Case Study on *Dempster Mill Manufacturing Company*

Warren Buffett's communication to shareholders on Dempster is presented in the same order here—so please expect some repetition. How did Buffett find this investment and what ways did he reach an intrinsic value? How many margins of safety did he have? What "type" of investment is this—is earning power below Asset Value? Is this a franchise? Why or why not is this occurring? ***Was Buffett lucky in this investment?*** *Why or why not? How would Graham approach an investment like this? What would have been the big difference between Graham and Buffett concerning Dempster Mills?*

Warren Buffett writes below:

We are presently (1962) involved in the control of *Dempster Mill Manufacturing Company* of Beatrice, Nebraska. Our first stock was purchased as a generally undervalued security five years ago. A block later became available, and I went on the Board about four years ago. In August 1961, we obtained majority control, which is indicative of the fact that many of our operations are not exactly of the "overnight" variety.

Presently we own 70% of the stock of *Dempster* with another 10% held by a few associates. With only 150 or so other stockholders, a market on the stock is virtually non-existent, and in any case, would have no meaning for a controlling block. Our own actions in such a market could drastically affect the quoted price.

Therefore, it is necessary for me to estimate the value at yearend of our controlling interest. This is of particular importance since, in effect, new partners are buying in based upon this price, and old partners are selling a portion of their interest based upon the same price. The estimated value should not be what we hope it would be worth, or what it might be worth to an eager buyer, etc., but what I would estimate our interest would bring if sold under current conditions in a reasonably short period of time. Our efforts will be devoted toward increasing this value, and we feel there are decent prospects of doing this.

Dempster is a manufacturer of farm implements and water systems with sales in 1961 of about $9 million. **Operations have produced only nominal profits in relation to invested capital during recent years.** This reflected a poor management situation, along with a fairly tough industry situation. Presently, consolidated net worth (book value) is about $4.5 million, or $75 per share, consolidated working capital about $50 per share, and at yearend we valued our interest at $35 per share. While I claim no oracular vision in a matter such as this, I feel this is a fair valuation to both new and old partners. Certainly, if even moderate earning power can be restored, a higher valuation will be justified, and even if it cannot, *Dempster* should work out at a higher figure. Our controlling interest was acquired at an average price of about $28, and this holding currently represents 21% of partnership net assets based on the $35 value.

Of course, this section of our portfolio is not going to be worth more money merely because *General Motors, U.S. Steel*, etc., sell higher. In a raging bull market, operations in control situations will seem like a very difficult way to make money, compared to just buying the general market. However, I am more conscious of the dangers presented at current market levels than the opportunities. **Control situations, along with work-outs, provide a means of insulating a**

portion of our portfolio from these dangers.
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1963

Having read this far, you are entitled to a report on how we have done to date in 1962. For the period ending October 31st, the Dow-Jones Industrials showed an overall loss, including dividends received, of approximately 16.8%. We intend to use the same method or valuing our controlling interest in *Dempster Mill Manufacturing* at this yearend that we did at the end of last year. This involved applying various discounts to the balance sheet items to reflect my opinion as to what could be realized on a very prompt sale. Last year this involved a 40% discount on inventories, a 15% discount on receivables, estimated auction value of fixed assets, etc., which led to an approximate value or $35.00 per share.

The successful conversion of substantial portions of the assets of *Dempster* to cash, at virtually 100 cents on the dollar, has been the high point of 1962. For example, inventory of $4.2 million at last yearend will probably be about $1.9 million this yearend, reducing the discount on this item by about $920,000 (40% of $2.3 million reduction). I will give this story my full journalistic treatment in my annual letter. Suffice to say at this point that applying the same discounts described above will probably result in a yearend value of at least $50.00 per share. The extent of the asset conversion job can perhaps best be illustrated in a sentence by pointing out that whereas we had $166,000 of cash and $2,315,000 of liabilities at November 30, 1961 (*Dempster* fiscal yearend), we expect this year to have about $1 million in cash and investments (of the type the Partnership buys) against total liabilities of $250,000. Prospects for further improvement in this situation in 1963 appear good, and we expect a substantially expanded investment portfolio in *Dempster* next year.

