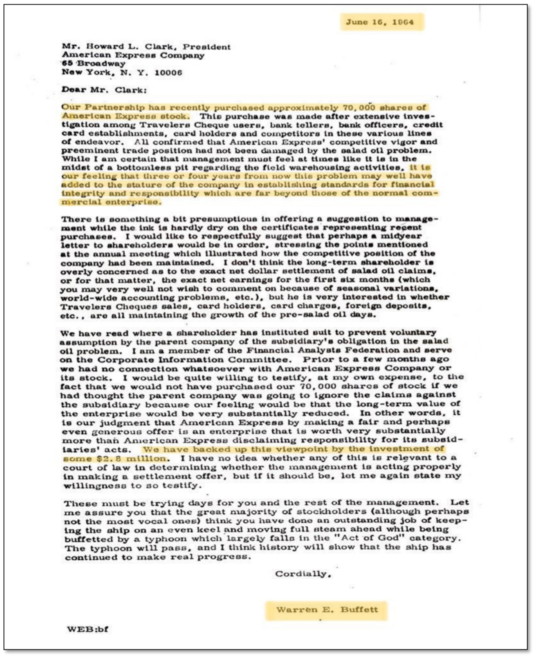
American Express

Buffett Partnership's Best Investment



June 16, 1964

Mr. Howard L. Clark, President
American Express Company
65 Broadway
New York, N. Y. 10006

Dear Mr. Clark:

Our Partnership has recently purchased approximately 70,000 shares of American Express stock. This purchase was made after extensive investigation among Travelers Cheque users, bank tellers, bank officers, credit card establishments, card holders and competitors in these various lines of endeavor. All confirmed that American Express' competitive vigor and preeminent trade position had not been damaged by the salad oil problem. While I am certain that management must feel at times like it is in the midst of a bottomless pit regarding the field warehousing activities, it is our feeling that three or four years from now this problem may well have added to the stature of the company in establishing standards for financial integrity and responsibility which are far beyond those of the normal commercial enterprise.

There is something a bit presumptious in offering a suggestion to management while the ink is hardly dry on the certificates representing recent purchases. I would like to respectfully suggest that perhaps a midyear letter to shareholders would be in order, stressing the points mentioned at the annual meeting which illustrated how the competitive position of the company had been maintained. I don't think the long-term shareholder is overly concerned as to the exact net dollar settlement of salad oil claims, or for that matter, the exact net earnings for the first six months (which you may very well not wish to comment on because of seasonal variations, world-wide accounting problems, etc.), but he is very interested in whether Travelers Cheques sales, card holders, card charges, foreign deposits, etc., are all maintaining the growth of the pre-salad oil days.

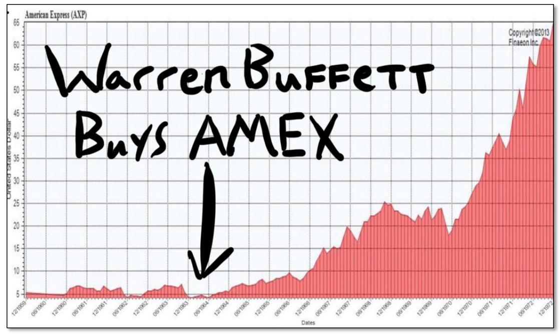
We have read where a shareholder has instituted suit to prevent voluntary assumption by the parent company of the subsidiary's obligation in the salad oil problem. I am a member of the Financial Analysts Federation and serve on the Corporate Information Committee. Prior to a few months ago we had no connection whatsoever with American Express Company or its stock. I would be quite willing to testify, at my own expense, to the fact that we would not have purchased our 70,000 shares of stock if we had thought the parent company was going to ignore the claims against the subsidiary because our feeling would be that the long-term value of the enterprise would be very substantially reduced. In other words, it is our judgment that American Express by making a fair and perhaps even generous offer is an enterprise that is worth very substantially more than American Express disclaiming responsibility for its subsidiaries' acts. We have backed up this viewpoint by the investment of some $2.8 million. I have no idea whether any of this is relevant to a court of law in determining whether the management is acting properly in making a settlement offer, but if it should be, let me again state my willingness to so testify.

These must be trying days for you and the rest of the management. Let me assure you that the great majority of stockholders (although perhaps not the most vocal ones) think you have done an outstanding job of keeping the ship on an even keel and moving full steam ahead while being buffetted by a typhoon which largely falls in the "Act of God" category. The typhoon will pass, and I think history will show that the ship has continued to make real progress.

Cordially,

Warren E. Buffett

WEB:bf



Warren Buffett on American Express:

"That was my partnership's best investment"

In 1964, Buffett put $2.8M of his $17.5M fund into AMEX. AMEX grew to a 40% holding, "the largest investment the partnership ever made," and compounded at 50% for four years.

Here's the story…

Things had never looked rosier at American Express Co. than they did in mid-November, 1963. Under President Howard L. Clark, who was rounding out his fourth year as chief executive, the company's net income had been rising sharply—the figure for all of 1963 was a record $11,263,841—and the company's stock was only a shade below its all-time high on the over-the-counter market. Its credit-card business, in the black after three years of heavy losses, was racking up new gains. Overseas, where American Express operates a network of commercial-banking offices, deposits were up 64 percent since 1959. The American Express traveler's check, which has no close rival anywhere in the world, was continuing its steady 10 percent a year growth in sales. Clark, who is only forty-eight himself, had filled many of the top posts at the company's headquarters in downtown New York with young, imaginative men and had infused new aggressiveness and profit-mindedness into the organization. The company, which has no long-term debt, seemed to be rolling.

At 24 times this year's estimated earnings of $2.50 a share and yielding a thin 2¼% return, American Express is no bargain. But true growth stocks of prime investment quality are never cheap. This stock fully deserves inclusion in the diversified portfolio of a conservative investor who wishes to participate in what seems to me the inevitable further growth of international travel.

