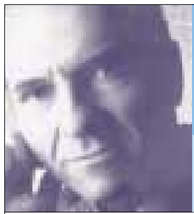


Ed Thorp

A MATHEMATICIAN ON WALL STREET

Berkshire Hathaway

From a cigar butt to a humidor full of Havanas, courtesy of Mr Buffett

The Gerards invited my wife Vivian and I to dinner with Warren and his charming blonde wife Susie. She told us about how Warren was helping her with her ambition to be a night club singer, which she later achieved. (Tragically, she recently died unexpectedly.) Impressed by Warren's mind and his methods, as well as how far he'd already come, I told Vivian that he would eventually become the richest man in America. This happened for a few months in the 1990s until he was passed by Bill Gates and, later, a few other dot.comers. He's now the second richest man in the world, close behind his friend Bill Gates. A mutual friend talked recently with Warren, who spoke warmly of our meetings, of *Beat the Dealer* and *Beat the Market*, and of non-transitive dice. Evidently the Gerards liked what they heard from Warren for they invested with me for the rest of their lives.

Ralph Gerard gave me copies of Buffett's letters to his partners and his partnership document, a simple two page affair. It was clear to me from this that I should pool my investing for myself and others into a limited partnership, or hedge fund, as Warren had done. Then I'd only have one account to manage and could spend more time investing, rather than on tedious accounting and administration.

In November 1969 I and Jay Regan launched the first market neutral derivatives hedge fund, Princeton Newport Partners. The Gerards joined and we happily compounded. In his letter to partners of October 9th, 1969, Buffett outlined the windup of BPL (Buffett Partners Limited). Partners would get a payout consisting of at least 56 per cent cash, possibly some scraps of stock in assorted companies, and an estimated 30 per cent to 35 per cent "if you dispose of them" in two companies, Diversified Retailing Company, Inc. and a troubled New England textile company called Berkshire Hathaway, Inc. "I expect a breakeven performance ... for 1969. We were lucky." The largest part of the letter was spent strongly recommending Bill Ruane as a manager. He added the discouraging "For the first time in my investment lifetime, I now believe there is little choice for the average investor between professionally managed money in stocks and passive investment in bonds."

As I reread Buffett's letter today I see no clue now, nor did I then, that Berkshire Hathaway would become Warren's investment vehicle. Gerard, who was close to Buffett, never did either. Buffett had about $100 million to distribute to partners, about $25 million of which was his, as I recall. He ended up with nearly half of Berkshire.

Berkshire was what Buffett and Benjamin Graham called a "cigar butt" – you can pick it up cheaply and get one last puff. As *Forbes* said in 1990, "[Buffett] Bought Berkshire Hathaway textile mills 1965 ($12/share), dissolved partnership 1969 after thirty fold growth, decided to use Berkshire Hathaway as prime investment vehicle. Textile business floundered (ceased operations in 1985) but investment business boomed."

In 1974 Gerard passed away. You can read about his remarkable scientific aptitude and career on The National Academics Press website www.nap.edu/books, in *Biographical Memoirs* v.53 (1982), National Academy of Sciences. His wife

Leona ("Frosty") survived him for several years. When she passed away, part of their Princeton Newport investment went to support UCI. Then in 1983, although focused on Princeton Newport, I heard about the remarkable growth of a company called Berkshire Hathaway. Having closed 1969 at $42 a share, it was now trading at over $900. I knew at once what it meant. The "cigar butt" had become a humidor of Havanas. Despite it having increased by a multiple of more than 23 in 14 years, I made my first purchase at $982.50 a share and continued to accumulate stock. In a recent conversation with a bank president in San Francisco, he mentioned that his mother was a limited partner in BPL and held Berkshire when BPL closed. That's wonderful, I said. At today's prices ($80,000 a share or so) she must be very rich. Sadly, he said, she sold at $79 for a several hundred percent profit.

The fortune teller

If asked for advice, I recommended the stock to savvy family, friends and associates with the understanding that it was a long term holding with a possibly volatile future. I didn't want to suggest it to those who couldn't understand the reasoning behind the purchase and who would likely be scared out by a big down fluctuation. Since I don't have the inclination to become an expert "stock picker," this is the only stock I have recommended during the last 35 years.

