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# The Security I Like Best

WARREN E. BUFFETT

Buffett-Falk & Co., Omaha, Nebr.

**Government Employees Insurance Co.**

Full employment, boomtime profits and record dividend payments do not set the stage for depressed security prices. Most industries have been riding this wave of prosperity during the past five years with few ripples to disturb the tide.

Warren E. Buffett

The auto insurance business has not shared in the boom. After the staggering losses of the immediate postwar period, the situation began to right itself in 1949. In 1950, stock casualty companies again took it on the chin with underwriting experience the second worst in 15 years. The recent earnings reports of casualty companies, particularly those with the bulk of writings in auto lines, have diverted bull market enthusiasm from their stocks. On the basis of normal earning power and asset factors, many of these stocks appear undervalued.

The nature of the industry is such as to ease cyclical bumps. Auto insurance is regarded as a necessity by the majority of purchasers. Contracts must be renewed yearly at rates based upon experience. The lag of rates behind costs, although detrimental in a period of rising prices as has characterized the 1945-1951 period, should prove beneficial if deflationary forces should be set in action.

Other industry advantages include lack of inventory, collection, labor and raw material problems. The hazard of product obsolescence and related equipment obsolescence is also absent.

Government Employees Insurance Corporation was organized in the mid-30's to provide complete auto insurance on a nationwide basis to an eligible class including: (1) Federal, State and municipal government employees; (2) active and reserve commissioned officers and the first three pay grades of non-commissioned officers of the Armed Forces; (3) veterans who were eligible when on active duty; (4) former policyholders; (5) faculty members of universities, colleges and schools; (6) government contractor employees engaged in defense work exclusively, and (7) stockholders.

The company has no agents or branch offices. As a result, policyholders receive standard auto insurance policies at premium discounts running as high as 30% off manual rates. Claims are handled promptly through approximately 500 representatives throughout the country.

The term "growth company" has been applied with abandon during the past few years to companies whose sales increases represented little more than inflation of prices and general easing of business competition. GEICO qualifies as a legitimate growth company based upon the following record:

| Year— | Premiums Written | Policyholders |
|---|---|---|
| 1936 | $103,696.31 | 3,754 |
| 1940 | 768,057.86 | 25,514 |
| 1945 | 1,638,562.09 | 51,697 |
| 1950 | 8,016,975.79 | 143,944 |

Of course the investor of today does not profit from yesterday's growth. In GEICO's case, there is reason to believe the major portion of growth lies ahead. Prior to 1950, the company was only licensed in 15 of 50 jurisdictions including D. C. and Hawaii. At the beginning of the year there were less than 3,000 policyholders in New York State. Yet 25% saved on an insurance bill of $125 in New York should look bigger to the prospect than the 25% saved on the $50 rate in more sparsely settled regions.

As cost competition increases in importance during times of recession, GEICO's rate attraction should become even more effective in diverting business from the brother-in-law. With insurance rates moving higher due to inflation, the 25% spread in rates becomes wider in terms of dollars and cents.

There is no pressure from agents to accept questionable applicants or renew poor risks. In States where the rate structure is inadequate, new promotion may be halted.

Probably the biggest attraction of GEICO is the profit margin advantage it enjoys. The ratio of underwriting profit to premiums earned in 1949 was 27.5% for GEICO as compared to 6.7% for the 135 stock casualty and surety companies summarized by Best's. As experience turned for the worse in 1950, Best's aggregate's profit margin dropped to 3.0% and GEICO's dropped to 18.0%. GEICO does not write all casualty lines; however, bodily injury and property damage, both important lines for GEICO, were among the least profitable lines. GEICO also does a large amount of collision writing, which was a profitable line in 1950.

During the first half of 1951, practically all insurers operated in the red on casualty lines with bodily injury and property damage among the most unprofitable. Whereas GEICO's profit margin was cut to slightly above 9%, Massachusett's Bonding & Insurance showed a 16% loss, New Amsterdam Casualty an 8% loss, Standard Accident Insurance a 9% loss, etc.

Because of the rapid growth of GEICO, cash dividends have had to remain low. Stock dividends and a 25-for-1 split increased the outstanding shares from 3,000 on June 1, 1948, to 250,000 on Nov. 10, 1951. Valuable rights to subscribe to stock of affiliated companies have also been issued.

Benjamin Graham has been Chairman of the Board since his investment trust acquired and distributed a large block of the stock in 1948. Leo Goodwin, who has guided GEICO's growth since inception, is the able President. At the end of 1950, the 10 members of the Board of Directors owned approximately one-third of the outstanding stock.

Earnings in 1950 amounted to $3.92 as contrasted to $4.71 on the smaller amount of business in 1949. These figures include no allowance for the increase in the unearned premium reserve which was substantial in both years. Earnings in 1951 will be lower than 1950, but the wave of rate increases during the past summer should evidence themselves in 1952 earnings. Investment income quadrupled between 1947 and 1950, reflecting the growth of the company's assets.