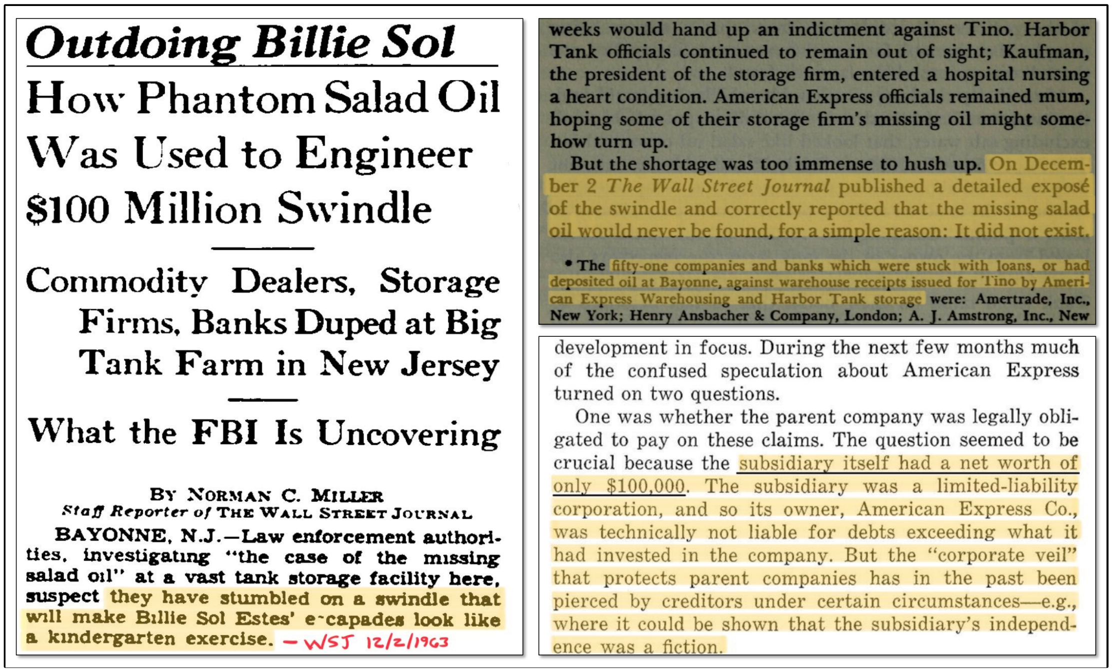
FORBES, AUGUST 1, 1963

	1963	1962	1961	1960	1959	1958	1957	1956	1955	1954
Income from Operations	$ 100,418,000	$ 86,771,000	$ 77,378,000	$ 74,709,000	$ 67,117,000	$ 59,045,000	$ 53,821,000	$ 47,936,000	$ 42,219,000	$ 37,144,000
Profit on Sales of Securities	1,436,000	2,028,000	2,884,000	2,700,000	2,476,000	2,405,000	859,000	1,392,000	1,315,000	1,205,000
Operating Expenses	85,875,000	76,848,000	69,068,000	65,913,000	59,984,000	52,945,000	46,560,000	42,026,000	37,261,000	33,128,000
Provision for U. S. and Foreign Income Taxes	4,715,000	1,820,000	1,990,000	2,489,000	1,172,000	919,000	1,249,000	958,000	842,000	536,000
Net Income	$ 11,264,000	$ 10,131,000	$ 9,204,000	$ 9,007,000	$ 8,437,000	$ 7,586,000	$ 6,871,000	$ 6,344,000	$ 5,431,000	$ 4,685,000
Net Income Per Share	$ 2.52	$ 2.27	$ 2.06	$ 2.02	$ 1.89	$ 1.70	$ 1.54	$ 1.42	$ 1.22	$ 1.05
Dividends Declared Per Share	$ 1.40	$ 1.25	$ 1.20	$ 1.20	$ 1.05	$ 1.00	$ .95	$ .82½	$ .63¾	$ .60
Number of Shareholders at Year End (All figures based on 4,461,058 $5 Par Value Shares)	24,055	23,366	23,814	24,665	24,335	25,341	25,111	25,302	25,366	25,642
Cash and Due from Banks	$ 266,637,000	$187,307,000	$169,151,000	$155,637,000	$124,590,000	$124,686,000	$141,080,000	$148,958,000	$131,184,000	$125,575,000
Security Investments	443,775,000	463,480,000	473,544,000	461,916,000	453,564,000	443,223,000	445,839,000	453,179,000	423,927,000	390,193,000
Loans and Discounts	172,410,000	141,505,000	85,149,000	58,426,000	39,262,000	28,996,000	24,468,000	15,650,000	11,487,000	8,029,000
Total Assets	1,020,206,000	915,179,000	876,546,000	787,844,000	732,703,000	680,115,000	667,635,000	700,136,000	629,326,000	620,963,000
Travelers Cheques and Travelers Letters of Credit Outstanding	470,127,000	421,063,000	386,389,000	365,526,000	358,703,000	337,510,000	320,297,000	304,436,000	282,832,000	259,637,000
Customers' Deposits and Credit Balances	366,491,000	337,238,000	303,538,000	286,080,000	223,842,000	215,640,000	243,049,000	266,758,000	243,054,000	222,829,000
Shareholders' Equity	$ 78,696,000	$ 68,356,000	$ 63,805,000	$ 60,102,000	$ 56,399,000	$ 52,996,000	$ 49,867,000	$ 47,178,000	$ 44,296,000	$ 41,655,000
Number of Employees at Year End:										
Domestic	5,530	4,944	5,138	5,326	5,213	4,839	4,114	4,054	3,847	3,638
Overseas	5,424	5,333	5,107	4,927	4,770	4,609	4,698	4,657	4,580	4,397
TOTAL	10,954*	10,277	10,245	10,253	9,983	9,448	8,812	8,711	8,427	8,035
Number of Offices at Year End:										
Domestic Offices	115	105	108	99	96	96	96	91	85	77
Overseas Commercial Offices	110	105	98	99	102	94	90	87	84	75
Overseas Offices at Military Bases	177	179	173	181	186	183	213	208	203	197
TOTAL	402	389	379	379	384	373	399	386	372	349
American Express Correspondents	5,921	5,902	4,631	4,551	4,541	4,465	4,478	4,399	4,351	4,267
Other American Express Selling Outlets	75,378	70,471	69,338	67,614	67,736	66,280	64,271	66,436	64,457	63,294
American Express Credit Card Service Establishments	85,580	81,989	50,676	46,982	41,455	32,183	–	–	–	–

*Including 601 employees of Wells Fargo.

"Things had never looked rosier at AMEX than they did in mid-November 1963." Traveler's checks. Charge cards. Deposits. Earnings. The stock. Everything was "growing by leaps and bounds." AMEX was a "true growth stock of prime investment quality.

But that was about to change.



Outdoing Billie Sol

How Phantom Salad Oil Was Used to Engineer $100 Million Swindle

Commodity Dealers, Storage Firms, Banks Duped at Big Tank Farm in New Jersey

What the FBI Is Uncovering

By Norman C. Miller
Staff Reporter of The Wall Street Journal

BAYONNE, N.J.—Law enforcement authorities, investigating "the case of the missing salad oil" at a vast tank storage facility here, suspect they have stumbled on a swindle that will make Billie Sol Estes' e-capades look like a kindergarten exercise. – WSJ 12/2/1963

weeks would hand up an indictment against Tino. Harbor Tank officials continued to remain out of sight; Kaufman, the president of the storage firm, entered a hospital nursing a heart condition. American Express officials remained mum, hoping some of their storage firm's missing oil might somehow turn up.

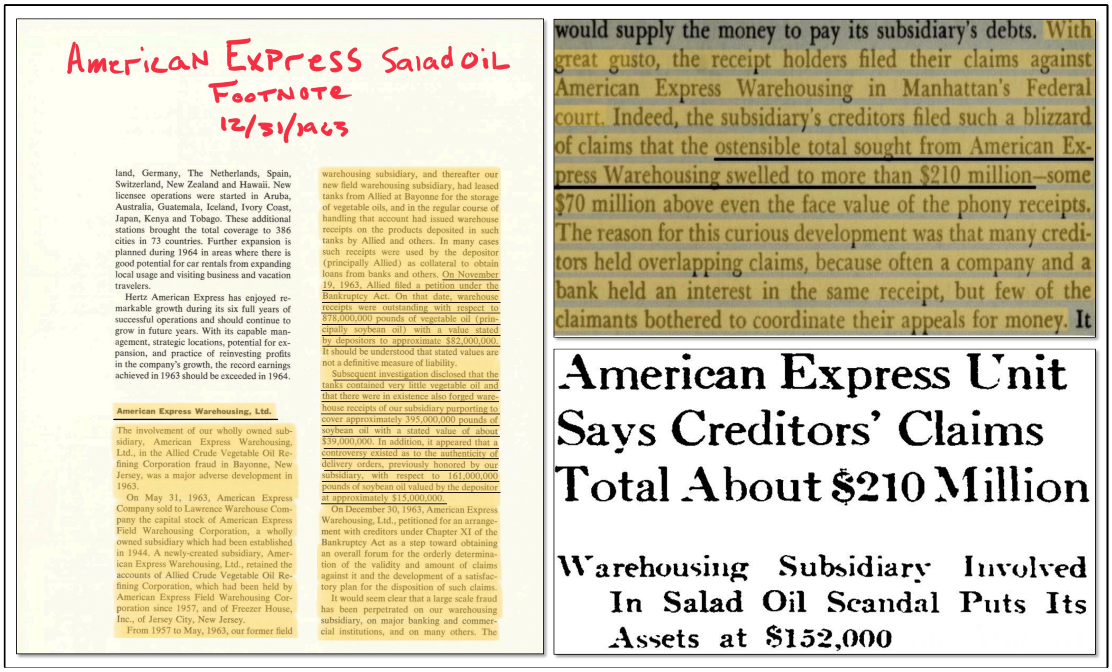
But the shortage was too immense to hush up. On December 2 *The Wall Street Journal* published a detailed exposé of the swindle and correctly reported that the missing salad oil would never be found, for a simple reason: It did not exist.

