in long-term debt, which fails criteria 3 in Exhibit 8. They do however, fill criteria 2 in Exhibit 8 by bringing in about $3. 6 million more in net income from 2005 to 2004 (Exhibit 7) although more data would be needed to see if PacifiCorp was consistently earning a profit.

Compared to 6 other companies in the same field in Exhibit 9, PacifiCorp doesn't seem like the best investment. PacifiCorp is number 2 for total assets, but also number 2 for total liabilities. This goes in hand with their

total long-term debt as they are also number 2, but for short-term debt they are number 5. For total debt they are number 2. For total revenue before taxes, PacifiCorp is number 4. What these numbers mean is that compared to other companies, it seems that PacifiCorp is a more risky investment. PacifiCorp generally has more debt and is not bringing in as much revenue, though they still have positive growth in net income.

Another source of concern is that PacifiCorp has very low earnings per share with a EPS of just $0. 81 with the next competitor having an EPS of $1. 42 (Exhibit 10). From looking at the data presented in the tables, shareholders should not endorse the acquisition of PacifiCorp because the company fails several criteria that were established by Berkshire Hathaway as guidelines for acquiring corporations, and it is unlikely that the acquisition will result in the 15% annual growth of the intrinsic value of the firm.