At the present price of about eight times the earnings of 1950, a poor year for the industry, it appears that no price is being paid for the tremendous growth potential of the company.

*This is part of a continuous forum appearing in the "Chronicle," in which each week, a different group of experts in the investment and advisory field from all sections of the country participate and give their reasons for favoring a particular security.*

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# The Security I Like Best

**A continuous forum in which, each week, a different group of experts in the investment and advisory field from all sections of the country participate and give their reasons for favoring a particular security.**

(The articles contained in this forum are not intended to be, nor are they to be regarded, as an offer to sell the securities discussed.)

This Week's Forum Participants and Their Selections

Western Insurance Securities Co. — Warren E. Buffett, Buffett-Falk & Co., Omaha, Neb. (P. 2)

Lloydminster Development Co., Ltd. — J. P. O'Rourke, J. P. O'Rourke & Co., Chicago, Ill. (Page 43)

WARREN E. BUFFETT
Buffett-Falk & Co., Omaha, Nebr.

**Western Insurance Securities Common Stock**

Again my favorite security is the equity stock of a young, rapidly growing and ably managed insurance company. Although Government Employees Insurance Co., my selection of 15 months ago, has had a price rise of more than 100%, it still appears very attractive as a vehicle for long-term capital growth.

Warren E. Buffett

Rarely is an investor offered the opportunity to participate in the growth of two excellently managed and expanding insurance companies on the grossly undervalued basis which appears possible in the case of the Western Insurance Securities Company. The two operating subsidiaries, Western Casualty & Surety, and Western Fire, wrote a premium volume of $26,009,929 in 1952 on consolidated admitted assets of $29,590,142. Now licensed in 38 states, their impressive growth record, both absolutely and relative to the industry, is summarized in Table I below.

Western Insurance Securities owns 92% of Western Casualty and Surety, which in turn owns 99.95% of Western Fire Insurance. Other assets of Western Insurance Securities are minor, consisting of approximately $180,000 in net quick assets. The capitalization consists of 7,000 shares of $100 par 6% preferred, callable at $125; 35,000 shares of Class A preferred, callable at $60, which is entitled to a $2.50 regular dividend and participates further up to a maximum total of $4 per share; and 50,000 shares of common stock. The arrears on the Class A presently amount to $36.75.

The management headed by Ray DuBoc is of the highest grade. Mr. DuBoc has ably steered the company since its inception in 1924 and has a reputation in the insurance industry of being a man of outstanding integrity and ability. The second tier of executives is also of top caliber.

During the formative years of the company, senior charges were out of line with the earning power of the enterprise. The reader can clearly perceive why the same senior charges that caused such great difficulty when premium volume ranged about the $3,000,000 mark would cause little trouble upon the attainment of premium volume in excess of $26,000,000.

Adjusting for only 25% of the increase in the unearned premium reserve, earnings of $1,367,063 in 1952, a very depressed year for auto insurers, were sufficient to cover total senior charges of $129,500 more than 10 times over, leaving earnings of $24.74 on each share of common stock.

It is quite evident that the common stock has finally arrived, although investors do not appear to realize it since the stock is quoted at less than twice earnings and at a discount of approximately 55% from the December 31, 1952, book value of $86.26 per share. Table II indicates the postwar record of earnings and dramatically illustrates the benefits being realized by the common stock because of the expanded earnings base. The book value is calculated with allowance for a 25% equity in the unearned premium reserve and is after allowance for call price plus arrears on the preferreds:

Since Western has achieved such an excellent record in increasing its industry share of premium volume, the reader may well wonder whether underwriting standards have been compromised. This is definitely not the case. During the past ten years Western's operating ratios have proved quite superior to the average multiple line company. The combined loss and expense ratios for the two Western companies as reported by the Alfred M. Best Co. on a case basis are compared in Table III with similar ratios for all stock fire and casualty companies:

The careful reader will not overlook the possibility that Western's superior performance has been due to a concentration of writings in unusually profitable lines. Actually the reverse is true. Although represented in all major lines, Western is still primarily an automobile insurer with 60% of its volume derived from auto lines. Since automobile underwriting has proven generally unsatisfactory in the postwar period, and particularly so in the last three years, Western's experience was even more favorable relative to the industry than the tabular comparison would indicate.

Western has always maintained ample loss reserves on unsettled claims. Underwriting results in the postwar period have shown Western to be over-reserved at the end of each year. Triennial examinations conducted by the insurance commissioners have confirmed these findings.

Turning to their investment picture, we of course find a growth in invested assets and investment income paralleling the growth in premium volume. Consolidated net assets have risen from $5,154,367 in 1940 to their present level of $29,590,142. Western follows an extremely conservative investment policy, relying upon growth in premium volume for expansion in investment income. Of the year-end portfolio of $21,889,243, governments plus a list of well diversified high quality municipals total $20,141,246 or 92% and stocks only $1,747,997 or 8%. Net investment income of $474,472 in 1952 was equal to $6.14 per share of Western Insurance common after minority interest and assuming senior charges were covered entirely from investment income.