• The fifty-one companies and banks which were stuck with loans, or had deposited oil at Bayonne, against warehouse receipts issued for Tino by American Express Warehousing and Harbor Tank storage were: Amertrade, Inc., New York; Henry Ansbacher & Company, London; A. J. Amstrong, Inc., New

development in focus. During the next few months much of the confused speculation about American Express turned on two questions.

One was whether the parent company was legally obligated to pay on these claims. The question seemed to be crucial because the subsidiary itself had a net worth of only $100,000. The subsidiary was a limited-liability corporation, and so its owner, American Express Co., was technically not liable for debts exceeding what it had invested in the company. But the "corporate veil" that protects parent companies has in the past been pierced by creditors under certain circumstances—e.g., where it could be shown that the subsidiary's independence was a fiction.

On December 2, 1963, the WSJ broke a story about fraud at an AMEX subsidiary. American Express Warehousing, Ltd. issued $82M of receipts against salad oil inventory that "was either missing or had never existed." And this subsidiary had just $100K of net worth to back the claims.



It got worse.

AMEX received an additional $54M of forged and $70M of double-counted receipts. "The subsidiary's creditors filed such a blizzard of claims that the total sought from AMEX swelled to more than $210M." That $210M exceeded AMEX's $79M consolidated equity by $131M.

American Express Company
and Consolidated Subsidiary Companies

Consolidated Balance Sheet, December 31, 1963 and 1962

ASSETS	1963	1962
Cash and Due from Banks	$ 266,637,122	$187,306,540
Security Investments — At Cost (note 2):		
U. S. Government Obligations	141,208,249	102,201,433
State and Municipal Obligations	229,784,429	225,241,401
Other Bonds and Obligations	39,614,783	92,676,747
Preferred Stocks	18,968,863	19,451,610
Common Stocks	14,198,704	23,908,432
Total Security Investments (current market valuation: 1963, $450,500,000; 1962, $479,010,000)	443,775,028	463,479,623
U. S. Government Depositary Bonds (see contra) (note 2)	35,000,000	35,000,000
Loans and Discounts	172,410,264	141,505,217
Accounts Receivable and Accrued Interest (less reserves: 1963, $2,741,819; 1962, $1,714,232)	51,660,293	42,832,134
American Express Company Capital Stock Reacquired — At Cost (1963, 33,340 shares; 1962, 37,700 shares) (note 3)	1,436,565	1,627,535
Investments in Subsidiary and Affiliated Companies not Consolidated — At Cost (equity in net assets: 1963, $4,096,000; 1962, $5,654,000)	3,580,002	4,791,987
Land, Buildings and Equipment — At Cost (less reserves: 1963, $11,927,151; 1962, $10,461,370)	14,347,038	12,669,124
Customers' Acceptance Liability	18,873,203	15,225,152
Other Assets	12,486,135	10,741,415
Total	$1,020,205,650	$915,178,727
LIABILITIES		
Travelers Cheques and Travelers Letters of Credit	$ 470,126,789	$421,063,300
Customers' Deposits and Credit Balances with The American Express Company, Incorporated	366,490,835	337,237,710
Deposit Liability Relating to U. S. Government Depositary Bonds (see contra)	35,000,000	35,000,000
Acceptances Outstanding	18,903,238	15,690,404
Other Liabilities	50,989,231	37,830,871
Total	941,510,093	846,822,285
Shareholders' Equity:		
Capital Stock — Authorized, 5,000,000 shares of $5 par value; Issued 4,461,058 shares	22,305,290	22,305,290
Surplus	56,390,267	46,051,152
Total Shareholders' Equity	78,695,557	68,356,442
Total	$1,020,205,650	$915,178,727

See Notes to Financial Statements.

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The unusual status of American Express as an unincorporated company was brought into prominence by the company's involvement in the salad oil scandal triggered by the bankruptcy of Allied Crude Vegetable Oil Refining Corp., Bayonne, N.J., last November.

From a legal standpoint, the 4,461,058 shares held by the company's 24,000 stockholders are equivalent to partnership interests, and the shareholders, at least theoretically, are potentially subject to assessment for any debts the company itself can't pay.

The possibility that the parent might be liable made the second question even more intriguing. For the parent American Express Co. is not a corporation at all but a "joint stock association," one of the largest of its kind in the U.S. This means that all of its stockholders (there are now about 24,000) are like members of a partnership, and can theoretically be forced to pay any debts that exceed the company's net assets. What if the parent *were* forced to meet the claims against its subsidiary and could not raise sufficient funds to do so? Would each of those stockholders be forced to pay part of the bill?

Here's where it got really bad.

The $131M deficit was "assessable" to shareholders. Why? AMEX wasn't a C-Corp. It was a 'joint stock association' where "stockholders are like members of a partnership and can be forced to pay debts that exceed the company's net assets."


New York World-Telegram and The Sun

ALL Sports FINAL

PRESIDENT SHOT DEAD

Cut Down By Sniper In Dallas

EXTRA

President Kennedy in motorcade moving toward downtown Dallas just before he was shot.

Stunned City Find News 'Unbelievable'

Exchanges Close On Bad News

BUFFETT: American Express had this huge salad oil scandal in November 1963—right around the time [President John] Kennedy was shot. And there was real worry about whether the company would survive.

holding tanks full of nothing but worthless seawater—saw its stock plummet. The story began to hit the newspapers.

Two days later, on Friday, November 22, 1963, President John F. Kennedy was assassinated while riding in a Dallas motorcade.

Buffett was downstairs eating lunch in the Kiewit Plaza cafeteria when somebody came in with the news that Kennedy had been shot. He went back upstairs to his office and found that stocks were plunging on heavy trading. Then the exchange closed, its first emergency closing during trading since the Great Depression.[33]

As a stunned country erupted in sorrow, anger, and shame, Buffett went home to sit, along with the rest of the country, and watch the nonstop television coverage throughout the weekend.

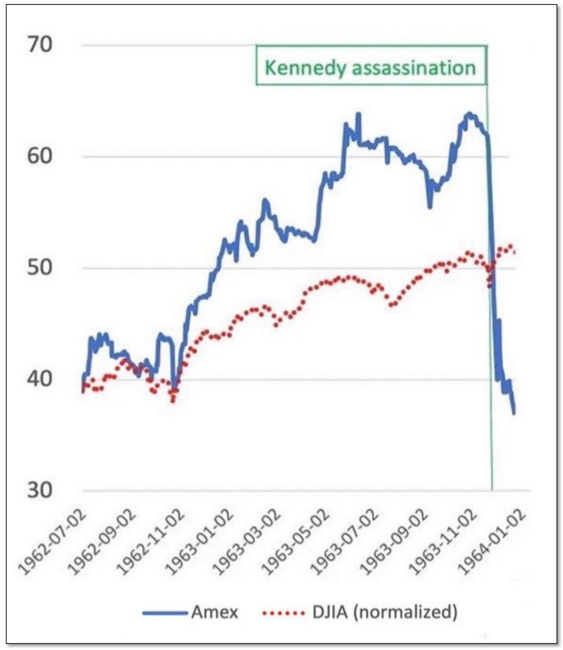
The salad oil scandal also unfolded under the cloud of President Kennedy's assassination. "A stunned country erupted in sorrow, anger and shame." "Stocks were plunging on heavy trading. Then the exchange closed, its first closing during trading since the Great Depression."

