Three Lectures by Warren Buffett to Notre Dame Faculty, MBA Students and Undergraduate Students

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Highlights

[The transcript of Buffett's lectures is 39 pages. For those of you who don't have the time to read the entire transcript, we've pulled out some of the highlights – the most interesting things Buffett said and/or the things that we've never heard him say anywhere else.]

Keys to Investment Success

I found some strange things when I was 20 years old. I went through Moody's Bank and Finance Manual, about 1,000 pages. I went through it twice. The first time I went through, I saw a company called Western Insurance Security Company in Fort Scott, Kansas. They owned 92%, at that time, of the Western Casualty and Surety Company. Perfectly sound company. I knew people that represented them in Omaha. Earnings per share $20, stock price $16. (garbled) ... much more than that. I ran ads in the Fort Scott, Kansas paper to try and buy that stock – it had only 300 or 400 shareholders. It was selling at one times earnings, it had a first class [management team]...

[Tape ends here]

... Incidentally, I would say that almost everybody I know in Wall Street has had as many good ideas as I have, they just had a lot of [bad] ideas too. And I'm serious about that. I mean when I bought Western Insurance Security selling at $16 and earning $20 per share, I put half my net worth into it. I checked it out first – I went down to the insurance commission and got out the convention statements, I read Best's, and I did a lot of things first. But, I mean, my dad wasn't in it, I'd only had one insurance class at Columbia – but it was not beyond my capabilities to do that, and it isn't beyond your capabilities.

Now if I had some rare insight about software, or something like that – I would say that, maybe, other people couldn't do that – or biotechnology, or something. And I'm not saying that every insight that I have is an insight that somebody else could have, but there were all kinds of people that could have understood American Express Company as well as I understood it in '62. They may have been...they may have had a different temperament than I did, so that they were paralyzed by fear, or that they wanted the crowd to be with them, or something like that, but I didn't know anything about credit cards that they didn't know, or about travelers checks. Those are not hard products to understand. But what I did have was an intense interest and I was willing, when I saw something I wanted to do, to do it. And if I couldn't see something to do, to not do anything. By far, the most important quality is not how much IQ you've got. IQ is not the scarce factor. You need a reasonable amount of intelligence, but the *temperament* is 90% of it.

That's why Graham is so important. Graham's book [The Intelligent Investor] talks about the qualities of temperament you have to bring to the game, and that is the game.

Require a Statement Before Being Allowed to Buy a Stock
You shouldn't buy a stock, in my view, for any other reason than the fact that you think it's selling for less than it's worth, considering all the factors about the business.

I used to tell the stock exchange people that before a person bought 100 shares of General Motors they should have to write out on a [piece of paper:] "I'm buying 100 shares of General Motors at X" and multiply that by the number of shares "and therefore General Motors is worth more than $32 billion" or whatever it multiplies out to, "because ... [fill in the reasons]" And if they couldn't answer that question, their order wouldn't be accepted.

That test *should be applied*. I should never buy anything unless I can fill out that piece of paper. I may be wrong, but I would know the answer to that. "I'm buying Coca Cola right now, 660 million shares of stock, a little under $50. The whole company costs me about $32 billion dollars." Before you buy 100 shares of stock at $48 you ought to be able to answer "I'm paying $32 billion today for the Coca Cola Company because..." [Banging the podium for emphasis.] If you can't answer that question, you shouldn't buy it. If you *can* answer that question, and you do it a few times, you'll make a lot of money.

Tests of a Good Business
A couple of fast tests about how good a business is. First question is "how long does the management have to think before they decide to raise prices?" You're looking at marvelous business when you look in the mirror and say "mirror, mirror on the wall, how much should I charge for Coke this fall?" [And the mirror replies, "More."] That's a great business. When you say, like we used to in the textile business, when you get down on your knees, call in all the priests, rabbis, and everyone else, [and say] "just another half cent a yard." Then you get up and they say "We won't pay it." It's just night and day. I mean, if you walk into a drugstore, and you say "I'd like a Hershey bar" and the man says "I don't have any Hershey bars, but I've got this unmarked chocolate bar, and it's a nickel cheaper than a Hershey bar" you just go across the street and buy a Hershey bar. *That* is a good business.