Valuing *Dempster* at $50 per share, our overall gain (before any payments to partners) to October 31st for the Partnership has been 5.5%. This 22.3 percentage-points advantage over the Dow, if maintained until the end of the year, will be among the largest we have ever had. **About 60% of this advantage was accomplished by the portfolio other than *Dempster*, and 40% was the result of increased value at *Dempster*.**

I want all partners and prospective partners to realize the results described above are distinctly abnormal and will recur infrequently, if at all. **This performance is mainly the result of having a large portion of our money in controlled assets and workout situations rather than general market situations at a time when the Dow declined substantially.** If the Dow had advanced materially in 1962, we could have looked very bad on a relative basis, and our success to date in 1962 certainly does not reflect any ability on my part to guess the market (I never try), but merely reflects the fact that the high prices of generals partially forced me into other categories or investment. If the Dow had continued to soar, we would have been low man on the totem pole. We fully expect to have years when our method of operation will not even match the results of the Dow, although obviously I don't expect this on any long-term basis or I would throw in the towel and buy the Dow.

I'll cut this sermon short with the conclusion that I certainly do not want anyone to think that the pattern of the last few years is likely to be repeated; I expect future performance to reflect much smaller advantages on average over the Dow.

Each letter ends with the request that you let me know about anything that isn't clear. Please be sure that you do this. We are all geared up with secretarial help, a new typewriter, etc., and we want to be sure that this letter and agreement are understood by all.
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Many times **Generals** represent a form of "coattail riding" where we feel the dominating stockholder group has plans for the conversion of unprofitable or under-utilized assets to a better use. We have done that ourselves in Sanborn and *Dempster*, but everything else equal we would rather let others do the work. Obviously, not only do the values have to be ample in a case like this, but we also have to be careful whose coat we are holding.
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Dempster Mill Manufacturing Company

The high point of 1962 from a performance standpoint was our present control situation --73% owned *Dempster* Mill. *Dempster* has been primarily in farm implements (mostly items retailing for $1,000 or under), water systems, water well supplies and jobbed plumbing lines.

The operations for the past decade have been characterized by static sales, low inventory turnover and virtually no profits in relation to invested capital.

We obtained control in August, 1961 at an average price of about $28 per share, having bought some stock as low as $16 in earlier years, but the vast majority in an offer of $30.25 in August. When control of a company is obtained, obviously what then becomes all-important is the **value of assets**, not the market quotation for a piece of paper (stock certificate).

Last year, our *Dempster* holding was valued by applying what I felt were appropriate discounts to the various assets. These valuations were based on their status as non-earning assets and were not assessed on the basis of potential, but on the basis of what I thought a prompt sale would produce at that date. Our job was to compound these values at a decent rate. The consolidated balance sheet last year and the calculation of fair value are shown below.

(000's omitted)

Assets	Book Figure	Valued @	Adjusted Valuation	Liabilities	
Cash	$166	100%	$166	Notes Payable	$1,230
Accts. Rec. (net)	$1,040	85%	$884	Other Liabilities	$1,088
Inventory	$4,203	60%	$2,522		
Ppd. Exp. Etc.	$82	25%	$21		
Current Assets	$5,491		$3,593	Total Liabilities	$2,318
Cash Value Life ins., etc.	$45	100 Est. net auction value	$45	Net Work per Books:	$4,601
Net Plant Equipment	$1383		$800	Net Work as Adjusted to Quickly Realizable Values	$2,120
Total Assets	$6,919		$4,438	Shares outstanding 60,146 Adj. Value per Share	$35.25

Dempster's fiscal year ends November 30th, and because the audit was unavailable in complete form, I approximated some of the figures and rounded to $35 per share last year.

Initially, we worked with the old management toward more effective utilization of capital, better operating margins, reduction of overhead, etc. These efforts were completely fruitless. After spinning our wheels for about six months, it became obvious that while lip service was being given to our objective, either through inability or unwillingness, <u>nothing was being accomplished</u>. A change was necessary.