In 1985 our divorced house cleaner, Carolyn, got $6,000 as a settlement from an automobile accident. She wanted to invest it to send her children, ages 5 and 6, through college. Week after week she pleaded with me to advise her, but as she knew absolutely nothing about securities or investing, I declined. Urged on by her fortune teller, who told her that I would double or even triple her money for her, she persisted. In a weak moment I relented, provided that she would buy the stock I recommended and never sell unless she first checked with me. I arranged very low commissions for her, as a favor to me by a broker friend, and she bought two shares of Berkshire Hathaway (BRK) for $2,500 each. She moved and we lost touch with her. Meanwhile BRK rose to about $5,000 a share just before the October 1987 crash. I learned later from the broker that Carolyn had sold near the post crash bottom at $2,600 a share.

The annual meeting

In the first quarter of 2003, the stock ranged between about $60,000 and $74,000 a share. The small annual shareholder meetings of thirty years earlier had grown into a huge multi-day celebration featuring "Berkshire millionaires" and informally known as "Woodstock for capitalists." My wife and I, our oldest daughter Raun and her husband Brian, their seven year old daughter, Ava, and my son Jeff decided, at Jeff's suggestion, to go to the May 2003 annual meeting held, as always, in Warren's hometown of Omaha, Nebraska. I wrote Warren ahead of time mentioning that we were coming and that seven year old Ava, also a shareholder, had some questions for him. Although we hadn't been in contact since 1969 he remembered our meetings fondly and accurately and said in his letter to tell Ava that he would "bone up" so he'd be ready for her questions.

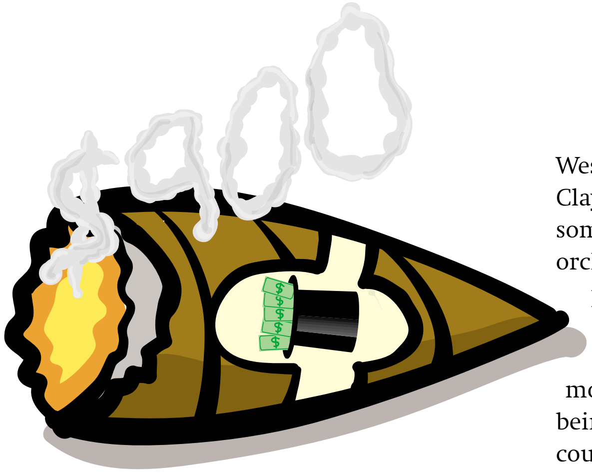
Omaha turned out to be a surprising treat. A Midwest town that had peaked early in the last century, it now had migrated out to suburbs, leaving a fairly quiet and spacious downtown. The shareholder's meeting was on a Saturday morning and we flew in the previous Thursday, expecting to leave, variously, on Sunday and Monday.

We began by sampling from the array of Berkshire Companies including Dairy Queen (a chain of ice cream confection stores), Borsheim's jewelry (the largest independent jewelry store) and its special "annual meeting weekend" rates for shareholders, Nebraska Furniture Mart (the largest independent furniture store), and of course, See's Candy, a California favorite.. Every Berkshire company employee we encountered – and they were many and diverse – seemed competent, courteous and well trained, a remarkable fact, the learning of which in itself (considering our stake) made the trip worthwhile. Friday night we went to Gorat's Steakhouse, Buffett's favorite, and had a large and delicious T-bone with trimmings for... $18.95. Buffett and his partner, Charlie Munger, were scheduled to eat there Saturday night at a special shareholder's dinner, so we booked that too – nearly impossible (but my son Jeff figured out how).

The shareholder's meeting began at 7:30 a.m. with a video for the early arrivals. We slept in and ambled over to the Omaha Civic auditorium just before 9:30, when Warren and Charlie would take the stage. On the way we passed several incoherently screaming protesters – a first? – wearing signs accusing Warren and the company of supporting infanticide. They displayed horrible and bloody photos of aborted fetuses and incorrectly accused the company of being pro abortion. The ironic consequences are reported below.