American Express had a field warehousing company which was a tiny subsidiary, with [no] capital. The field warehousing company's job was to certify that inventories existed. That was their job. They stuck their name on it, and you could take those certificates that said there was a given amount of whatever there was, and you could borrow against these certificates. Tino De Angelis had this tank farm about 15 miles from lower Manhattan. And the American Express field warehousing company authenticated the existence of salad oil in these tanks. And at one time, they were authenticating the existence of more salad oil than the Department of Agriculture, in its monthly reports, was saying existed in the United States. But they never told us of that discrepancy. Late in 1963, right at the time Kennedy was assassinated, within a day or two, the thing blew. A couple of New York Stock Exchange firms went broke – Ira Haupt, maybe one other – because they lent on these phony certificates.

And American Express, which never even thought of this little field warehousing operation, it was nothing compared to their money order, credit card, and travel checks businesses, all of a sudden, they've got this little subsidiary, not the parent company, but the subsidiary, that was on the hook for tens and tens of millions of dollars, and nobody knows how much. And that is the nice thing about fraud...

BUFFETT

There was one other little wrinkle which was terribly interesting. American Express was not a corporation. It then was the only major publicly traded security that was a joint stock association. As such, the ownership of the company was assessable. If it turned out that the liabilities were greater than the assets, [then] the ownership was assessable. So every trust department in the United States panicked. I remember the Continental Bank held over 5% of the company and all of a sudden not only do they see that the trust accounts were going to have stock worth zero, but it could get assessed. The stock just poured out, of course, and the market got slightly inefficient for a short period of time.



"Every trust department panicked." The market had closed, AMEX had "a liability of unknown and potentially huge proportions," and shareholders could "get assessed." "The stock just poured out, and the market got slightly inefficient for a short period of time."

The newspapers, of course, relegated the American Express scandal to their back inside pages for days as the dramatic headlines took precedence.[34] But Buffett went looking for it. The stock never recovered from the blow it took on Friday when the market closed, and afterward it continued to slide downhill. Investors were fleeing from the stock of one of America's most prestigious financial institutions.[35] It wasn't clear whether American Express would survive.

But the company was an emerging financial powerhouse. Half a billion dollars of its Travelers Cheques floated around the world. Its credit card, launched five years earlier, was a huge success. The company's value was its brand name. American Express sold *trust*. Had the taint to its reputation so leaked into customers' consciousness that they no longer trusted the name? Buffett started dropping in on Omaha restaurants and visiting places that took American Express cards and Travelers Cheques.[36] He put Henry Brandt on the case.

Brandt scouted Travelers Cheque users, bank tellers, restaurants, and credit-card holders to gauge how American Express was doing versus its competitors.[37] Back came the usual foot-high stack of material. Buffett's verdict after sorting through it was that customers were still happy to be associated with the name American Express. The tarnish on Wall Street had not spread to Main Street.[38]

During the months that Buffett was investigating American Express, his father's health declined precipitously. Despite hav-

BUFFETT: American Express had a very special position in people's mind about financial integrity over the years, and ubiquity of acceptance. When the banks closed in the early '30s, American Express traveler's checks actually substituted, to some extent, for bank activity during that period.

As these events were unfolding, Buffett paid a visit to Ross's Steak House in Omaha, in the same inquiring spirit as when he had earlier dropped in on the clothier Sol Parsow. On this evening, Buffett was interested not in the customers' steaks, nor in their suits or hats. He positioned himself behind the cashier, chatted with the owner, and watched. What Buffett observed was that, scandal or no, Ross's patrons were continuing to use the American Express card to pay for their dinners.[7] From this, he deduced that the same would be true in steakhouses in St. Louis, Chicago, and Birmingham.

Then he went to banks and travel agencies in Omaha and found that they were doing their usual business in traveler's checks. Similarly, he went to supermarkets and drugstores that sold American Express money orders. Finally, he talked to American Express's competitors. His sleuthing led to two conclusions, both at odds with the prevailing wisdom:

1. American Express was not going down the tubes.
2. Its name was one of the great franchises in the world.[8]

Did the business change?

Buffett checked. He visited "places that took cards and traveler's checks" and collected "reams" of data. His verdict: "The tarnish of Wall St. had not spread to Main St." AMEX's "special position in people's minds about financial integrity" survived.

WARREN BUFFETT: American Express was — had a very special position in people's mind about financial integrity over the years, and ubiquity of acceptance. When the banks closed in the early '30s, American Express traveler's checks actually substituted, to some extent, for bank activity during that period.

The worldwide acceptance of this name meant that when American Express sold traveler's checks — for many years, their two primary competitors were what are now Citicorp — First National City — and the Bank of America.

And, despite the fact that American Express charged you one percent when you bought your traveler's checks, and you had two other premier organizations, Citicorp, imagine, and BofA, and — actually, Barclays had one and Thomas Cook had one.

And American Express still had two-thirds of the market after 60 or 70 years — two-thirds of the worldwide market — while charging more for the product than these other very well-known competitors charged.

Anytime you can charge more for a product and maintain or increase market share against well-entrenched, well-known competitors, you have something very special in people's minds. Same thing came about when the credit card came around.

Originally, American Express wanted the credit card because they thought they were going to get killed on traveler's checks. And they thought it was going to be a substitute, and therefore, they had to go into — it was a defensive move.

It came about because a fellow named Ralph Schneider, and Al Bloomingdale, and a couple people came up with the Diners Club idea. And the Diners Club idea was sweeping, well, initially New York, and then the country in the mid-'50s.

And American Express got very worried because they thought, you know, people are going to use these cards. Nobody had ever heard of Visa at that point, or anything of the sort.

But people were going to use these cards instead of traveler's checks. So they backed into the traveler's check business — I mean, it backed into the credit card business.

Immediately, despite the jump the Diners Club had on the — on this business — because Diners Club had the restaurants signed up already, and they already had the high rollers carrying around their card, and nobody had an American Express card.

But American Express went in and they started charging more than Diners Club for the card, and they kept taking market share away.

Well, that is a great position to be in people's minds where they are willing to — when faced with a choice — they're willing to go with the newer product, at a higher price, and leave behind the entrenched product.

And it just showed the power of American Express. American Express had a special cache. It identified you as something special.

When you pulled out your American Express, as opposed to your Diners Club card, and as opposed to the Carte Blanche card, which was the third main competitor at the time. Visa still did not exist. And you could see this dominance prevail.

The other way in which issuers of travelers checks make a profit is by charging the customer a commission commonly 1 percent in this area. How ever, in California and other parts of the country, par value (no commission) travelers checks are becoming the accepted custom. Agents such as banks who sell others' brand name travelers checks remit a fee to the issuer. American Express costs the agent the most money, 1/3 of the 1 percent commission, whereas Citibank and Bank of American each charge 1/10 of 1 percent; others like Cooks charge nothing. When a California agent is obliged for competitive reasons to sell American Express Travelers Cheques at par, he must still pay the company.

WARREN BUFFETT: Incidentally, you'll find in this 50-year history of Berkshire, you know, American Express did wonders for us back in the 1960s. And there's a little history in there on the fact that it was an assessable stock until 1965, which nobody paid any attention to until 1963 on. But the company has an incredible history of adapting. I mean, they started out as an express company, you know, move trunks around, and valuables around. And then the railroad came around and started doing the same thing, so they went to traveler's checks as a way to — very handy way — of moving money around the world.

And then the credit card came along, Diners Club came along, in the 1950s, and that threatened the traveler's check and then they moved into the Travel and Entertainment card, as it was called then. The interesting thing is that Diners Club, who was first — Ralph Schneider and Al Bloomingdale priced their card at, as I remember, $3, and they looked like they were sewing up the market. And American Express came along and did something very interesting. They priced their card, I think, at $5, and actually established a better image.