A good friend *(Charlie Munger)*, whose inclination is not toward enthusiastic descriptions, highly recommended *Harry Bottle* for our type of problem. On April 17, 1962 I met Harry in Los Angeles, presented a deal which provided for rewards to him based upon our objectives being met, and on April 23rd he was sitting in the president's chair in Beatrice.

Harry is unquestionably the man of the year. Every goal we have set for Harry has been met, and all the surprises have been on the pleasant side. He has accomplished one thing after another that has been labeled as impossible, and has always taken the tough things first. Our breakeven point has been cut virtually in half, slow-moving or dead merchandise has been sold or written off, marketing procedures have been revamped, and unprofitable facilities have been sold.

The results of this program are partially shown in the balance sheet below, which, since it still represents non-earning assets, is valued on the same basis as last year.

(000's omitted)

Assets	**Book Figure**	**Valued @**	**Adjusted Valuation**	**Liabilities**	
Cash	$60	100%	$60	Notes payable	$0
Marketable securities	$758	Mrt. 12/31/62	$834	Other liabilities	<u>$346</u>
Accts. Rec. (net)	$796	85%	$676	Total liabilities	$346
Inventory	$1,634	60%	$981		
Cash value life ins.	$41	100%	$41	Net Worth:	
Recoverable Income Tax	$170	100%	$170	Per Books	$4,077
Ppd. Exp. Etc.	<u>$14</u>	25%	<u>$4</u>	As Adjusted to quickly realizable values	$3,125
				Add: proceeds from potential exercise of option to Harry Bottle	<u>$60</u>
Current Assets	$3,473		$2,766		
				Shares outstanding 60,146	
Misc. Invest.	$5	100%	$5	Add: shs. Potentially outstanding under option 2000	
				Total shs. 62,146	
Net Plant Equipment	<u>$945</u>	Est. net auction value	<u>$700</u>		
				Adjusted value per share	$51.26
Total Assets	$4,423		$3,471		

Three facts stand out: (1) Although net worth has been reduced somewhat by the housecleaning and write-downs ($550,000 was written out of inventory; fixed assets overall brought more than book value), we have converted assets to cash at a rate far superior to that implied in our year-earlier valuation. (2) To some extent, we have converted the assets from the manufacturing business (which has been a poor business) to a business which we think is a good business -- securities. (3) By buying assets at a bargain price, we don't need to pull any rabbits out of a hat to get extremely good percentage gains *(a prelude of Berkshire?).*

This is the cornerstone of our <u>investment philosophy</u>: "Never count on making a good sale. Have the purchase price be so attractive that even a mediocre sale gives good results. The better sales will be the frosting on the cake."

On January 2, 1963, *Dempster* received an unsecured term loan of $1,250,000. These funds, together with the funds all ready "freed-up" will enable us to have a security portfolio of about $35 per share at *Dempster*, or considerably more than we paid for the whole company. Thus our present valuation will involve a net of about $16 per share in the manufacturing operation and $35 in a security operation comparable to that of *Buffett Partnership, Ltd.*

We, of course, are devoted to compounding the $16 in manufacturing at an attractive rate and believe we have some good ideas as to how to accomplish this. While this will be easy if the business as presently conducted earns money, we have some promising ideas even if it shouldn't.

It should be pointed out that *Dempster* last year was 100% an <u>asset conversion problem</u> and therefore, completely unaffected by the stock market and tremendously affected by our success with the assets. In 1963, the manufacturing assets will still be important, but from a valuation standpoint it will behave considerably more like a general since we will have a large portion of its money invested in generals pretty much identical with those in *Buffett Partnership, Ltd.* For tax reasons, we will probably not put workouts in *Dempster*. Therefore, if the Dow should drop substantially, it would have a significant effect on the *Dempster* valuation. Likewise, *Dempster* would benefit this year from an advancing Dow which would not have been the case most of last year.

