Shareholder Letters: Accounting Themes

Book value vs. intrinsic value

Berkshire letters: 1992, 1994, 2018

Jaeyoon Yu, Ph.D.
Central Michigan University

What the Letter Says

> *“The annual change in Berkshire’s book value … is a metric that has lost the relevance it once had.”*
>
> Warren E. Buffett, 2018 letter

- Key letters: 1992, 1994, 2018
- Course fit: ACC250 Ch2, Ch11 · ACC531 — · Difficulty: Intro

Step 1: Book Value per Share

	Amount
Total stockholders' equity	$600M
÷ Shares outstanding	2M
Book value per share	$300

- Book value = assets − liabilities, as recorded on the balance sheet.

Step 2: Why Value Can Differ from Book

- Assets are recorded at **historical cost**.
- Internally built value (brands, customer loyalty) is **not recorded**.

EX. Land bought in 1970 for $10 is worth $200 today; the balance sheet still shows $10.

Step 3: Intrinsic Value

- **Intrinsic value**: the present value of the cash a business will produce in the future.
- An estimate, not a recorded number → two people can disagree.

Back to the Letter

- Buffett (1994): book value is “a rough, albeit significantly understated, tracking measure” of intrinsic value.
- Buffett (2018): book value “has lost the relevance it once had” → dropped as the headline measure.

Questions

1. Total stockholders' equity is $600 million and 2 million shares are outstanding. What is book value per share ($)?
2. Why can intrinsic value be far above book value?

   A. Book value includes market prices of all assets

   B. Liabilities are ignored in book value

   C. Book value is measured in future dollars

   D. Assets are mostly recorded at historical cost, and internally built value (brands, goodwill) is not recorded

Sources

- Warren E. Buffett, 1992 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 1994 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 2018 letter (berkshirehathaway.com/letters)
- Reading packet and question sheet for this theme

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