I mean, people that pulled out their American Express card at a dinner table, they looked like J.P. Morgan. And the guy that pulled out a Diners Club card, they'd have a whole bunch of flashy things on it, he looked like a guy who was kiting his expense account or something of the sort. So you just automatically felt like a more important person with your American Express card.

That "special position" gave AMEX pricing power. Traveler's checks? AMEX charged 33bps vs the banks' 10-0bps. Card membership? AMEX charged $5 vs the incumbents' $3-0. Card acceptance? AMEX charged 4% vs a market discount rate of 3-2%.

AMEX even raised prices during the scandal.

	1963	1962	1961	1960
Income from Operations	$ 100,418,000	$ 86,771,000	$ 77,378,000	$ 74,709,000
Profit on Sales of Securities	1,436,000	2,028,000	2,884,000	2,700,000
Operating Expenses	85,875,000	76,848,000	69,068,000	65,913,000
Provision for U. S. and Foreign Income Taxes	4,715,000	1,820,000	1,990,000	2,489,000
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Net Income Per Share	$ 2.52	$ 2.27	$ 2.06	$ 2.02
Dividends Declared Per Share	$ 1.40	$ 1.25	$ 1.20	$ 1.20
Number of Shareholders at Year End (All figures based on 4,461,058 $5 Par Value Shares)	24,055	23,366	23,814	24,665
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Shareholders' Equity	$ 78,696,000	$ 68,356,000	$ 63,805,000	$ 60,102,000
Number of Employees at Year End:				
Domestic	5,530	4,944	5,138	5,326
Overseas	5,424	5,333	5,107	4,927
TOTAL	10,954*	10,277	10,245	10,253
Number of Offices at Year End:				
Domestic Offices	115	105	108	99
Overseas Commercial Offices	110	105	98	99
Overseas Offices at Military Bases	177	179	173	181
TOTAL	402	389	379	379
American Express Correspondents	5,921	5,902	4,631	4,551
Other American Express Selling Outlets	75,378	70,471	69,338	67,614
American Express Credit Card Service Establishments	85,580	81,989	50,676	46,982

*Including 601 employees of Wells Fargo.

The unsaturated float

In a way, the profits from traveler's checks are also indirect. As is well known, American Express makes nothing on the 1 percent fee charged purchasers. Nearly all of the checks are sold by agents, mostly banks, which are allowed to keep two-thirds of this fee; that leaves only 33⅓ cents per $100 of checks sold to apply to the company's clerical costs. The real profit in the operation is made by investing the huge "float" of funds generated by the traveler's check operation. On the average, a check doesn't return to the company for payment until about forty-five days after it is issued; meanwhile the company has the customer's money. Last year it apparently sold about $2.6 billion of traveler's checks—it is cagey about the precise figure—and on December 31 it had an investment portfolio of $470,127,000. The float would be

A reasonable prospect, then, is that the float will continue to grow and with it American Express' earnings from investment. The company invests conservatively: nearly half the current total is in tax-exempt state and municipal bonds, with the rest in cash, U.S. governments, corporate bonds, and preferred stocks. During the peak travel season the company also invests heavily in commercial paper and other short-term issues. There are no legal restrictions on its adding common stock to the portfolio; however, it has never done so, and Clark feels it would be unsuitable. "As a matter of policy, American Express does not invest other people's money in common stocks," he says, "because this is a demand obligation. We think it is more appropriate to invest the T.C. money in more stable, fixed-income securities." None of the float money, American Express men emphasize, will be used to pay claims in the salad-oil scandal, since it is a reserve against traveler's checks outstanding.

Best of all: AMEX had float.

Customers paid AMEX cash upfront for traveler's checks, but "a check didn't return to the company for payment until about 45 days after it was issued." During that 45-day window, AMEX invested the cash.

Float was AMEX's "real profit center."

June 16, 1964

Mr. Howard L. Clark, President
American Express Company
65 Broadway
New York, N. Y. 10006

Dear Mr. Clark:

Our Partnership has recently purchased approximately 70,000 shares of American Express stock. This purchase was made after extensive investigation among Travelers Cheque users, bank tellers, bank officers, credit card establishments, card holders and competitors in these various lines of endeavor. All confirmed that American Express' competitive vigor and preeminent trade position had not been damaged by the salad oil problem. While I am certain that management must feel at times like it is in the midst of a bottomless pit regarding the field warehousing activities, it is our feeling that three or four years from now this problem may well have added to the stature of the company in establishing standards for financial integrity and responsibility which are far beyond those of the normal commercial enterprise.

There is something a bit presumptious in offering a suggestion to management while the ink is hardly dry on the certificates representing recent purchases. I would like to respectfully suggest that perhaps a midyear letter to shareholders would be in order, stressing the points mentioned at the annual meeting which illustrated how the competitive position of the company had been maintained. I don't think the long-term shareholder is overly concerned as to the exact net dollar settlement of salad oil claims, or for that matter, the exact net earnings for the first six months (which you may very well not wish to comment on because of seasonal variations, world-wide accounting problems, etc.), but he is very interested in whether Travelers Cheques sales, card holders, card charges, foreign deposits, etc., are all maintaining the growth of the pre-salad oil days.

We have read where a shareholder has instituted suit to prevent voluntary assumption by the parent company of the subsidiary's obligation in the salad oil problem. I am a member of the Financial Analysts Federation and serve on the Corporate Information Committee. Prior to a few months ago we had no connection whatsoever with American Express Company or its stock. I would be quite willing to testify, at my own expense, to the fact that we would not have purchased our 70,000 shares of stock if we had thought the parent company was going to ignore the claims against the subsidiary because our feeling would be that the long-term value of the enterprise would be very substantially reduced. In other words, it is our judgment that American Express by making a fair and perhaps even generous offer is an enterprise that is worth very substantially more than American Express disclaiming responsibility for its subsidiaries' acts. We have backed up this viewpoint by the investment of some $2.8 million. I have no idea whether any of this is relevant to a court of law in determining whether the management is acting properly in making a settlement offer, but if it should be, let me again state my willingness to so testify.

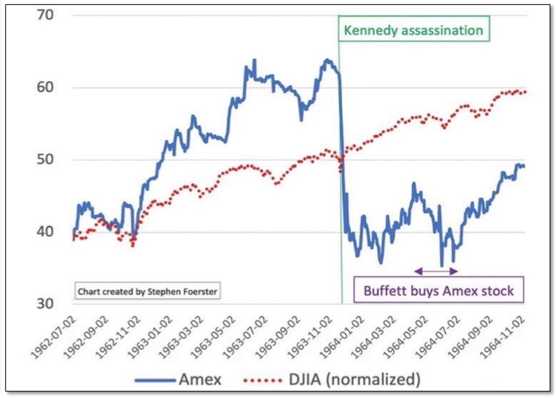
These must be trying days for you and the rest of the management. Let me assure you that the great majority of stockholders (although perhaps not the most vocal ones) think you have done an outstanding job of keeping the ship on an even keel and moving full steam ahead while being buffetted by a typhoon which largely falls in the "Act of God" category. The typhoon will pass, and I think history will show that the ship has continued to make real progress.

Cordially,

Warren E. Buffett

WEB:bf

ever seen: BPL's capital at the beginning of 1964 stood at just under $17.5 million. His own money had exploded: He was now worth $1.8 million. During Howard's last weeks, Warren began to invest in American Express, working tirelessly and methodically to get as many shares as he could without running up the price. Only five years before, he had had to scrape and scrounge to find a few tens of thousands for National American. Never had he put to work anything approaching this much money, and so fast, in his life.



Buffett bought AMEX in early 1964. He worked "tirelessly to get as much as he could," and by June he owned 70,000 shares at a $40 basis. AMEX cost $2.8M and consumed 16% of BPL's capital. "Never had he put to work anything approaching this much money, and so fast, in his life."