There is one final point of real significance for *Buffett Partnership, Ltd.* **We now have a relationship with an operating man which could be of great benefit in future control situations.** Harry had never thought of running an implement company six days before he took over. He is mobile, hardworking and carries out policies once they are set. He likes to get paid well for doing well, and I like dealing with someone who is not trying to figure how to get the fixtures in the executive washroom gold-plated.

Harry and I like each other, and his relationship with *Buffett Partnership, Ltd.* should be profitable for all of us.

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<u>Dempster Mill Manufacturing Company</u>

In our most recent annual letter, I described Harry Bottle as the "man of the year". This was an understatement.

Last year Harry did an extraordinary job of converting unproductive assets into cash which we then, of course, began to invest in undervalued securities. Harry has continued this year to turn under-utilized assets into cash, but in addition, he has made the remaining needed assets productive. Thus we have had the following transformation in balance sheets during the last nineteen months:

November 30, 1961 (000's omitted)

Assets	**Book Figure**	**Valued @**	**Adj. Valuation**	**Liabilities**	
Cash	$166	100%	$166	Notes Payable	$1,230
Accts. Rec. (net)	$1,040	85%	$884	Other Liabilities	$1,088
Inventory	$4,203	60%	$2,522		
Ppd. Exp. Etc.	$82	25%	$21	Total Liabilities	$2,318
Current Assets	$5,491		$3,593	Net Worth:	
				Per Books	$4,601
Cash Value Life ins., etc.	$45	100%	$45	As adjusted to quickly realizable values	$2,120
Net Plant & equipment	$1,383	Est. Net Auction Value	$800		
Total Assets	$6,919		$4,438	Share outstanding 60,146. Adj. Value per Share	$35.25

November 30, 1962 (000's omitted)

Assets	**Book Figure**	**Valued @**	**Adjusted Valuation**	**Liabilities**	
Cash	$60	100%	$60	Notes payable	$0
Marketable Securities	$758	Mkt. 12/31/62	$834	Other liabilities	$346
Accts. Rec. (net)	$796	85%	$676	Total liabilities	$346
Inventory	$1,634	60%	$981		
Cash value life ins.	$41	100%	$41	Net Worth:	
Recoverable income tax	$170	100%	$170	Per books	$4,077
Ppd. Exp. Etc	$14	25%	$4	As adjusted to quickly realizable values	$3,125
				Add: proceeds from potential exercise of option to Harry Bottle	$60
Current Assets	$3,473		$2,766		$3,185
				Shares Outstanding 60,146	
Misc. Invest.	$5	100%	$5	Add: shs. Potentially outstanding under option: 2,000	
				Total shs. 62,146	
Net plant & equipment	$945	Est. net auction value	$700	Adj. Value per Share	$51.26
Total Assets	$4,423		$3,471		

November 30, 1963 (000's omitted)

Assets	**Book Figure**	**Valued @**	**Adjusted Valuation**	**Liabilities**	
Cash	$144	100%	$144	Notes payable (paid 7/3/63)	$125
Marketable Securities	$1,772	Mkt. 6/30/63	$2,029	Other liabilities	$394
Accts. Rec. (net)	$1,262	85%	$1,073	Total Liabilities	$519
Inventory	$977	60%	$586		
Ppd. Exp. Etc	$12	25%	$3	Net Worth:	
				Per books	$4,582
Current Assets	$4,167		$3,835	As adjusted to quickly realizable values	$4,028
Misc. Invest	$62	100%	$62	Shares outstanding 62,146	
Net plant & equip.	$872	Est. net auction value	$650	Adj. Value per share	$64.81
Total assets	$5,101		$4,547		

I have included above the conversion factors we have previously used in valuing *Dempster* for *B.P.L.* purposes to reflect estimated immediate sale values of non-earning assets.

As can be seen, Harry has converted the assets at a much more favorable basis than was implied by my valuations. This largely reflects Harry's expertise and, perhaps, to a minor degree my own conservatism in valuation.

