

Notes on meeting with Warren Buffett on October 10, 2003

On living a successful life:

Look among your classmates/colleagues and ask yourself “If I could purchase 10% of anyone’s income, who would I choose?.....If I could short 10% of someone’s income, who would it be?”

Ben Graham used this exercise quite extensively.

Ask yourself the basis for your selection and write down on a piece of paper the qualities for each of these individuals – Understand that these are not God given qualities...they are based on determination and habit “Chains of habit are too light to be felt until they are too heavy to be broken”. You don’t want to wait until you’re 50 or 60.

Ask yourself, would you be uncomfortable with your decisions being written on the front page of the newspaper by an unfriendly but intelligent reporter.

On what changes/additions he would make to The Intelligent Investor:

He wouldn’t make many changes. The principles of the book are just as relevant today as they were when they were written. The important chapters are Chapters 8 and 20.

Key tenets of investing – think of stocks as businesses, don’t be influenced by Mr. Market and always have a margin of safety. If you follow these simple principles you HAVE to do well. The biggest obstacle in following these simple principles is detaching yourself from the feelings of others.

You only need a few good ideas in a lifetime

Business are generally sound over time but the difference between low price and high price in any year can be 3x (over 3000 companies are priced once a day)...this provides tremendous opportunities.

Understanding and following the principles set out in the intelligent investor is not a function of intellect, people either catch on or they do not.

On value investing and what is the hardest aspect of its implementation:

Berkshire Hathaway has too much money which has caused the universe of acceptable investments to shrink. Value investing is always difficult as it is hard to detach oneself from the emotional aspect of investing. Pascal said, “Most of man’s trouble rises from the inability to sit quietly in a room.” It is not the toughest game and opportunities come in clumps. There are very few mistakes a smart guy can make, one of which is leverage. When Genius Failed is a good book which clearly shows the trouble with leverage. It is a terrible mistake to assume that you can reduce human behavior to mathematical formulas. It is also difficult to detach yourself from the crowd. WEB worked in NY for 2 years but

he would not have done as well as if he had continued to live there. He would have been “overstimulated” by the many ideas and the emotional charge.

His life has not changed dramatically with the accumulation of wealth. Our lives should not change with money.

Despite the fact that he is worth billions, his life is very similar to ours – we still sleep 7 hours, eat the same, watch sports, wear similar clothes....the point is to keep perspective and don't let the money consume you. The key point is that you're having fun

Investing is simple, but it's not easy. One should not try to get rich too quick.

Stock market is liquid so it can also be highly volatile without the underlying fundamentals of a business changing.

Variance in price of farm land or other hard assets is generally low

Stock market opportunities come in clumps

On whether it's too late to get into the game:

Age is an advantage. From 8 to 19, I actually wasted years, a period during which I was not actively investing. Over time, you learn how to value businesses and how to realize when you can't value a business.

“It is not too late. There's plenty of time. You don't need many ideas.”

You probably only need to know 4 or 5 industries really well.

“If you love the field, you want to immerse in it. You want to learn about businesses.”

When he bought NFM, he knew the business. He knows which businesses are in his circle of competence.

On what books to read:

Outside of Ben Graham, read Phil Fisher's books from 1960's (Common Stocks and Uncommon Profits and Conservative Investors Sleep Well). You have to read a “zillion” annual reports.

Look for businesses that you think are very likely to succeed 10, 15 years from now. Do they have pricing power, exclusive franchise (“Maybe it's the only Cadillac distributor in Omaha.”)

“I like to go for cinches.”

“I like to shoot fish in a barrel. But I like to do it after the water has run out.”

Three things to look for:

1. The business
2. Management
3. Price

Every year he raises prices at See's Candies the day after Christmas. "That is my Christmas present to myself." "Mirror, mirror on the wall, how much should I charge for candy this fall? More. That's my kind of mirror."

In this country, people buy chocolates as gifts. You're not going to buy cheaper chocolate and tell your girlfriend that you took the low bid.