The casualty insurance industry during the past several years has suffered staggering losses on automobile insurance lines. This trend was sharply reversed during late 1952. Substantial rate increases in 1951 and 1952 are being brought to bear on underwriting results with increasing force as policies are renewed at much higher premiums. Earnings within the casualty industry are expected to be on a very satisfactory basis in 1953 and 1954.

Western, while operating very profitably during the entire trying period, may be expected to reoort increased earnings as a result of expanding premium volume, increased assets, and the higher rate structure. An earned premium volume of $30,000,000 may be conservatively expected by 1954. Normal earning power on this volume should average about $30.00 per share, with investment income contributing approximately $8.40 per share after deducting all senior charges from investment income.

The patient investor in Western Insurance common can be reasonably assured of a tangible acknowledgement of his enormously strengthened equity position. It is well to bear in mind that the operating companies have expanded premium volume some 550% in the last 12 years. This has required an increase in surplus of 350% and consequently restricted the payment of dividends. Recent dividend increases by Western Casualty should pave the way for more prompt payment on arrearages. Any leveling off of premium volume will permit more liberal dividends while a continuation of the past rate of increase, which in my opinion is very unlikely, would of course make for much greater earnings.

Operating in a stable industry with an excellent record of growth and profitability, I believe Western Insurance common to be an outstanding vehicle for substantial capital appreciation at its present price of about 40. The stock is traded over-the-counter.

*Continued on page 43*

**TABLE I**

| Years— | Average Premium Volume Western Insurance | Percent of Total Stock Fire & Casualty Premiums |
|---|---|---|
| 1924-30 | $838,860 | |
| 1931-35 | 2,667,003 | 0.05% |
| 1936-40 | 3,955,403 | 0.20 |
| 1941-45 | 5,023,219 | 0.25 |
| 1946-50 | 13,959,506 | 0.24 |
| 1951 | 22,055,001 | 0.33 |
| 1952 | 26,006,929 | 0.38 |
| | | 0.41 (Est.) |

**TABLE II**

| Year | Common Stock Earnings | Asset Value |
|---|---|---|
| 1948 | $20.08 | |
| 1949 | 21.66 | ($0.41) |
| 1950 | 23.64 | 21.25 |
| 1951 | 16.61 | 44.90 |
| 1952 | 24.74 | 61.50 |
| | | 86.26 |

**TABLE III**

| Year | Industry | Western Fire | Western Casualty |
|---|---|---|---|
| 1948 | 91.2% | 90.1% | |
| 1949 | 87.6% | 84.2% | 74.6% |
| 1950 | 93.0% | 85.6% | 92.4% |
| 1951 | 97.1% | 91.2% | 90.7% |
| 1952 | 94.0% (Est.) | 91.8% | 101.1% |
| | | | 96.7% |
| Average | 92.6% | 88.6% | 91.1% |

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holders. The corresponding net asset value on June 30, 1952, the end of the corporation's previous fiscal year, was $71.57 per share.

The net ordinary income for the nine months ended March 31, 1953, amounted to $3,206,680, as compared with $3,341,133 in the corresponding period of the previous year. Net realized profit on investments at the end of the same period amounted to $4,861,144, compared to $3,971,569 for the corresponding period of the previous year.

During the three-month period, the corporation purchased stocks at a total cost of $2,035,103, as against total proceeds from securities sold of $2,176,248. The corporation's U. S. Bond and Cash and Receivables amounted to $18,-553,385, or 12.4% of net assets on March 31, 1953, against $18,-082,821, or 11.8% three months ago. Common stocks constituted 83.5% of net assets on March 31, 1953, as against 84.7% on Dec. 31, 1952.

New additions to the portfolio during the quarter were 34,100 shares of Simpsons Limited and 10,000 shares of Colgate-Palmolive-Peet Company. Chief increases were 5,000 shares of Northern Pacific Railway Company and 5,000 shares of National Cash Register, increasing both of these holdings to 15,000 shares. Sold were 19,320 shares of Duquesne Light Company; 9,000 shares of Philip Morris Co., Limited, leaving 5,000 shares in the portfolio; 32,113 shares of Columbia Gas Systems, Inc.; and 6,400 shares of Marathon Corporation, leaving a balance of 10,000 shares in the portfolio.

**EARNINGS** of The United Corporation for the first quarter of 1953 amounted to $1,036,268, equal to 7.4 cents per share on the 14,-072,149½ shares of common stock outstanding, Wm. M. Hickey, President, announced yesterday. These earnings compared with 1952 first quarter earnings of $867,243, or 6.2 cents per share. Included in the 1953 earnings were profits on the sale of securities amounting to $218,383, or 1.6 cents per share. In the 1952 first quarter such profits amounted to only $15,759, or 0.1 cent per share.