American Express did not have a margin of safety in the Ben Graham sense of the word, and it is unthinkable that Graham would have invested in it. The Graham canon was quite clear: a stock ought to be purchased on the basis of "simple and definite arithmetical reasoning from statistical data." In other words, on the basis of working capital, plant and equipment, and other tangible assets—stuff that one could measure.

But Buffett saw a type of asset that eluded Graham: the franchise value of American Express's name. For franchise, think: a market lock. The Cardinals own the franchise for baseball in St. Louis; no other team need apply. American Express was nearly that good. Nationally, it had 80 percent of the traveler's check market, and a dominant share in charge cards. In Buffett's opinion, nothing had shaken it, and nothing could. The loyalty of its customers could not be deduced from Graham's "simple statistical data"; it did not appear on the company's balance sheet as would a tangible asset, such as the factories of a Berkshire Hathaway. Yet there was value in this franchise—in Buffett's view, immense value. American Express had earned record profits in each of the past ten years. Salad oil or not, its customers were not going away. And the stock market was pricing the company as if they already had.

By early 1964, the shares had plunged to 35. Wall Street's chorus, all reading the same lyrics, was chanting, "Sell." Buffett decided to buy. He put close to one-quarter of his assets on that single stock—one with a liability of unknown and potentially huge proportions. If Buffett was wrong, his accumulated profits and reputation stood to go up in flames.

Buffett Partnership's American Express Investment

(in millions except per share amounts)

Share price — $2.8 million for 70,000 shares purchased from January 1963 and June 1964	$	40.00
Shares outstanding at year-end 1963		4.5
Market value	$	178
Market cap to 1963 net income ($10.3 million or $2.29 per share)		17.5
Market cap to 1964 net income ($12.4 million or $2.64 per share)		15.2
Market cap to 1963 book value ($78.7 million or $17.64 per share)		2.3
Market cap to 1964 book value ($83.6 million or $18.74 per share)		2.1
Face value of bonafide claims	$	82
Face value of counterfeit claims		54
Excess claims by creditors due to double-counting		70
Interest, accruals & other		4
Total claims presented to court in January 1964 subsidiary bankruptcy filing	$	210

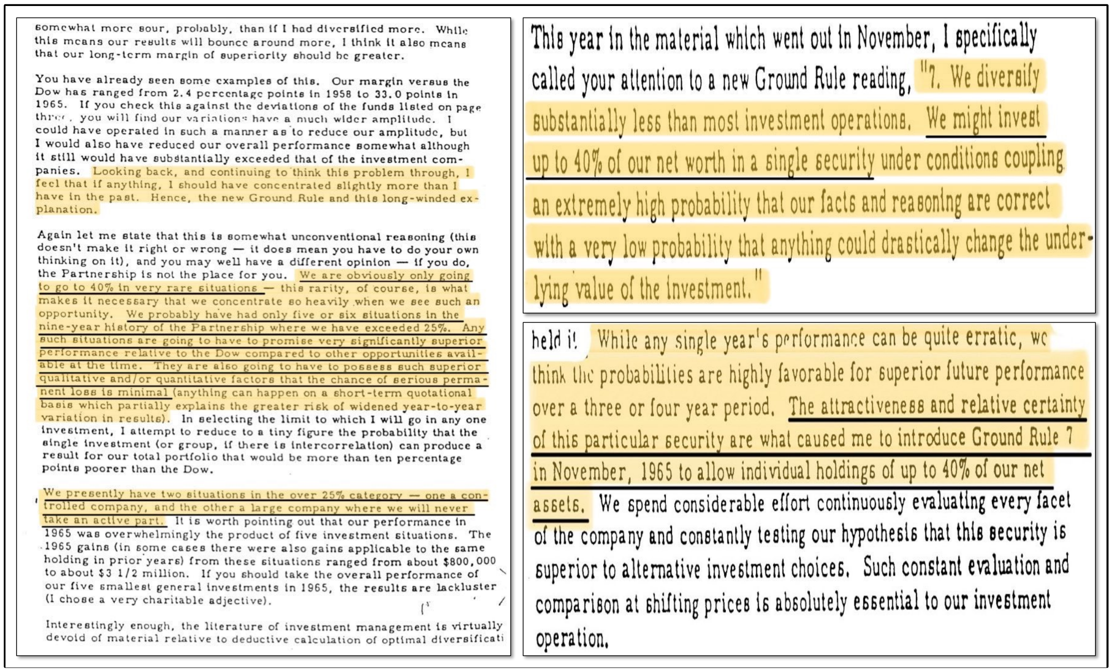
1963, devastated by a scandal involving a large quantity of nonexistent salad oil, the company saw its stock price plummet from around $60 to $34. It was hardly a Ben Graham investment situation: facing a $60 million loss, American Express effectively had no net worth. There was no Margin of Safety.

''But as far as I was concerned,'' Buffett says, ''that $60 million was a dividend they'd mailed to the stockholders, and it got lost in the mail. I mean, if they'd declared a $60 million dividend, everybody wouldn't have thought the world was going to hell.''

A careful scrutiny of the company revealed that American Express virtually owned the nation's traveler's check business and possessed by far the strongest credit card, assets that were entirely unaffected by the scandal. Together, the check and card businesses constituted an unassailable franchise - what Buffett calls ''a castle with a moat around it,'' his new Margin of Safety. A

AMEX was no Graham-like bargain.

The $40 cost was 17.5X $2.29 EPS and 2.3X $17.64 equity. And equity excluded $18 of salad oil claims. Adjusting for these claims, "AMEX had no net worth." Buffett was betting on an "asset that eluded Graham: the franchise value of AMEX's name."


somewhat more sour, probably, than if I had diversified more. While this means our results will bounce around more, I think it also means that our long-term margin of superiority should be greater.

You have already seen some examples of this. Our margin versus the Dow has ranged from 2.4 percentage points in 1958 to 33.0 points in 1965. If you check this against the deviations of the funds listed on page three, you will find our variations have a much wider amplitude. I could have operated in such a manner as to reduce our amplitude, but I would also have reduced our overall performance somewhat although it still would have substantially exceeded that of the investment companies. Looking back, and continuing to think this problem through, I feel that if anything, I should have concentrated slightly more than I have in the past. Hence, the new Ground Rule and this long-winded explanation.

Again let me state that this is somewhat unconventional reasoning (this doesn't make it right or wrong — it does mean you have to do your own thinking on it), and you may well have a different opinion — if you do, the Partnership is not the place for you. We are obviously only going to go to 40% in very rare situations — this rarity, of course, is what makes it necessary that we concentrate so heavily when we see such an opportunity. We probably have had only five or six situations in the nine-year history of the Partnership where we have exceeded 25%. Any such situations are going to have to promise very significantly superior performance relative to the Dow compared to other opportunities available at the time. They are also going to have to possess such superior qualitative and/or quantitative factors that the chance of serious permanent loss is minimal (anything can happen on a short-term quotational basis which partially explains the greater risk of widened year-to-year variation in results). In selecting the limit to which I will go in any one investment, I attempt to reduce to a tiny figure the probability that the single investment (or group, if there is intercorrelation) can produce a result for our total portfolio that would be more than ten percentage points poorer than the Dow.

We presently have two situations in the over 25% category — one a controlled company, and the other a large company where we will never take an active part. It is worth pointing out that our performance in 1965 was overwhelmingly the product of five investment situations. The 1965 gains (in some cases there were also gains applicable to the same holding in prior years) from these situations ranged from about $800,000 to about $3 1/2 million. If you should take the overall performance of our five smallest general investments in 1965, the results are lackluster (I chose a very charitable adjective).

Interestingly enough, the literature of investment management is virtually devoid of material relative to deductive calculation of optimal diversificati

This year in the material which went out in November, I specifically called your attention to a new Ground Rule reading, "7. We diversify substantially less than most investment operations. We might invest up to 40% of our net worth in a single security under conditions coupling an extremely high probability that our facts and reasoning are correct with a very low probability that anything could drastically change the underlying value of the investment."