We found a crowd of 14,000 filling the Omaha Civic Auditorium and were sent to join 2,000 more in an overflow room. We listened to Warren and Charlie (on a big screen TV) present a cogent concise account of Berkshire's last year and then answer questions from all comers. There were ten microphone stations with long signup lists at each. Ava was ninth at the shortest list we could find. After an hour, the pace of the questions and answers made it evident that she had no chance of ever asking her questions. On the way out we visited the extensive product exhibits by various Berkshire companies. Berkshire has evolved from the simple stock picking days of the 1960s into a conglomerate with three major parts. First there are common stock holdings in major companies like Coca Cola, Gillette and the *Washington Post*. Second there are wholly owned or controlled companies like

Berkshire was what Buffett and Benjamin Graham called a "cigar butt" – you can pick it up cheaply and get one last puff



As a first year student Charlie was said to have regularly intimidated professors in the classroom. While autographing my menu, Charlie said (perhaps sadly) "That was a long time ago . . . a long time ago."

Wesco Finance, World Book Encyclopedia and Clayton Homes. The 2003 annual report lists some 66 of these, with 172,000 employees, orchestrated by Warren and Charlie from a corporate office that has "swollen" to 15.8 employees. Third and perhaps most important, is the insurance segment consisting mostly of GEICO and General Re (currently being investigated for deals with A.I.G.). You could buy See's Candy, sets of encyclopedias, and for $8 have your picture taken with a cardboard cutout of Warren. As my wife Vivian said, they're not giving anything away.

We headed for lunch and the NetJets exhibit at the local airport. Saturday night we were back at Gorat's! The price of the T-bone dinner we had Friday was, as a "special for shareholders," now $3 more! Charlie Munger reluctantly "worked" the room we were in and I mentioned to him a tale I'd heard about his youth. Charlie had gone to Harvard Law School and, when a friend of mine got his degree there a few years later, he found that Charlie was a legend – with many saying he was the smartest person ever to have attended. As a first year student Charlie was said to have regularly intimidated professors in the classroom. While autographing my menu, Charlie said (perhaps sadly) "That was a long time ago ... a long time ago."

Tornado time

Sunday we visited Omaha's fine art museum, which was featuring a spectacular photographic exhibit by Warren's son Howard. Also interesting was the zoo, which had two large and distinct domed walk-through habitats. Sunday afternoon the tornado warning sirens sounded and everyone in the hotel was directed to the basement of the gym. I worked out on some of the machines while my adventurous son-in-law Brian went to the fourth floor and looked outside. He saw the horizontal counterweighted arms of multistory construction cranes spinning freely on their vertical supports. This was to protect them from being demolished by the torque of the tornado. Alternating waves of lower and higher pressure caused the coke in his hand to repeatedly fizz excessively, then not at all. The tornado wandered randomly through town doing minor sporadic damage. A region of mid-America from Omaha to Dallas is the tornado belt, where an average of 80 tornados a year, more than anywhere else in the world, terrorize residents. Our tornado was accompanied by others in the surrounding areas.

Many flights out of Omaha including the one to Los Angeles for our daughter's family were cancelled. With perhaps 30,000 people who had come for the Berkshire weekend wanting to leave as soon as possible, it looked like they would be delayed a couple of days. We had a family conference and within an hour our son Jeff had a chartered private jet for us. The next morning we took a ten minute ride to the local airport and boarded our 13 seat G3 in minutes – no wait, no lines, no luggage hassle, no TSA body scans and searches. We had two engines, two pilots, a stewardess and a good lunch. Seven year old Ava was overjoyed and spoke for everyone when she declared she never wanted to fly any other way again. Whereas it took ten hours to go to Omaha, with hours of delay in Dallas due to thunderstorms, and travel and early check-in at the airport, it took just two hours returning.

The charitable contribution program

For many years Berkshire had a shareholder directed charitable contribution program. Each year Berkshire allowed each A shareholder to donate $X per share, where $X was $1 a share in the early days and gradually increased to something like $18 a share. Shareholders allocated their allowed amounts to charities they chose and Berkshire sent the money. As a result of the anti-abortion protests and the boycott of a Berkshire company, the program was discontinued. Ironically, since shareholders supported very diverse charities, the anti-abortion protesters succeeded in eliminating many contributions to organizations they would have supported. As Buffett said in the 2003 Annual Report, "Over the years we disbursed $197 million ... churches were the most frequently named ... ."

REFERENCE

Forbes 400, October 22, 1990 page 122.