The net asset value of United stock on March 31, 1953, was $72,-733,177, or $5.17 per share based on indicated market quotations for investments owned. On the same basis the net asset value was $72,811,001, or $5.17 per share on Dec. 31, 1952 and $70,798,922, or $5.03 on March 31, 1952.

Comparative first quarter income figures are as follows:

| | 1953 | 1952 |
|---|---|---|
| Income— | | |
| Dividends | $965,833 | $1,011,541 |
| Interest | 14,964 | 10,868 |
| Profit from sale of securities | 218,383 | 15,759 |
| Total income | $1,199,180 | $1,038,168 |
| Expenses other than taxes | 80,964 | 86,415 |
| | $1,118,216 | $951,753 |
| Taxes other than Fed. income tax | 13,948 | 12,510 |
| Provision for fed. income tax | 68,000 | 72,000 |
| | $1,036,268 | $867,243 |
| Earnings per share (14,072,149.5 shs. outstanding) | 7.4¢ | 6.2¢ |

Mr. Hickey also stated that on March 31, 1953, The U. S. Court of Appeals for the District of Columbia Circuit affirmed the Securities and Exchange Commission's Order of June 26, 1951, approving the company's final plan for transformation into an investment company.

**IN THE REPORT** of General American Investors Company, Inc., Frank Altschul, Chairman of the Board, stated that as of March 31, 1953 net assets were $51,747,-607. After dividends of $249,772, the decrease for the three months was $720,017.

Net assets, after deducting $6,-200,000 Preferred Stock, were equal to $25.30 per share of Common Stock on the 1,800,220 shares outstanding, as compared with $25.70 on Dec. 31, 1952.

Net income from dividends, interest and royalties for the period, after expenses and state and municipal taxes, was $300,834. Net profit from the sale of securities for the three months was $37,693.

Net assets as of March 31, 1953 and Dec. 31, 1952, with securities valued at market, were as follows:

| | Mar. 31, 1953 | Dec. 31, 1952 |
|---|---|---|
| Cash and Receivables (less liabilities) | $242,863 | $341,665 |
| U. S. Treasury Securities | 7,004,225 | 7,701,670 |
| Other Securities and Miscellaneous Investments | | |
| Bonds | 1,285,000 | 1,290,000 |
| Preferred Stocks | 20,000 | 30,315 |
| Common Stocks: | | |
| Railroad | 814,000 | 797,750 |
| Public Utility | 6,906,800 | 5,524,300 |
| Oil and natural gas | 21,420,750 | 21,779,500 |
| Industrial and other | 15,050,750 | 15,051,950 |
| Miscellaneous oil and gas investments | 242,219 | 346,414 |
| | $51,996,607 | $52,723,624 |
| Deduction for state and municipal taxes on appreciation, if realized | 249,000 | 256,000 |
| Total | $51,747,607 | $52,467,624 |

Following is a list of the principal holdings:

| Par Value | | Market Value |
|---|---|---|
| $7,065,000 | U. S. Treasury Certificates | $7,004,225 |
| 1,000,000 | Missouri Pacific RR. Co. First and Ref. 5% | 1,105,000 |
| Shares | | |
| 41,000 | Amerada Petroleum Corporation | 7,359,500 |
| 10,000 | Superior Oil Company | 5,850,000 |
| 118,000 | United Gas Corporation | 3,363,000 |
| 80,000 | Electric Bond & Share Company | 2,180,000 |
| 32,000 | Skelly Oil Company | 1,760,000 |
| 63,000 | Interprovincial Pipe Line Company | 1,386,000 |
| 15,000 | Signal Oil and Gas Company Class A | 1,305,000 |
| 20,000 | Thompson Products | 1,140,000 |
| 23,000 | Gulf Oil Corporation | 1,115,500 |
| 20,000 | International Paper Company | 1,070,000 |
| 20,000 | Pittsburgh Consolidation Coal Company | 1,050,000 |

## Walter D. Dunbar With Kohlmeyer & Co.

(Special to The Financial Chronicle)

NEW ORLEANS, La.—Walter D. Dunbar has become associated with Kohlmeyer & Co., 217 Carondelet Street, members of the New York Stock Exchange. Mr. Dunbar was formerly active as an individual dealer in securities.

## Two With Davies

(Special to The Financial Chronicle)

SAN FRANCISCO, Calif. —Lewis J. Day and Marvin Wong have become affiliated with Davies & Co., 425 Montgomery Street, members of the New York and San Francisco Stock Exchanges. Mr. Wong was previously with Stone & Youngberg.

*Continued from page 2*

# The Security I Like Best

J. P. O'ROURKE

J. P. O'Rourke & Co., Chicago, Ill.

**Lloydminster Development Company, Ltd.**

A vast majority of so-called "small investors" today want a low-priced security that over a reasonable period of time will show some appreciation in price.