As can also be seen, *Dempster* earned a very satisfactory operating profit in the first half (as well as a substantial unrealized gain in securities) and there is little question that the operating business, as now conducted, has at least moderate earning power on the vastly reduced assets needed to conduct it. Because of a very important-seasonal factor and also the presence of a tax carry forward, however, the earning power is not nearly what might be inferred simply by a comparison of the 11/30/62 and 6/30/63 balance sheets. Partly because of this seasonality, but more importantly, because of possible developments in *Dempster* before 1963 yearend, we have left our *Dempster* holdings at the same $51.26 valuation used at yearend 1962 in our figures for *B.P.L's* first half. However, I would be very surprised if it does not work out higher than this figure at yearend.

One sidelight for the fundamentalists in our group: B.P.L. owns 71.7% of *Dempster* acquired at a cost of $1,262,577.27. On June 30, 1963 *Dempster* had a small safe deposit box at the Omaha National Bank containing securities worth $2,028,415.25. Our 71.7% share of $2,028,415.25 amounts to $1,454,373.70. **Thus, everything above ground (and part of it underground) is profit.** My security analyst friends may find this a rather primitive method of accounting, but I must confess that I find a bit more substance in this fingers and toes method than in any prayerful reliance that someone will pay me 35 times next year's earnings. *(Greater fool speculation and known vs. unknown).*

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<u>*DEMPSTER MILL MFG.* History of Investment</u>

This situation started as a general in 1956. At that time the stock was selling at $18 with about $72 in book value of which $50 per share was in current assets (Cash, receivables and inventory) less all liabilities. *Dempster* had earned good money in the past but was only breaking even currently.

The qualitative situation was on the negative side (a fairly tough industry and unimpressive management), but the figures were extremely attractive. Experience shows you can buy 100 situations like this and have perhaps 70 or 80 work out to reasonable profits in one to three years. Just why any particular one should do so is hard to say at the time of purchase, but the <u>group expectancy is favorable</u>, whether the impetus is from an improved industry situation, a takeover offer, a change in investor psychology, etc.

We continued to buy the stock in small quantities for five years. During most or this period I was a director and was becoming consistently less impressed with the earnings prospects under existing management. However, I also became more familiar with the assets and operations and my evaluation of the quantitative factors remained very favorable.

By mid-1961 we owned about 30% or *Dempster* (we had made several tender offers with poor results), but in August and September 1961 made, several large purchases at $30.25 per share, which coupled with a subsequent tender offer at the same price, brought our holding to over 70%. Our purchases over the previous five years had been in the $16-$25 range.

On assuming control, we elevated the executive vice president to president to see what he would do unfettered by the previous policies. The results were unsatisfactory and on April 23, 1962 we hired Harry Bottle as president.

Harry was the perfect man for the job. I have recited his triumphs before and the accompanying comparative balance sheets speak louder than any words in demonstrating <u>the re-employment of capital.</u>

	11/30/61	**7/31/63 (unaudited)**
Cash	$166,000	$89,000
US Gov't Securities – at cost		$289,000
Other marketable securities – at market (which exceeds cost)		$2,049,000
Total Cash and Securities	**$166,000**	**$2,436,000**
Accounts receivable (net)	$1,040,000	$864,000
Inventory	$4,203,000	$890,000
Prepaid expenses, etc.	$82,000	$12,000
Current Assets	**$5,491,000**	**$4,202,000**
Other Assets	$45,000	$62,000
Net Plant and Equipment	$1,383,000	$862,000

Total Assets	**$6,919,000**	**$5,126,000**
Notes Payable	$1,230,000	
Other Liability	$1,088,000	$274,000
Total Liabilities	**$2,318,000**	**$274,000**
Net worth		
60,146 shs. 11/30/61		
62,146 shs. 7/31/63	$4,601,000	$4,852,000
Total liabilities and net worth	**$6,919,000**	**$5,126,000**

Harry:

(1) took the inventory from over $4 million (much of it slow moving) to under $1 million reducing carrying costs and obsolescence risks tremendously;

(2) correspondingly freed up capital for marketable security purchases from which we gained over $400,000

(3) cut administration and selling expense from $150,000 to $75,000 per month;

(4) cut factory overhead burden from $6 to $4.50 per direct labor hour;

(5) closed the five branches operating unprofitably (leaving us with three good ones) and replaced them with more productive distributors;

(6) cleaned up a headache at an auxiliary factory operation at Columbus, Nebraska;

(7) eliminated jobbed lines tying up considerable money (which could be used profitably in securities) while producing no profits;

(8) adjusted prices of repair parts, thereby producing an estimated $200,000 additional profit with virtually no loss of volume; and most important;

(9) through these and many other steps, restored the earning capacity to a level commensurate with the capital employed.