The ability to raise prices – the ability to differentiate yourself in a real way, and a real way means you can charge a different price – *that* makes a great business.

I'll try this on the students later: What's the highest price of a daily newspaper in the United States? [Pause] [This is what he said to the students later: Most of you are familiar with it. The highest priced daily newspaper in the United States, with any circulation at all, is the *Daily Racing Form*. It sells about 150,000 copies a day, and it has for about 50 years, and it's either $2.00 or $2.25 (they keep raising prices) and it's essential. If you're heading to the racetrack and you've got a choice between betting on your wife's birthday, and Joe's Little Green Sheet, and the *Daily Racing Form*, if you're a serious racing handicapper, you want *The Form*. You can charge $2.00 for *The Form*, you can charge $1.50, you can charge $2.50 and people are going to buy it. It's like selling needles to addicts, basically. It's an essential business. It will be an essential business five or 10 years from now. You have to decide whether horse racing will be around five or 10 years from now, and you have to decide whether there's any way people will get their information about past performances of different horses from different sources. But you've only got about two questions to answer, and if you answer them, you know the business will make a lot of money. *The Form* has huge profit margins, incidentally. Wider than any other newspaper. They charge what they want to basically. It's an easy to understand business – so easy to understand.]

There are products like that, and there are products like sheet steel. And they're night and day.

Agony vs. Ecstasy Businesses: Example 1

It does make a difference what kind of a business you get associated with. For that reason I've set forth in this little handout Company A and Company E. I'm not going to tell you for the moment what these companies are. I'm going to tell you one thing about the two companies. One of the companies, to the point of where this cuts off, lost its investors more money than virtually any business in the world. The other company made its owner more money than virtually any company in the world. So one of these two companies, Company A and Company E, has made one of its owners one of the five wealthiest people in the world, while the other company made its owners appreciably poorer, probably more so than any other company to that point in time.

Now I'll tell you a little bit about these companies (we're leading up to the question of whether the business makes a difference). Company A had thousands of MBAs working for it. Company E had none. I wanted to get your attention. Company A had all kinds of employee benefit programs, stock options, pensions, the works. Company E never had stock options. Company A had thousands of patents – they probably held more patents than just about any company in the United States. Company E never invented anything. Company A's product improved dramatically in this period, Company E's product just sat.

So far, based on what I've told you, does anybody have any idea of which company was the great success, and why?

If you get to buy one of these two companies, and this is all you know, and you get to ask me one question to decide on which one to buy. If you ask me the right question, you will probably make the right decision about the company's stock, and one will make you enormously wealthy.

[Audience asks questions]

Both companies make products used every day. They started as necessities, highly useful, nothing esoteric about either one, although company A does have all these patents. There's more technology involved in company A.

[How many companies compete with either one?]

Good question, very good question. In effect, neither company had any competition. And that might differentiate in some cases.

Well, I'll tell you a little more about it. Company A is known as company A because it was in agony, and Company E, as Company E, because it was in ecstasy. Company A is American Telephone and Telegraph. I've omitted eight zeros on the left hand side, and the American

Telephone and Telegraph Company, at the end of 1979, was selling for $10 billion less than the shareholders had either put in or left in the business. In other words, if shareholder's equity was "X" the market value was X minus $10 billion. So the money that shareholders had put in, or left in, the business had shrunk by $10 billion in terms of market value.

Company E, the excellent company, I left off only six zeros. And that happens to be a company called Thompson Newspapers. Thomson Newspapers, which most of you have probably never heard of, actually owns about 5% of the newspapers in the United States. But they're all small ones. And, as I said, it has no MBAs, no stock options – still doesn't – and it made its owner, Lord Thompson. He wasn't Lord Thompson when he started – he started with 1,500 bucks in North Bay, Ontario buying a little radio station but, when he got to be one of the five richest men, he became Lord Thompson.