John P. O'Rourke

Where else, on this continent, should we look for this type of investment but to our Canadian neighbors. More and more people talk of the many natural resources of Canada. The greatest magnet of such resources is the magic word "OIL."

Companies with both American and Canadian sponsorship have sprung up in recent years and many more will follow along as drilling for oil becomes more active.

The provincial Governments of Saskatchewan, Alberta and British Columbia make it a simple problem for wealthy and influential groups to acquire leases. An oil lease, unless it is proven, is more of a handicap than an asset. Also a lease is an expense item until it is developed, and oil or gas is found.

After looking at many newly-formed Drilling Companies, Development Companies and kindred ilk, I would say the important item — and something you must have to be successful — is experienced management. For the number of situations capable of successful development there is nowhere near enough experienced groups available for this work.

Western Canada is a vast country, and oil or gas seems to be everywhere, waiting in the ground for the experienced man, not only to bring it to the surface, but to arrange for sale and transportation; and of equal, if not more importance, the maintenance and upkeep of wells after completion of the drilling.

It takes much time to review the many producing situations in Canada, and to arrive at a favored few is not easy. The largest oil situation, and about the most active in Western Canada, is Imperial Oil, a subsidiary of Standard Oil of New Jersey. Among the leaders in Canadian Oil operation is Canadian Superior Oil of California, now in their fourth year of operation, Calgary & Edmonton, Amurex now in their second year since formation, Pacific Pete, Royalite Oil, British American Oil Company, Home Oil Co., Ltd. Most of the large American Oil Companies also have subsidiaries working in Western Canada.

If you are of an analytical mind it will probably pay you to check through the smaller little-known producing companies, always keeping a windward eye for satisfactory management; not overly extended capitalization; and drilling in a proven area where distribution facilities are workable. If the company you select is built on a solid base, extra capital, as needed for expansion is available, and should be quickly supplied.

Such a company, in my opinion, is Lloydminster Development Company, Ltd. of Lloydminster, Saskatchewan. Their 1952 report of operations shows 27 wells, oil or gas, wholly owned in the heavy oil area of middle western Saskatchewan. Mr. O. C. Yates, President of Lloydminster Development Co., Ltd., brought in one of the first gas wells in this area some 20 years ago. With his partners they formed the Lloydminster Gas Company, which today still has the gas franchise for Lloydminster. In 1946 this group formed the Development Company. All gas discovered is sold to the Gas Company and the oil produced by Lloydminster Development Company drilling is sold to the refineries in the town of Lloydminster. The Development Company have plans for drilling 25 or 30 wells during 1953. Gross revenue for 1952 (their 3rd year of operation) was $137,000, and 1953 gross is estimated at $275,-000, based on the number of wells owned at the end of 1952. The wells drilled in 1953 should increase further gross revenue for this year over the estimate of $275,000. Price of the stock since late 1952 has ranged from 1 to 2⅛. Capitalization — December 31, 1952 was 2,000,000 shares authorized, $1.00 par, with 665,000 shares outstanding. Bonds outstanding, $153,000 — 5½% S. F. first Mortgage, due June 1, 1966.

# *Securities Salesman's Corner*

By JOHN DUTTON

## One Call Sale!

There are times when you can make a sale on your first call. There is no difference in the procedure of what goes on between the salesman and the prospect whether the sale takes place during the first call or after many interviews. If you can establish confidence and find out what your prospect wants you can do business the first time you meet just as well as the second or third. Here is a case history of a one call sale.

This prospect answered an advertisement offering a service in regard to taxes. He mailed his list in for analysis and after the work was completed he was mailed the proper information that he had requested. He telephoned his thanks and when he did so a brief conversation ensued. The salesman that handled this lead made an appointment for the following day which was a Saturday morning.

When he called the prospect ushered him into his living room, pulled up an easy chair and proceeded to light his pipe. The salesman took notice that this man was ready for a prolonged opportunity to do some talking. He led him on. He asked some questions. Then he noticed that the prospect's wife was hovering near by. He asked if she would like to join. She did for a few moments and left for her household chores. The monologue continued and the prospect finally covered almost everything from his past career to his views on religion. Finally, after almost two hours had passed he said, "My, I didn't realize how much you've had to listen to. You've come way out here to talk to me about investments and you have had hardly a chance to say a word."

This was the salesman's cue. Here is where he made the sale. He replied, "I've been listening to your very interesting conversation Mr. Jones and, quite frankly, I've wanted to do so. It is always a help to me to know what my clients want, what they are thinking, and what is on their minds. In this way we can understand each other better and we can work together so that our business relations are mutually beneficial. Now that you have told me these things I am sure that if we some day do some business that it will be done to your satisfaction." The prospect replied, "That's the first time in my life I've ever met a salesman who had sense enough to keep quiet and let me do some of the talking. Now let's look at my Willys Overland. I have three hundred shares of it and I think it's time to sell it. What do you think?"