In 1963, the heavy corporate taxes we were facing (Harry surprised me by the speed with which he had earned up our tax loss carry-forward) coupled with excess liquid funds within the corporation compelled us to either in some way de-incorporate or to sell the business.

We set out to do either one or the other before the end of 1963. De-incorporating had many problems but would have, in effect, doubled earnings for our partners and also eliminated the problem of corporate capital gain tax on *Dempster* securities.

At virtually the last minute, after several earlier deals had fallen through at reasonably advanced stages, a sale of assets was made. Although there were a good many wrinkles to the sale, the net effect was to bring approximately book value. This, coupled with the gain we have in our portfolio of marketable securities, gives us a realization of about $80 per share. *Dempster* (now named First Beatrice Corp. - we sold the name to the new Co.) is down to almost entirely cash and marketable securities now. On BPL's yearend audit, our First Beatrice holdings were valued at asset value (with securities at market) less a $200,000 reserve for various contingencies.

I might mention that we think the buyers will do very well with *Dempster*. They impress us as people of ability and they have sound plans to expand the business and its profitability. We would have been quite happy to operate *Dempster* on an unincorporated basis, but we are also quite happy to sell it for a reasonable price. Our business is making excellent purchases -- not making extraordinary sales.

Harry works the same way I do -- he likes big carrots. He is presently a limited partner of BPL, and the next belt-tightening operation we have, he's our man.

The *Dempster* saga points up several morals:

(1) Our business is one requiring patience. It has little in common with a portfolio of high-flying glamour stocks and during periods of popularity for the latter, we may appear quite stodgy.

It is to our advantage to have securities do nothing price wise for months, or perhaps years, why we are buying them. This points up the need to measure our results over an adequate period of time. We suggest three years as a minimum.

(2) We cannot talk about our current investment operations. Such an open-mouth policy could never improve our results and in some situations could seriously hurt us. For this reason, should anyone, including partners, ask us whether we are interested in any security, we must plead the "5th Amendment."

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Appendix

To the stockholders of *Dempster Mill Mfg. Co.* (Written by Warren E. Buffett)

Enclosed is the notice of a special meeting of the stockholders, to be held in Beatrice on Wed, July 31, 1963, at 7 P.M. This letter is written so that you will be in a position to give advance consideration to the matters that will be voted on at this meeting.

Attached are financial statements showing the unaudited earnings for the first seven months of the fiscal year as well as a balance sheet showing the financial condition of the company on June 30, 1963. It is apparent that the fine job Harry Bottle started as president last year has been continued this year. There is a very substantial seasonal element to our business, so that operations at about break-even are expected during the balance of the year. Nevertheless, it appears that operations fro the full year will result in one of the best years in recent history.

This dramatic improvement in operating results has been produced by eliminating unprofitable lines, closing unprofitable branch locations, eliminating unneeded overhead, adjusting prices where warranted, etc. In addition to restoring the Company to profitable operations, these actions have substantially reduced the capital needs of the business. Accordingly, on June 30, we owned $1,772,000 of marketable securities with a market value on that date of $2,028,000. It appears that the company will soon be in a position where only about 60% of its asset will be utilized in the manufacturing business. This over-capitalization presents important problems to the management in its efforts to produce a satisfactory return on the total capital committed to the corporation