On Katherine Graham:

The most important Buffett did for her is helping her have confidence.

When he was teaching her about business and reading 10Ks, "at first she fell asleep."

She had two basic misconceptions:

1. Men were smarter than women ("After she met me, she got away from that.")
2. She was inferior because she didn't go to b-school.

Katherine Graham was looking at a fun house mirror and I just had to put in a real mirror. All of that was the result of years of being told she was inferior – by her mother and a very domineering husband.

Most important thing in the world is what you teach kids in those first couple of years. "Make sure you deserve to be their hero. Because you'll be their hero." As a parent you are in a teaching position all the time.

An important thing in life is whom do you have as your heroes.

On hedge funds:

WEB stumbled into the partnership form having worked for Newman and Graham and that is the form he would use to attract capital.

It is unethical to take a fee and a share of profits.

"It's open to significant abuse." Asset gathering is more important than performance. There are wrong incentives. "It's also unethical not to have your money in it."

If you were investing smaller sums of money, say \$10-20M, would you look for the fat pitches that are great, high ROE companies (like Coke), or ones that are statistically cheap, but possibly below average businesses? Which would you invest in--cigar butts, special situations of average businesses, or great but small-and-ignored companies?

“I would find more things looking at other things than Coke.” You want to work where there is little competition. If you look at the smaller cigar butt investments, you have just eliminated some pretty serious competition: Buffett (because he’s too big to dabble there), and all the people who listen only to sell-side research (because they don’t cover those little things).

One of the secrets in life is weak competition.

Forbes reported in 1993 that you spend 5-6 hours per day reading. What in the world could take that long? Annual reports? Periodicals? Books? All of the above? “I tend to read everything in sight. I used to read 5-6 hours a day.” Now he’s in the computer 12 hours a week playing bridge. That has to come out of something. “It’s not coming out of sleeping, or eating. It’s coming out of reading.” Nevertheless, he still reads a lot.

Excluding email, he spends more time in the computer than Bill Gates.

He’s willing to spend millions of dollars playing bridge on the Internet but they still haven’t found a way to do it.

“Meg Whitman’s got a very good business model.”

“We have no meetings at Berkshire. We don’t have a PowerPoint around here.”

What models do you have/use that enable you to make a bid for a company in 15 minutes?

“Models. That’s Charlie’s word.”

“If you know enough to do it, you know enough to do it immediately.”

Models:

- Do I understand the business?
- What are the competitive advantages of the business and will they endure?
- Is there going to be change? “I don’t like change.” It is good for humanity but not for investing

Nebraska Furniture Mart

- Short time frame to investment
- Asked about receivables and how much she owed
- Looked at unaudited income statement and no balance sheet

Clayton Homes

- Good business in a tough industry
- Made bid on second call over the phone – he never visited the company
- Prepare your life for making these quick decisions (learn to spot the opportunity and pounce on it)

Larson Juhl

- Never thought about the business
- 15 minute phone call
- 18,000 locations with sales force that called on all clients 6x a year – difficult to compete (investment in sales force, distribution, low price sensitivity – want it tomorrow – don't care if it's \$72 or \$84)
- no brainer

MiTek

- Connector plate business
- Small item of cost relative to cost of home
- Contractor wants reliability, not the lowest price
- Internet not going to change the business
- Never went to see the business

We all know about your famous sins of omission which you say have cost Berkshire shareholders billions and billions of dollars. Could you talk about some of your less successful investments (that is, sins of commission) you've made and what you've learned from them?

Sins of commission:

1. Buying Berkshire
2. Department store in the partnership years (Hochschild, Kohn) bought by Diversified Retailing
3. Blue Chip Stamps. It did \$120 million...this year \$50K (“The old Buffett touch”)

Oddly enough, these are the “three streams” out of which today's Berkshire flowed.

On China:

Too many variables in China that can translate into investment action.