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.

"By 1965, AMEX was almost one-third of the partnership's portfolio." But "Buffett kept buying." "The attractiveness and relative certainty" of AMEX "caused [him] to introduce Ground Rule 7 in November 1965 to allow individual holdings of up to 40% of net assets."

BERKSHIRE HATHAWAY INC.

Marketable Securities

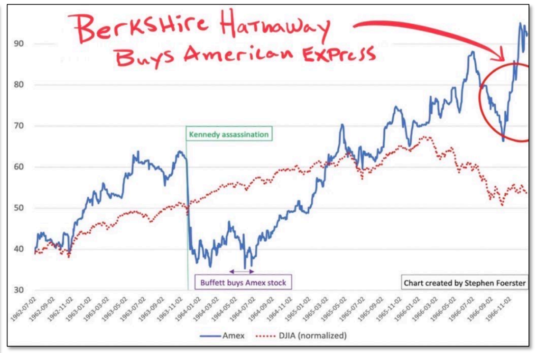
Year ended December 28, 1968

* 45K Shares After 3:1 SPLIT

Schedule I

Security	Number of shares or face value	Amount at which carried on balance sheet (cost)	Value based on current market quotations at balance sheet date
Common stocks:			
American Express Co.	45,000 *	$ 1,065,000	3,454,000
John Blair & Co.	13,400	227,880	683,000
Crompton Company	800	23,203	26,000
Disney Productions	14,498.28	290,669	1,247,000
Florida Gas Company	500	6,504	10,000
Investors Diversified Services A	40,676	1,162,456	2,191,000
Investors Diversified Services B	2,100	14,962	29,000
Massachusetts Indemnity & Life Insurance Co.	2,200	55,462	99,000
Rank Organization Ltd.	11,175	37,977	137,000
Sperry & Hutchinson Co.	57,500	1,036,209	2,429,000
Wm. Wrigley, Jr.	1,600	165,902	184,000
		4,086,224	10,489,000
Commercial paper:			
General Motors Acceptance Corporation			
Notes:			
6% due February 21, 1969	$ 1,100,000	1,087,717	1,088,000
6 1/8% due February 21, 1969	100,000	98,928	99,000
6 1/4% due February 21, 1969	150,000	148,515	148,000
		1,335,160	1,335,000
		$ 5,421,384	11,824,000

14



BERKSHIRE HATHAWAY INC.

Marketable Securities

Year ended September 30, 1967

Schedule I

Name of issuer	Number of shares	Amount at which carried on balance sheet (cost)	Value based on current market quotations at balance sheet date
American Express Company	15,000	$ 1,065,000	2,047,000
John Blair & Company	9,400	145,650	254,000
Walt Disney Productions	7,931	332,297	793,000
Florida Gas Company	500	6,504	8,000
Investors Diversified Services A	40,676	1,162,456	1,627,000
Investors Diversified Services B	2,100	14,962	21,000
Massachusetts Indemnity & Life Insurance Company	2,200	55,462	67,000
Rank Organization Ltd.	11,175	37,977	80,000
Sperry & Hutchinson Company	57,500	1,036,209	1,948,000
		$ 3,856,517	6,845,000

Then he bought AMEX for Berkshire.

In late 1966, Buffett invested $1M of Berkshire's excess cash into AMEX at $71 a share. It was one of the first stocks Buffett bought for Berkshire. And it was the company's largest holding, accounting for 28% of the portfolio.

BUFFETT: American Express Company was synonymous with financial integrity and a money substitute around the world. When Roosevelt closed the banks, he exempted American Express Traveler's Checks, so they substituted as US currency. It was not a business that should have been selling for $150 million, but everyone was terrified. It was very hard to tell how it would all come out in the end. But probably it was going to be between $60 and $100 million, and that was a lot more money back then. I just took the attitude that they declared a dividend of $75 million, sent it out and it got lost. Would that have caused a panic – if somebody else gets your dividen?

American Express Gets Clearance to Become Limited Liability Firm

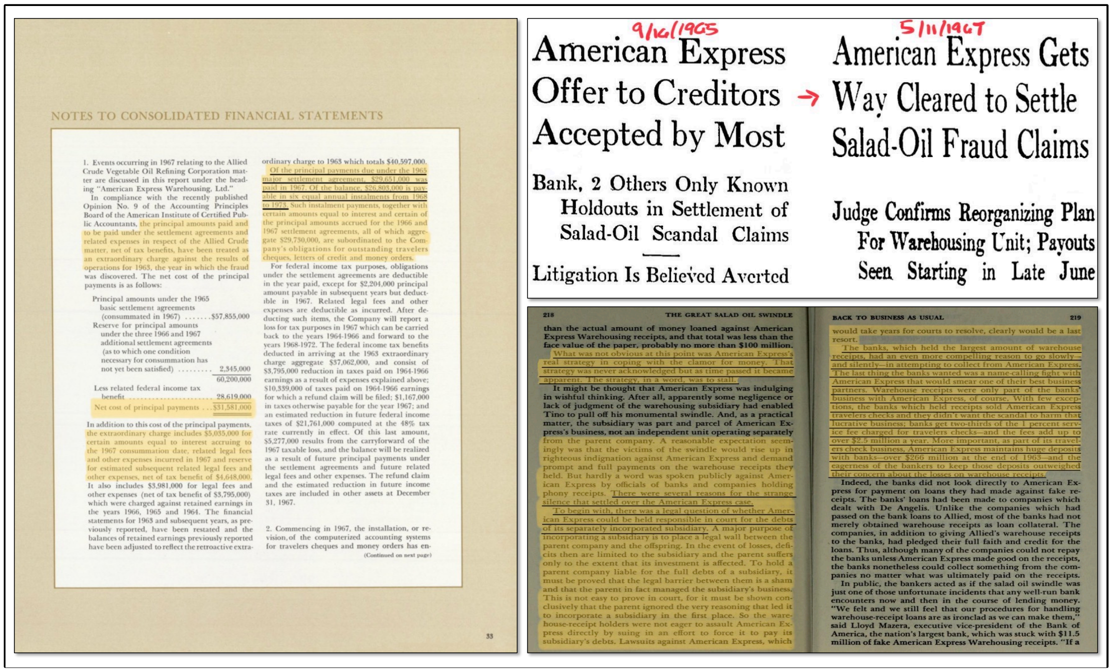
Gov. Rockefeller Signs New Law Allowing Joint Stock Groups To File Incorporation Plans

American Express Unit In Salad Oil Scandal Lists $144,570,781 Debts

Assets at Time of Filing Under Chapter 11 Placed at $368,683 Plus 'Undetermined' Amounts

What about the salad oil scandal?

Here's what happened as Buffett invested in Q1 1964: A law change ended the assessment risk; the $210M liability fell to $145M; and AMEX offered $58M to settle. Buffett said "It was hard to tell how it would end" but expected a $60-100M payment.



The actual payment: $60M ($32M after tax)

In 1965, AMEX settled with "the overwhelming majority of claimants." But the "real strategy was to stall." AMEX deferred payment to 1967, and creditors only got $30M upfront. The other $30M came "in six installments from 1968 to 1973."