…The telephone company, with the patents, the MBAs, the stock options, and everything else, had one problem, and that problem is illustrated by those figures on that lower left hand column. And those figures show the plant investment in the telephone business. That's $47 billion, starting off with, growing to $99 billion over an eight or nine year period. More and more and more money had to be tossed in, in order to make these increased earnings, going from $2.2 billion to $5.6 billion.

So, they got more money, but you can get more money from a savings account if you keep adding money to it every year. The progress in earnings that the telephone company made was only achievable because they kept on shoving more money into the savings account and the truth was, under the conditions of the '70s, they were not getting paid commensurate with the amount of money that they had to shove into the pot, whereas Lord Thompson, once he bought the paper in Council Bluffs, never put another dime in. They just mailed money every year. And as they got more money, he bought more newspapers. And, in fact, he said it was going to say on his tombstone that he bought newspapers in order to make more money in order to buy more newspapers [and so on].

The idea was that, essentially, he raised prices and raised earnings there every year without having to put more capital into the business.

One is a marvelous, absolutely sensational business, the other one is a terrible business. If you have a choice between going to work for a wonderful business that is not capital intensive, and one that is capital intensive, I suggest that you look at the one that is not capital intensive. I took 25 years to figure that out, incidentally.

Agony vs. Ecstasy Businesses: Example 2 (two Berkshire Hathaway companies)
On the next page, I've got a couple of other businesses here. Company E is the ecstasy on the left. You can see earnings went up nicely: they went from $4 million to $27 million. They only employed assets of $17 million, so that is really a wonderful business. On $17 million they earned $27 million, 150% on invested capital. That is a good business. The one on the right, Company A, the agony, had $11 or $12 million tied up, and some years made a few bucks, and in some years lost a few bucks.

Now, here again we might ask ourselves, "What differentiates these companies?" Does anybody have any idea why company E might have done so much better than Company A? Usually somebody says at this point "maybe company E was better managed than company A." There's only one problem with that conclusion and that is, Company E and Company A had the same manager – me!

The company E is our candy business, See's Candies out in California. I don't know how many of you come from the west, but it dominates the boxed chocolate business out there and the earnings went from $4 million to $27 million, and in the year that just ended they were about $38 million. In other words, they mail us all the money they make every year and they keep growing, and making more money, and everybody's very happy.

Company A was our textile business. That's a business that took me 22 years to figure out it wasn't very good. Well, in the textile business, we made over half of the men's suit linings in the United States. If you wore a men's suit, chances were that it had a Hathaway lining. And we made them during World War II, when customers couldn't get their linings from other people. Sears Roebuck voted us "Supplier of the Year." They were wild about us. The thing was, they wouldn't give us another half a cent a yard because nobody had ever gone into a men's clothing store and asked for a pin striped suit with a Hathaway lining. You just don't see that.

As a practical matter, if some guy's going to offer them a lining for 79 cents, [it makes no difference] who's going to take them fishing, and supplied them during World War II, and was personal friends with the Chairman of Sears. Because we charged 79½ cents a yard, it was "no dice."

See's Candies, on the other hand, made something that people had an emotional attraction to, and a physical attraction you might say. We're almost to Valentine's Day, so can you imagine going to your wife or sweetheart, handing her a box of candy and saying "Honey, I took the low bid."

Essentially, every year for 19 years I've raised the price of candy on December 26. And 19 years goes by and everyone keeps buying candy. Every *ten* years I tried to raise the price of linings a fraction of a cent, and they'd throw the linings back at me. Our linings were just as good as our candies. It was much harder to run the linings factory than it was to run the candy company. The problem is, just because a business is lousy doesn't mean it isn't difficult.

In the end, I like to think anyway that if Alfred P. Sloan [the legendary CEO of General Motors during its heyday] came back and tried to run the lining business, it wouldn't make as much money as a good business. The product was undifferentiated. The candy product is differentiated. (Garbled story of Hershey Bar and Coke versus unbranded but modestly cheaper products).

You really want something where, if they don't have it in stock, you want to go across the street to get it. Nobody cares what kind of steel goes into a car. Have you ever gone into a car dealership to buy a Cadillac and said "I'd like a Cadillac with steel that came from the South Works of US Steel." It just doesn't work that way, so that when General Motors buys they call in all the steel companies and say "here's the best price we've got so far, and you've got to decide if you want to beat their price, or have your plant sit idle."