The management has given consideration to many alternative methods of employing this capital in the business as well as explored possibilities whereby these excess funds might be made directly available to share-holders without the imposition of very substantial ordinary income taxes. It appears to be impossible to make any prorate distribution without such a distribution being taxable as an ordinary dividend. Our legal advisors have recommended that the most effective way to placing this capital in the hands of Dempster stockholders would be through sale of the operating assets of the Company as a going concern, to be followed by the liquidation of the corporation. This does not mean a liquidation of the operating business, for it will have been previously sold as a going concern. Then all funds may be distributed pro rata to stockholders subject only to a capital gains tax on the excess amount received over each stockholder's tax basis of his stock. It is particularly recommend that this action be taken promptly since the Company has about exhausted the tax carry-forward as computed by our auditors and henceforth our operating profits will be subject to 52% Federal income taxes.

As it is now conducted, the Board of Directors unanimously believes the business of Dempster Mill has a value as a going business in excess of the mere liquidation value of its assets. Therefore, we believe it to be to the best interests of the stockholders, employees and customers that it be sold as a going concern. Harry Bottle will be available as manager for any purchaser. He has been instructed to conduct operations during the intervening period before sale in a manner consistent with out plan of operation during the past year. Material will be purchased, production planed, etc., based on the same pattern as prevailed regarding products and distribution last year.

Very recently, there have been negotiations between the Executive Committee and representatives of several possible purchasers looking toward such a sale as a going business. These have not led to a contract, although in two cases differences seemed relatively minor. Currently, the operations are being studied by an interested party whose intentions have been stated to us to involve substantial expansion of the Beatrice operation.

Because of the seasonal nature of our business, it is necessary for any purchaser to take over operations in early fall to intelligently prepare for the big spring selling season. Therefore, your Board feels something concrete should be done in the relatively near future.

The enclosed Notice of a Special Meeting describes the procedure to be followed:

Through Sept. 13th, our efforts will be continued to sell the business as a going concern on a negotiated basis.

The intent to sell will be widely advertised immediately after the stockholders' meeting. It is intended that major companies in the pump, implement and fertilizer field will be contacted. We will reserve the right to sell on a negotiated basis until Sept. 13th. During this period it will be possible to tailor a contract to the desires of a purchasing party.

Failing a negotiated sale by Sept 13th, a Public Sale on Sept. 30th will be held with a standard Contract of Sale which we will provide and to which all bidders must conform. Such a sale will be for cash. BPL, owner of 44,557 Dempster shares, presently intends to bid if this sale should take place and would arrange to enter into a partnership or joint venture with any other stockholder or group of stockholders in a bid, if they wanted to do so. Any stockholders of Dempster, of course, will be able to bid individually.

We wish to emphasize Dempster will be sold as an operating business and the buyer will purchase the right to use the Dempster name in operation. After the sale, it the present intention of the Board to proceed with the orderly distribution of proceeds from the sale and form the disposition of other asset except for those asset which may be conveniently distributed in kind.

While it is obviously impossible to estimate what the final realization to stockholders may be, it would appear certain to be substantially higher than current or past quotations on Dempster stock. Therefore, it would appear advisable for stockholders to retain their shares, at least until further word as to how sales efforts have proceeded.

We hope all stockholders can attend the special meeting so that all questions may be answered. If you cannot attend, any written questions will be answered promptly.

Yours very truly,

WEB, Chairman of the Board.
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From: President H. T. Bottle

December 17, 1962

TO OUR DEMPSTER CUSTOMER:

We entered 1962 faced with many challenges—inventories were heavy, bank debts were high, expenses excessive, cash position low and employee complement for too great. We immediately established a set of basic corporate objectives to direct all phases of our operation.

Some of the things done, we must admit were distasteful to all of us, but we were determined in our objectives. We cleaned up our inventory by selling surplus, obsolete and scrap materials—we cut or eliminated expenses in all areas of operations—we promoted bargain and phase out sales of undesirable merchandise--we revitalized our marketing divisions and adopted distribution patterns to help you obtain a growing share of the implements, fertilizer and water systems market.