	1967	1966	1965	1964
Revenue from operations	$ 219,612,000	$ 187,950,000	$ 156,273,000	$ 130,010,000
Operating expenses	192,428,000	159,943,000	132,076,000	109,911,000
Provision for U.S. and foreign income taxes	5,286,000	9,197,000	9,075,000	7,733,000
Net operating income	21,898,000	18,810,000	15,122,000	12,366,000
Per share (note 3)	4.61	3.96	3.18	2.64
Profit on sales of investment securities—net of related U.S. income taxes	724,000	430,000	221,000	221,000
Net income (before extraordinary items)	22,622,000	19,240,000	15,343,000	12,587,000
Per share (note 3)	4.76	4.05	3.23	2.69
Dividends declared per share	$ 1.40	$ 1.40	$ 1.40	$ 1.40
Number of shareholders at year end	19,835	21,070	22,629	27,673
Cash and due from banks	$ 298,332,000	$ 252,781,000	$ 225,561,000	$ 266,819,000
Security investments	730,047,000	674,712,000	639,523,000	507,757,000
Loans and discounts	322,545,000	277,348,000	232,050,000	186,638,000
Total assets	1,756,664,000	1,552,165,000	1,384,700,000	1,201,871,000
Travelers Cheques and Travelers Letters of Credit outstanding	646,826,000	605,717,000	572,458,000	525,667,000
Customers' deposits and credit balances	540,473,000	488,246,000	429,249,000	387,697,000
Shareholders' equity (restated—note 1)	93,386,000	72,479,000	59,806,000	46,374,000
Number of employees at year end:				
Domestic (including Canada and Mexico)	7,196	7,616	6,602	6,123
Overseas	6,295	6,016	5,816	5,666
TOTAL	13,491	13,632	12,418	11,789
Number of offices at year end:				
Domestic offices	112	137	132	114
Overseas commercial offices	139	131	121	114
Overseas offices at military bases	156	167	170	180
Representative offices	435	233	—	—
TOTAL	842	668	423	408
American Express correspondents	5,862	5,971	6,005	5,953
Other American Express selling outlets	91,570	87,307	84,234	83,034

$68m

$70M TOTAL Earnings

1. Adjusted in compliance with the recently published Opinion No. 9 of the Accounting Principles Board of the American Institute of Certified Public Accountants to reflect, in 1963, the warehousing settlement. See note 1 to the financial statements on page 33.

AMERICAN EXPRESS COMPANY

(in millions)

	Year ended December 31,									
	1973	1972	1971	1970	1969	1968	1967	1966	1965	1964
Net profit	151	124	103	85	75	64	22	19	15	12
total net profit	*669*	*518*	*394*	*292*	*206*	*132*	*68*	*46*	*27*	*12*
Settlement payment	5	5	5	5	5	5	30	-	-	-
Less: tax benefit	(2)	(2)	(2)	(2)	(2)	(2)	(14)	-	-	-
Net settlement payment	3	3	3	3	3	3	16	-	-	-
total net settlement payment	*32*	*29*	*26*	*24*	*21*	*18*	*16*	-	-	-

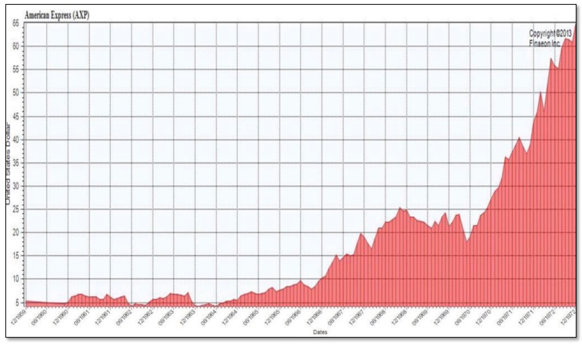
Buffett wrote that an American Express that paid the $60 million to the banks would be "worth very substantially more than American Express disclaiming responsibility for its subsidiary's acts."[1] He described the $60 million payment as inconsequential in the long run, like a dividend check that got "lost in the mail."

The stall tactic worked. AMEX's $32M after-tax cost amounted to a manageable 47% of the $68M earned by the first payment in 1967 and an "inconsequential" 5% of the $669M earned by the last payment in 1973. Buffett compared it to "a dividend check that got lost in the mail."

AMERICAN EXPRESS COMPANY

(in millions except per share amounts)

	CAGR (1967-1963)	1967	1966	1965	1964	1963	1962	1961	1960
		Year ended December 31,							
Revenues	20%	220	188	156	130	107	92	82	79
year-over-year		17%	31%	21%	18%	16%	12%	4%	11%
Operating income	17%	27	28	24	20	15	10	8	9
operating margin		12%	15%	15%	15%	14%	11%	10%	11%
Net income	21%	22	19	15	12	10	9	7	7
Shares outstanding	2%	4.8	4.8	4.8	4.7	4.5	4.5	4.5	4.5
Net income per share	19%	4.61	3.96	3.18	2.64	2.29	1.92	1.57	1.57
Dividends per share	0%	1.40	1.40	1.40	1.40	1.40	1.25	1.20	1.20
payout ratio		30%	35%	44%	53%	61%	65%	76%	76%
yield to lows		1.6%	2.1%	2.9%	4.0%	3.9%	3.7%	2.5%	3.1%
Return on beginning shareholders' equity		21%	21%	19%	16%	16%	16%	15%	16%
Share price — high		189.00	94.50	74.75	50.00	62.38	61.75	62.50	55.25
Share price — low		89.25	66.13	48.75	34.63	35.63	33.50	47.50	38.25
Market cap — high		898	449	355	234	278	276	279	246
Market cap — low		424	314	232	162	159	150	212	171
Shareholders' equity		93	109	94	84	79	68	64	60
shareholders' equity per share		19.66	22.97	19.74	17.85	17.66	15.30	14.28	13.48
P / E — high		41.0	23.9	23.5	18.9	27.2	32.2	39.8	35.2
P / E — low		19.4	16.7	15.3	13.1	15.6	17.4	30.3	24.4
P / B — high		9.6	4.1	3.8	2.8	3.5	4.0	4.4	4.1
P / B — low		4.5	2.9	2.5	1.9	2.0	2.2	3.3	2.8



NIFTY FIFTY

3M	Burroughs	General Electric	Louisiana Land	Revlon
American Express	Chesebrough Ponds	Gillette	Lubrizol	Schering
AHP	Coca-Cola	Halliburton	McDonald's	Schlitz
AHS	DEC	Heublein	Merck	Schlumberger
AMP	Disney	IBM	MGIC	Sears
Anheuser-Busch	Dow Chemical	IFF	Pepsi	Simplicity Patterns
Avon	Eastman Kodak	ITT	Pfizer	Squibb
Baxter	Eli Lilly	JC Penney	Philip Morris	Texas Instruments
Black & Decker	Emery	J&J	Polaroid	Upjohn
Bristol-Myers	First National City	Kresge	Procter & Gamble	Xerox

The long-term impact of the salad oil scandal?

As Buffett predicted, it "added to the stature of the company." Post-scandal EPS growth improved from low- to high-teens, and AMEX joined the NIFTY FIFTY list of most highly-valued stocks.

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. A

AMERICAN EXPRESS COMPANY

	CAGR (1968-1964)	Sale *(1H 1968)*	Purchase *(1H 1964)*
Earnings per share	*19%*	4.61	2.29
Multiple	*26%*	43.4	17.5
Share price	*50%*	200.00	40.00
Multiple of invested capital			5.00
Dividends to invested capital			0.14

**For shares held from 1H 1964 to 1H 1968.*

BUFFETT: Truth is, we've made a couple of our greatest investments where people have made similar errors. We bought our American Express stock — that was the best investment I ever made in my partnership years — we bought our American Express stock in 1964 because somebody was incented to do the wrong thing in something called the American Express Field Warehousing Company.

By early 1968, AMEX's EPS doubled from $2.29 to $4.61 and its multiple expanded from 17.5X to 43.4X. Buffett's $40 stock was now worth $200. Over four years, AMEX compounded at 50% and produced a 5X return. "It was the best investment [Buffett] ever made for [his] partnership."

Sources

- The Great Salad Oil Swindle (Norman Miller)
- The Snowball (Alice Schroeder)
- Buffett (Roger Lowenstein)
- The Future of American Express (Edmund Faltermayer)
- Foreign Travel Boom (Heinz Biel)

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