Arrangements were made to sell the Willys Overland the following Monday morning. A reinvestment naturally followed. In addition, the entire account is now under the watching care of the salesman who so well entrenched himself with this customer in one call that all he has to do from now on is to give service and handle the account properly.

Some time ago I headed up a column by quoting a saying that I noticed on the wall of a business firm's reception office. It went something like this:

**"They say Samson slew one thousand Philistines with the jaw-bone of an ass. Every day 10,000 sales are killed with the same weapon."**

## Schlafly Nolan Stock To Be Offered at $4

Subject to SEC approval, L. H. Rothchild & Co., New York, plans to publicly offer an issue of 150,-000 shares of common stock (par 25 cents) of Schlafly Nolan Oil Co., Inc., at $4 per share.

Schlafly Nolan Oil Co., Inc., organized in Delaware on Feb. 18, 1953, proposes to engage in the exploration for oil and gas and the development of prospective oil and gas properties in Illinois, Indiana and Kentucky.

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# The Security I Like Best

**A continuous forum in which, each week, a different group of experts in the investment and advisory field from all sections of the country participate and give their reasons for favoring a particular security.**

**(The articles contained in this forum are not intended to be, nor are they to be regarded, as an offer to sell the securities discussed.)**

## This Week's Forum Participants and Their Selections

Home Protective Company—Warren E. Buffett, Manager — Several Private Investment Groups, Omaha, Neb. (Page 2).

Southdown Sugars, Inc. — G. Shelby Friedrichs, Partner, Howard, Weil, Labouisse, Friedrichs & Co., New Orleans, La. (Page 2).

WARREN E. BUFFETT
Manager—Several Private Investment Groups
Omaha, Nebr.

### HOME PROTECTIVE CO.
(A Life Insurance Stock)

Home Protective Co. probably represents the last "undiscovered" equity security of a major life insurance company. This lack of investor awareness causes the security to sell at less than half of the lowest price-earnings ratio placed on comparable companies. Home Protective is currently selling at less than four times earnings. Any education of investors to the facts concerning the company should result in a substantially higher appraisal.

Warren E. Buffett

Home Protective has only 61,463 shares of stock outstanding. The company owns 98½% of the outstanding stock of the Home Life Insurance Co. of America, a leading Pennsylvania insurer with over 400,000 policyholders. After allowing for inter-company items, Home Protective has very little in the way of other assets and liabilities. As a practical matter, with only 1½% of the stock of Home Life held by others, Home Protective Co. is the Home Life Insurance Co. of America from a stockholder standpoint.

Whereas some years back the company had a very dubious financial position, strict adherence to the highest standards of investment in the placement of new funds plus utilization of retained earnings in very substantial charges against over-valued assets have given Home a very strong financial picture. While in 1946 government-guaranteed mortgages only accounted for about 13% of assets, they now represent over 50% of assets which is greatly above the industry average. During the same period the average rate earned on assets has increased from 2.04% to 3.60%. This gain based on present assets of $1,100 per share amounts to over $16 per share annually.

Home's business is entirely non-participating. The stockholder need make no guesses as to what belongs to him and what really belongs to the policyholder. Currently Home has close to $300 million of insurance in force with practically no low-profit group. The business is almost entirely ordinary and industrial with the latter fully as profitable as the former. The lapse ratio of the company has been very low indicating well-seasoned business and experienced mortality has been excellent.

Dividends have been small while the company has been writing down assets to realistic values and the 50-cent annual rate will probably be continued for some years while the capital base is enlarged in line with the amount of business on the books. However, the earnings power has been maintaining a steady march upward and with a continuation of higher yields, low taxation and favorable mortality, a greater base of business should create further increases in earnings. With each share of Home Protective representing $1,100 in assets, a ½ of 1% change in interest rates represents a $5.50 per share change in earning power. While it takes considerable time to be fully effective, we have witnessed such a change within the past year and it has not yet been reflected in Home's earnings.

The company possesses an additional "kicker" in large holdings of contiguous undeveloped land on the Main Line in Philadelphia. Given proper zoning such holdings can have substantially greater value, particularly when related to only 61,463 shares outstanding.

Adjusting for changes in insurance in force at conservative rates, the following earnings are indicated for the past six years:

| Year | Adjusted Earnings per Share |
|---|---|
| 1951 | $9.92 |
| 1952 | 12.12 |
| 1953 | 12.25 |
| 1954 | 15.08 |
| 1955 | 18.42 |
| 1956 | 22.62 |

A continuation of such increases which appears likely added to greater investor recognition should provide substantial capital gains to today's buyer at the 85 level in the Over-the-Counter market.

G. SHELBY FRIEDRICHS
Partner: Howard, Weil, Labouisse, Friedrichs & Co., New Orleans, La.
Members, New Orleans Stock Exchange and Midwest Stock Exchange

### Southdown Sugars, Inc.

The security I like best offers stability, high intrinsic value and built-in growth of income which should have appeal during this time of unsettled market conditions, generally.