The Importance of Management: Cap Cities vs. CBS

I put one business in here, CBS versus Cap Cities in 1957, when my friend Tom Murphy took over Cap Cities. They had a little bankrupt UHF station in Albany. They ran it out of a home for retired nuns. And it was very appropriate because they had to pray every day. At that time CBS was the largest advertising medium in the world: $385 million in revenues whereas Cap Cities had $900,000 in revenues. Cap Cities made $37,000 a year and they paid my friend Murph $12,000 a year. CBS made $48 million pretax. Cap Cities was selling for $5 million in the market and priced on the come, while CBS was selling for $500 million.

Now, if you look at the two companies, Cap Cities has a market value of about $7 billion and CBS has a market value of about $2 billion. They were both in the same business, broadcasting. Neither one had, certainly Cap Cities didn't have, any patents. Cap Cities didn't have anything that CBS didn't have. And somehow CBS took a wonderful business that was worth $500 million, and over about 30 years they managed a little increase – peanuts – while my friend Murphy, with exactly the same business, with one little tiny UHF station in Albany, (bear in mind that CBS had the largest stations in New York City and Chicago) and my friend Murph just killed them. And you say "how can that happen?" And that's what you ought to study in business school. You ought to study Tom Murphy at Cap Cities. And you also ought to study Bill Paley [who was the CEO] at CBS.

We have a saying around Berkshire that "all we ever want to know is where we're going to die, so we'll never go there." And CBS is what you don't want. It's as important not to do what CBS did, and it is important to do what Cap Cities did. Cap Cities did a lot of things right, but if CBS had done the same things right, Cap Cities would have never come close.

They had all the IQ at CBS that they had at Cap Cities. They had 50 times as many people, and they were all coming to work early and going home late. They had all kinds of strategic planners, they had management consultants. They had more than I can say. Yet they *lost*. They lost to a guy that started out with a leaky rowboat, at the same time the other guy left in the QE II. By the time they got into New York, the guy in the rowboat brought in more cargo than the QE II did. There's a real story in that. And you can understand broadcasting, so it's really worth studying what two people in the same field did, and why one succeeded so much and one failed.

I couldn't resist kicking in the last page: the only public offering Cap Cities ever made, back in 1957 which raised, as you can see, $300,000. And this was when they were going to buy the station in Raleigh/Durham. The only public offering of stock the company's every made (aside: they sold us a block of stock when they bought ABC). And if you look very carefully you'll see that the underwriting commission – they took two firms to get this sold – the total underwriting commission was $6,500 bucks.

The Perils of the "Mindless Imitation of One's Peers"

The last thing I want to show you, before we get onto your questions, is an ad that was run June 16, 1969, for 1,000,000 shares of American Motors. This is a reproduction from the *Wall Street*

Journal of that day. Now does anybody notice anything unusual about that ad?

[Guesses from audience.]

Everybody in that ad has disappeared. There are 37 investment bankers that sold that issue, plus American Motors, and they are *all* gone. Maybe that's why they call them tombstone ads. Now the average business of the New York Stock exchange in 1969 was 11 million shares. Average volume now is *fifteen* times as large. Now here's an industry whose volume has grown 15 to 1 in 20 years. Marvelous growth in the financial world. And here are 37 out of 37, and those are some of the biggest names on Wall Street, and some of them had been around the longest, and 37 out of 37 have disappeared. And that's why I say you ought to think about [the long-term durability of a business?] because these people obviously didn't.

These were run by people with high IQs, by people that worked ungodly hard. They were people that had an intense interest in success. They worked long hours. They *all* thought they were going to be leaders on Wall Street at some point, and they all went around, incidentally, giving advice to other companies about how to run their business. That's sort of interesting.

You go to Wall Street today, and there's some company the guy hadn't heard of two weeks before and he's trying to sell you. He will lay out this computer run of the next 10 years, yet he doesn't have the faintest idea of what his own business is going to earn next week!