You have to be right on 20 things for China to be profitable

There is nothing advantageous in looking for a silver needle in a golden haystack. Just take the haystack. The idea is to keep it simple.

Don't do triple dives. In investing, there is no score multiplier for making difficult investments. Just jump in the water at the low end of the pool – since there's no difficulty multiplier – the guy diving from the high platform gets the same amount of wet as you. He just worked more.

“We bought Petrochina because it was extremely cheap.”

What would you consider the greatest misconception that intelligent investors have about you as it regards your investing approach/style?

“Well, I first need to know what people’s perceptions are before knowing their misconceptions.”

On Berkshire, that it is a mutual fund, although that is happening less now. People may think that we get info from people, but we don’t. We don’t meet with managements. We used to. “I can figure it out by looking at the 10Ks.”

WEB buys 100 shares of many, many companies just to get the annual report.

This question is regarding inflation.....in your 1980 letter, you stated that "the great bulk ... of corporate capital is not even partially indexed [to inflation]," and consequently must reinvest a certain level of earnings just to maintain its current level of real earnings power. My question is, why isn't more corporate capital be indexed to inflation?

Inflation is the friend, or at least not the enemy, of the business that doesn’t take any capital, like See’s.

In your 2002 letter to shareholders, you wrote that you and Mr. Munger "view [derivatives] as time bombs, both for the parties that deal in them and the economic system." Does the rather non-committal and in some cases even dismissive reaction to your warning concern you? Are you personally disappointed that people haven't heeded your warning?

No, because it is a low probability event. Gen Re was one example of a time bomb although now we are down to 500 counterparties, which in my opinion is still a lot. I am in the insurance business where I have to recognize that while the odds of an event happening may be 1 in 40, it is still certain that at some point, it will happen.

If there were three people you could meet (deceased or not), who would they be and why?

“My baby doctor so I could start all over again.”

“The truth is everybody is pretty interesting.”

“I have the greatest collection of friends you can imagine.”

Charlie Munger is a very interesting person.

How will you handle the possibility of losing some of your mental edge? Ask Lou Simpson to slap you around when you start not making sense?

“How do I know I’m going ga-ga? That’s an important question.”

“I have assigned my family to do that.”

”They have to tell me as a group. If only one tells me, he’s out of the will.”

“Occasionally, I have to fire somebody. That’s the only thing I don’t like.”

Two things he enjoys:

1. "I come here every day. I get to paint the ceiling every day. I can do whatever I want." Nobody tells me how to paint it.
2. "The second thing I like is the applause. I like it that people like Berkshire."

On Arnold:

"I won the look-alike contest for Arnold."

Arnold has a very tough problem and is going to have to do some unpopular things.

Arnold is very smart; very financially smart.

Could you please talk about your view of the role of the firm in regards to corporate giving, especially in light of the recent Pampered Chef and Buffet Foundation developments?

The choice was simple because innocent people were losing their income because of us. Before that, we wanted to give people the choice of picking their own charities in a tax-effective way.

He mentioned specific donation such as Planned Parenthood. Women should have the right to make choices. "If I were a woman, I'd want to make my own choice."

How in business do you appraise people? What kind of due diligence, if any, do you conduct on people with whom you have business relationships, or are contemplating entering business relationships?

"I look at them in the eyes." He gets a sense of whether they like the money or the business. If they like the money they are going to leave. "I don't have any formulas, but you can feel it."

On what courses to take:

"Accounting is vital." It is the language of business. Accounting is substantially the most important.

Another asset: innate sense of probabilities. "I won't make a dumb bet. Not even for 50 cents."

"I'm wired to think in probabilistic way."

You must read Bob Rubin's upcoming book because he is a man who has excelled in probabilistic thinking.

Most CEOs are dumb about capital allocation. It is not their skill. As a CEO, he's buying businesses, but most of these guys won't even buy stock on their own. It is like

playing a violin your whole life and then getting to play at Carnegie Hall where they give you a piano.

On whether he follows other investors:

“Well, I read OID...but the answer is no.”