*Southdown Sugars, Inc.*, owns in fee over 46,000 acres of land located in the most attractive on-shore area for the exploration of oil and gas in the United States — south Louisiana. Although operating a stable and profitable cane sugar business, the mineral income, after taxes, from acreage leased to major oil companies last year exceeded net income from sugar operations, and will increase materially over the coming years. Southdown Sugars enjoys the advantages of participation in the results of production operations on its fee acreage without assuming any of the attendant risks. In addition, the land value of much of Southdown's property for industrial, commercial and residential purposes, adds substantially to the intrinsic value of the stock.

G. Shelby Friedrichs

The company is basically a completely integrated producer and refiner of cane sugar, operating three raw sugar factories and one refinery. Southdown has approximately 18,000 acres of cultivable land and purchases cane from other growers to supply the capacity requirements of its sugar factories. The company also imports Cuban raw sugar to fill refinery requirements. Income from this operation has been in the neighborhood of $1,500,000 per annum, before taxes.

The exploration for oil and gas in south Louisiana, dating back to the early 1930s, has had a marked effect on the company. Nearly all of the 46,000 acres of fee land have been under lease to major oil companies in recent years, and Southdown has been receiving royalty income since the discovery of the Gibson Field in Terrebonne Parish in 1937. Lease and royalty income has increased from $550,500 to $1,275,000 (before taxes) in the last five years (average 26% per annum) and gives every indication of continuing to increase at approximately this rate.

The development of the oil and gas industry, combined with the discovery of substantial sulphur deposits, plus large reserves of salt and an ample supply of fresh water, have combined to make south Louisiana a center for the petro-chemical industry. Plans have been announced by such companies as Dow Chemical, W. R. Grace, Kaiser Aluminum, Olin Mathieson and duPont for the investment of more than $250 million in plants located along the Mississippi River between New Orleans and Baton Rouge. Additions to the world's largest oil refinery — Esso's Baton Rouge plant—to the Shell plant at Norco and to Standard Oil of Indiana's refinery at Destrehan have also served to further industrialize this area. The discovery of oil and gas in the Gulf of Mexico, off the Louisiana coast, has also served to intensify activity in this area and has brought considerable expansion in oil field equipment and allied industries.

The result of all of this has been to bring about much improvement in land values, particularly those situated along strategic waterways, such as the Mississippi River, the Intra-Coastal Canal, etc., and the major highways. This influx of industry has also brought substantial increases in the population of the area, adding to the values of land for residential purposes. Approximately 13,000 acres of Southdown's land is located on the Mississippi River and all of the remainder is traversed by either main highways or other waterways, or both.

In an attempt to measure the intrinsic values that have thus been created, my firm (after consultation with oil geologists and land men and real estate experts) has made the accompanying appraisal of Southdown's properties. The values attributed are of the "horse-back variety and take into consideration mineral values as well as surface values. In my

*Continued on page 119*

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WARREN E. BUFFETT

Manager, Several Private Investment Groups, Omaha, Neb.

**Oil and Gas Property Management, Inc.**

A more fitting title for my selection would be "The Inflation Hedge I Like Best." Should inflation continue O & G may well be the vehicle to give the investor the same supercharged performance that highly leveraged investment trusts and warrants did in the early 40's.

Warren E. Buffett

O & G was organized in 1953 by interests affiliated with the Empire Trust to buy and manage producing oil and gas properties. The management is of the highest caliber and the Empire's reputation and experience in oil matters has undoubtedly been of considerable value. Purchases have been made subject to substantial oil payments with a large portion of income in early years used to extinguish these payments. This method might be compared to real estate purchased subject to large mortgages with rental income, exclusive of that portion needed for operating expenses, utilized for mortgage reduction. The tax laws facilitate this method very considerably when applied to oil by allowing all payments as a direct exclusion from income. Accounting-wise, the result is to show a very small gross income while the equity is being built up substantially. Accordingly, the financial services do not show accurately the operating picture of O & G and the interested reader should study the annual reports of the company.

The equity money for O & G was originally raised by the sale of $10 million income debentures with 300,000 shares of stock attached. This issue was exceptionally well placed in large blocks with Wall Street houses, investment trusts, etc. The underwriting fee on the sale amounted to about ¼ of 1%. An additional 80,000 shares of common were sold to the promoting group with the Empire Trust reputedly owning over 50,000 shares in a subsidiary. Large issues of warrants and options are conspicuous by their absence.

The equity money of O & G was invested by the end of 1954. Thus the company has acquired its properties on a somewhat more reasonable basis than might be expected at current higher prices for oil in the ground.