Here are a group of 37. And the question is, how can you get a result like that? That is not a result that you get by chance. How can people who are bright, who work hard, who have their own money in the business – these are not a bunch of absentee owners – how can they get such a bad result? And I suggest that's a good thing to think about before you get a job and go out into the world.

I would say that if you had to pick one thing that did it more than anything else, it's the mindless imitation of one's peers that produced this result. Whatever the other guy did, the other 36 were like a bunch of lemmings in terms of following. That's what's gotten all the big banks in trouble for the past 15 years. Every time somebody big does something dumb, other people can hardly wait to copy it. If you do nothing else when you get out of here, do things *only* when they make sense to you. You ought to be able to write "I am going to work for General Motors because ... "I am buying 100 shares of Coca Coals stock because..." And if you can't write an intelligent answer to those questions, don't do it.

I proposed this to the stock exchange some years ago: that everybody be able to write out "I am buying 100 shares of Coca Cola Company, market value $32 billion, because ...." and they wouldn't take your order until you filled that thing out.

I find this very useful when I write my annual report. I learn while I think when I write it out. Some of the things I think I think, I find don't make any sense when I start tying to write them down and explain them to people. You ought to be able to explain why you're taking the job you're taking, why you're making the investment you're making, or whatever it may be. And if it can't stand applying pencil to paper, you'd better think it through some more.

People in that ad did a lot of things that could not have stood that test. Some *major* bankers in the United States did a lot of things that could not meet that test. One of the bankers in the United States, who's in plenty of trouble now, bragged a few years ago he never made a loan. And, from the way things are starting to look, he's never going to collect on one either.

You should not be running one the major banks in the United States without having made loans. I mean, you learn about human nature, if nothing else, when you make loans.

The Perils of Leverage

The question is whether LBOs and junk bonds and so on have hurt the country in some fundamental way in terms of its competitiveness vis-à-vis the world. I wouldn't go that far, but I think on balance it's been a huge minus on the financial scene. Extreme leverage has been, generally speaking, a net minus. The analogy has been made (and there's just enough truth to it to get you in trouble) that in buying some company with enormous amounts of debt, that it's somewhat like driving a car down the road and placing a dagger on the steering wheel pointed at your heart. If you do that, you will be a better driver – that I can assure you. You will drive with unusual care. You also, someday, will hit a small pothole, or a piece of ice, and you will end up gasping. You will have fewer accidents, but when they come along, they'll be fatal. Essentially, that's what some of corporate America did in the last 10 years. And it was motivated by huge fees. And it was motivated by greed.

The most extreme case I saw was a television station. About three years ago, a television station in Tampa sold for an amount where, when they had to borrow the money, the interest amounted to more than the total sales of the station. If everybody donated their labor, if they donated their programming, if they donated their utilities, they still wouldn't have enough to pay the interest. They went crazy. And you can buy those bonds at 15 cents on the dollar. Charlie Keating's enterprise [Lincoln Savings and Loan Association in California, which became the nation's largest thrift failure] had a bunch of them too. There's a lot of crazy stuff that went on in the last five or six years. The fees on that deal, they paid $365 million for the station, they borrowed $385 million and you can guess where the extra money went. It went into the pockets of the people who put the deal together.

Donald Trump and the Perils of Leverage

Where did Donald Trump go wrong? The big problem with Donald Trump was he never went right. He basically overpaid for properties, but he got people to lend him the money. He was terrific at borrowing money. If you look at his assets, and what he paid for them, and what he borrowed to get them, there was never any real equity there. He owes, perhaps, $3.5 billion now, and, if you had to pick a figure as to the value of the assets, it might be more like $2.5 billion. He's a billion in the hole, which is a lot better than being $100 in the hole because if you're $100 in the hole, they come and take the TV set. If you're a billion in the hole, they say "hang in there Donald."

It's interesting why smart people go astray. That's one of the most interesting things in business. I've seen all sorts of people with terrific IQs that end up flopping in Wall Street or business because they beat themselves. They have 500 horsepower engines, and get 50 horsepower out of them. Or, worse than that, they have their foot on the brake and the accelerator at the same time. They really manage to screw themselves up.