Our programmed objectives paid off. Sales improved—production schedules materialized—the cash position began to be workable. We can now report our financial position has been sufficiently strengthened to operate in 1963 in a normal fashion. Our friends and business associates now realize that Dempster is going places and in business to stay.

Proudly we look to 1963 with enthusiasm and optimism—we are dedicated to work hard and diligently for improved quality and service. We assure you that Dempster will solidify and consolidate its' position and build the kind of successful, strong company of which you will be proud. This kind of Company assures our future together.

We appreciate the opportunity to engage in a person to person chat with you by means of this letter..

Yours very truly,

H. T. Bottle, President.

Additional Notes from various sources on Dempster Mills Manufacturing.

In 1961, Buffett bet $1 million—his biggest plunge ever—on a company that, had they known of it, would have made the doctors gasp. ***Dempster Mill Manufacturing ("DMM")*** was an eighty year old windmill and farm-implement maker in Beatrice, Nebraska, 90 miles south of Omaha. *Dempster* had suffered from static sales and dismal profitability. Buffett had nibbled at the stock—a cheap, typical-Graham play—a few years earlier. In 1961, he snapped up the controlling interest, giving him 70 percent—and staking a fifth of his partnerships' assets on it. Buffett appointed himself Chairman, a prophetic move (and unusual for a money manager) that signaled an ambition to be something more than just an investor.

Buffett, at first, couldn't get a handle on DMM. It needed an overhaul, but working with the gritty details was not his forte. It was like cleaning the fruit bins at the Buffett store; he preferred the numerical abstractions to the business itself. Each month, Buffett would entreat the managers to cut their overhead and trim the inventory, and they would give it lip service and wait for him to go back to Omaha. Promptly, Buffett put the company up for sale.

But he did not question the Graham-like premise that had led to its purchase.

Buffett was so consistently analytical-unusually so. He was always logical and even-tempered, always in the same, circumscribed arc.

In the spring, Buffett went to Munger with a problem: what to do about *Dempster*? Munger was no Ben Graham disciple. In his view, troubled companies, which tended to be the kind that sold at Graham-like discounts, were not easily put right.

Munger recommended Harry Bottle who might be the man for DMM. Bottle did the dirty work of laying off people, cutting inventories and squeezing cash from underperforming factories.

Buffett told partners, "To some extent, we have converted the assets from the manufacturing business which has been a poor business, to a business which we think is a good business-securities. After a year, DMM was trimmer but more profitable, and it had $2 million worth of securities to boot. In 1963, Buffett sold it—netting the partnership a $2.3 million profit and nearly tripling its investment.

Three things had made it work: the initial bargain price, Buffett's patience in holding on, and his and Bottle's turnaround. To Buffett—as ardently in Ben Graham's camp as ever—the first point outweighed the rest.

"This is the cornerstone of our investment philosophy: Never count on making a good sale. Have the purchase price be so attractive that even a mediocre sale gives good results.

Buffett went on the board of DMM to set it straight. He did not want to be seen as a liquidator.
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Source: Of Permanent Value

An undervalued investment the BP made as a "general" (undervalued stock to be held a long time) in 1956 was *Dempster* Mill Manufacturing Co.. The stock was selling for $18 per share and had a book vale of about $72.

One Berkshire shareholder thinks Buffett's thoughts about DMM were along these lines: Buy the company at a quarter of book value, liquidate a substantial portion of the book value to generate funds for investment, borrow money on the unleveraged company for further investment and then spin-off the core business.

Buffett continued buying DMM stock in small quantities for five years. By mid-1961, his partnership owned more than 70% of the company.

Bottle's employment agreement was based on a percentage of profits and other measures at *Dempster*.

Harry Bottle:

Charlie introduced me to Warren in early April 1962.

Warren stepped in and rescued an ailing sick business, made it well, sold it to local principals for continuance of operation and support for the area.

Buffett says today, "Hiring Harry may have been the most important management decision I ever made. *Dempster* was in big trouble under two previous managers, and the banks were treating us as a potential bankrupt. If *Dempster* had gone down, my life and fortunes would have been a lot different from that time forward."

Comments:____

End