The table below shows the substantial reserves of the company and illustrates the dynamic possibilities of the small issue of common stock even should no increase in oil and gas prices occur. Figures are based on the 1955 annual report and we understand there has been little change since that date.

| Item | Gross Reserves | Net Reserve for Stk. & Debs. | Est. Gross Value of Net Reserves |
|---|---|---|---|
| Oil & Plant Products | 38,017,000 bbls. | 26,600,000 bbls. | $73,150,000 ($2.75 bbl.) |
| Gas | 500,957,000 MCF | 139,800,000 MCF | $17,982,000 (9¢ MCF) |

The net reserves for stock and debentures reflect the reduction from gross reserves of amounts sufficient to retire oil payments and loans. The debentures are income bonds and are not expected to pay their interest (which cumulates) until most of the oil payments have been liquidated. Accordingly, it may be estimated that approximately $15 million will be required to retire the debentures with interest. Operating expenses of course must be deducted from the gross values in the last column of the table and in the case of plant products, which represent half the oil reserves, will be more than average. Allowing $35 million for operating expenses and possible taxes still leaves a potential for the common of $40 million. Future acquisitions could increase this substantially.

The 380,000 shares of common have a total market value of about $5 million which makes the arithmetic of the picture fascinating. An increase in the price of oil of 15 cents per barrel or 1 cent per MCF in the case of gas is equal to the entire market value of the common. If oil over the next few years were to increase in price 50 cents per barrel, the gain in value would be equal to almost 400% of the current total market price of the common.

At the end of 1955 the company had about $49 million of oil payments and about $17 million of loans and debentures ahead of the 380,000 shares of common. However, over $33 million of the payments is applicable to one property and it is important to note that payments are obligations of only the specific property, not the company. The balance of payments amounted to less than $16 million and were reduced by $4 million in 1955 alone. Currently the average payout on these is probably less than three years away.

It is interesting to compare O & G with its more well known counterpart — Producing Properties, Inc. This company also started with about $10 million of equity capital although it didn't get under way until early 1955. At a recent date PP's production was running about 2,200 barrels per day against over 7,000 for O & G and their net reserves were also less than a third those of O & G. On the other hand, they had invested only about half of their equity money so it is not to be implied that they were doing a poorer job of investing the money—it is just that they got off to a later start. However, PP common is selling in the market for about $14 million and, in our opinion, represents less value and potential than is present in O & G selling for $5 million. If O & G were to command only the same valuation, it would mean a price of over $35 per share.

O & G also owns a half interest in Yemen Development Corp. which holds a concession on two-thirds of Yemen covering 40,000 square miles including a large basin area. Geological reports are favorable although Suez unrest will undoubtedly delay testing this area. Offsetting this plus potential in the picture is a minus potential in that the largest property of O & G is involved in litigation concerning gas prices. O & G's position has been upheld by the FPC; however, the matter is now before the courts.

O & G common, selling around 14 in the Over-the-Counter Market, should do very well if present oil prices are maintained and presents outstanding possibilities should inflation continue. Behind $65 million of obligations with an estimated gross value of oil and gas offsetting these obligations of $150 million, the $5 million market valuation on the common seems to offer considerably higher chances for gain than for loss. A small investment in O & G should do the job that a many times larger investment in a non-leveraged oil holding would do while exposing the holder to a much smaller maximum loss.

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Oil and Gas Property Management, Inc.—Warren E. Buffett, Manager, General Private Investment Groups, Omaha, Neb. (Page 2)

Century Engineers, Inc.—Robert D. Tucker, Research Dept., Morgan & Co., Los Angeles, Calif. (Page 2)

ROBERT D. TUCKER

Research Department, Morgan & Co., Los Angeles, Calif.

Member Los Angeles Stock Exchange

**Century Engineers, Inc.**

Century Engineers is a highly competent technical organization which was formed in 1949 with the express aim of getting together a group of engineers well qualified in several fields to be the over-flow engineering department for large companies and the overall engineering department for small companies. This was the basis of the company's beginning and its early activity. However, it soon became evident that to take advantage of the creative ability of the engineers they should be supplemented with prototype shop facilities and, eventually, with manufacturing facilities.

Robert D. Tucker

From the 1949 beginning wherein three engineers produced a total gross revenue of $36,000 to 1956 when a total company organization of approximately 350 people will gross approximately $6.8 million, this plan has been closely followed. The engineering and scientific personnel at Century are men who are well qualified to discuss theoretical problems with military scientists one minute and discuss fabrication problems with their own experimental mechanics the next.

Century is presently operating in five separate, but not unrelated, fields of activity. Their ultimate aim of having overall systems capability for a complete weapon system is presently subdivided into the following fields:

(1) **Aircraft Armament:** Century has designed and produced various airborne rocket launchers for all sizes of rockets now in production. Also launchers and pylons for missiles.

(2) **Electro-mechanical Division:** This field includes precision data recording cameras, timing devices and various servo mechanisms. Details of the military items in this field are classified.

(3) **Aircraft Structures:** Century Engineers has participated in the design of major structural components of current military aircraft. They have designed and

*Continued on page 16*

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after remaining at practically stationary levels for three years now appear to be stirring due to improved Japanese economy.

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