… I would suggest that the big successes I've met had a fair amount of Ben Franklin in them. And Donald Trump did not.

Life Tends to Snap You at Your Weakest Link

One of the things you will find, which is interesting and people don't think of it enough, with most businesses and with most individuals, life tends to snap you at your weakest link. So it isn't the strongest link you're looking for among the individuals in the room. It isn't even the average strength of the chain. It's the weakest link that causes the problem.

It may be alcohol, it may be gambling, it may be a lot of things, it may be nothing, which is terrific. But it is a real weakest link problem.

When I look at our managers, I'm not trying to look at the guy who wakes up at night and says "E = MC 2" or something. I am looking for people that function very, very well. And that means not having any weak links. The two biggest weak links in my experience: I've seen more people fail because of liquor and leverage – leverage being borrowed money. Donald Trump failed because of leverage. He simply got infatuated with how much money he could borrow, and he did not give enough thought to how much money he could pay back.

Keys to Avoiding Trouble and Leading a Happy Life

You really don't need leverage in this world much. If you're smart, you're going to make a lot of money without borrowing. I've never borrowed a significant amount of money in my life. Never. Never will. I've got no interest in it. The other reason is I never thought I would be way happier when I had 2X instead of X. You ought to have a good time all the time as you go along. If you say "I'm taking this job – I don't really like this job but in three years it will lead to this," forget it. Find one you like right now.

Full Transcripts

Lecture to Faculty

Thank you. When you asked me what I did, in this year's annual report I tried to describe what I do...

> [Told Beemer the Clown story; excerpt from 1990 Berkshire Hathaway annual letter:
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> > Much of the extra value that exists in our businesses has been created by the managers now running them. Charlie and I feel free to brag about this group because we had nothing to do with developing the skills they possess: These superstars just came that way. Our job is merely to identify talented managers and provide an environment in which they can do their stuff. Having done it, they send their cash to headquarters and we face our only other task: the intelligent deployment of these funds.
> >
> > My own role in operations may best be illustrated by a small tale concerning my granddaughter, Emily, and her fourth birthday party last fall. Attending were other children, adoring relatives, and Beemer the Clown, a local entertainer who includes magic tricks in his act.
> >
> > Beginning these, Beemer asked Emily to help him by waving a "magic wand" over "the box of wonders." Green handkerchiefs went into the box, Emily waved the wand, and Beemer removed blue ones. Loose handkerchiefs went in and, upon a magisterial wave by Emily, emerged knotted. After four such transformations, each more amazing than its predecessor, Emily was unable to contain herself. Her face aglow, she exulted: "Gee, I'm really good at this."
> >
> > And that sums up my contribution to the performance of Berkshire's business magicians - the Blumkins, the Friedman family, Mike Goldberg, the Heldmans, Chuck Huggins, Stan Lipsey and Ralph Schey. They deserve your applause.]

We've never had a meeting of our managers. The fellow that runs the candy company we bought 19 years ago [See's Candies], last year came to Omaha because he and his wife wanted to see what the annual meeting was like, but he'd never come to Omaha [before that]. We've never had a meeting with his board. We moved the company's headquarters from Los Angeles to San Francisco because his wife liked living in San Francisco better than Los Angeles. We adapt our operations to the people that run our businesses.

We've got a uniform company in Cincinnati, Fechheimers. Does about $100 million. Bought it about five years ago. A fellow read the annual report where I list what I'm looking for. I run an ad in the annual report (I believe in advertising) and this fellow walked in and said "I fit those parameters, and the business does" and we made a deal with him. I've never visited Cincinnati. I've not seen that plant. It may be a [hoax] – for all I know, he makes up these little reports every five (garbled). But he sends me cash, and I like that.

So it’s a very peculiar operation. I bought a business eight years ago from an 89-year-old woman who started with $500, never put in another dime, and it was making about $12 million before taxes (about $18 million now). She doesn’t know what accruals are, she doesn’t know any of that sort of thing. She got mad at her grandsons, who work at the company, a few years ago, so she quit and went into competition with us. This taught me that the next time I buy a business from an 89-year-old woman, I’m getting a non-compete agreement. This woman now runs another successful business.

She’s a marvelous woman. She walked out of Russia. She landed in Seattle with a tag around her neck. She couldn’t speak a word of English. Fort Dodge, Iowa was where her relatives were. She got to Fort Dodge about 1920 or 1919, and they didn’t have a penny. She brought over seven siblings, as well as her mother and father, and that took her eight or 10 years, sending $50 bucks at a time. She made it selling used clothing. She started this company in 1937 with $500. She was boycotted by most of the suppliers, the main carpet companies in town. They took her into court on violation of fair trade laws. When she got before the judge, Judge Chase, she said “Judge, I paid $3 a yard for this. Brandeis (a carpet store) paid $3 too. They sell it for $6.99. I sell it for $3.99. Tell me how much you want me to rob people. If you tell me to rob them $1 a yard, I’ll charge them $4.99.” The newspaper picks up all this and the judge comes in and buys $1,400 worth of carpet. She beat them in court four times and every time she killed them.

This company is now the largest home furnishings store, by a factor of 2 to 1, over any home furnishings store in the United States. It does $160 million from one location. That one store makes about $18 million pretax. It has a 500,000 square foot warehouse (garbled).

That woman, who got an honorary degree from NYU business school about five or six years ago (garbled). You cannot beat her record. If you tell her this room is 38 by 16, she will tell you how many square yards it is, just like that. And she’s 97. She’ll tell you how many yards it is at $5.99, the extension, and she’ll have the sales tax, and she’ll knock off something if you’re a nice fresh face. And that’s it. She can do it all as fast as I’ve said that. She sold me the business in 30 seconds. She talked to me and told me how much she’d wanted. She’d never had an audit. I didn’t need an audit. Her word was better than the Bank of England.

We make all our deals that way. Our total legal and accounting fees on that deal, which was a $60 million deal, we had to file a 10Q with the SEC, we had to file a Hart-Scott-Rodino filing, our total legal and accounting fee came to $1,400 bucks. All on one page. There’s a mark where her name is. It says “Mrs. B on behalf of herself and her children.” She only owned 20% of the business. She made her mark, and the deal was cut.

All our deals are done like that. We’ve made all our deals, essentially, on the first contact. We never get warranties, we never get anything.

These people are rich, and we have to figure out if they’re the kind of people to keep working after they’ve sold out. We have to decide if they’re working because they love the business, or because they love money. And, if they love money, they’re not of any use to us because I can’t give them enough money after they’ve got all the money [from selling us] their business.

They've got to love the business. I would say that if we do anything very well at Berkshire, it's spotting the kind of people that, after they are very rich, will work even harder. We get no budgets from them. We have one board of directors meeting a year, which follows the shareholders meeting. No one has to come in. All they have to do is run the businesses. And we've got a bunch of those now.

They mail me the money – that's the second part of their job. And it's my job to allocate capital. They can do whatever makes sense in the candy business, or the newspaper business, but they don't have to go out and do a bunch of foolish things. We like businesses that generate cash. Sometimes we have something to do with it, sometimes we don't. We prefer to buy businesses with it but if we can't buy businesses with it, we buy pieces of businesses called stocks.

Our biggest holdings: we own 7% of the Coca Cola Company, worth about $2 billion. Your Chairman here [referring to the President of Coca Cola, Don Keough, who was also Chairman of Notre Dame's board] used to live across the street from me in Omaha 30 years ago when he was a salesman for Butternut Coffee. He had six kids, making $200 bucks a week, and starving to death. He was telling at lunch how he went into his boss one day, and told him about the six kids, about the parochial school, paying him $200 bucks a week and "it just ain't easy pal", and while he was doing this his boss, Paul Gallagher [the owner of Butternut Coffee], reached into his desk and pulled out a scissors and starting cutting strands off his fraying shirt. He walked away. Fortunately, things have improved some.

We have 7% of Coke. There are 660 million eight ounce servings of Coca Cola products being served around the world today, so in effect, we've got a 45 million soft drink business with our 7%. We think of businesses that way. I say to myself "just increase the price a penny and that's another $450,000 a day for Berkshire." I mean, it's a nice sort of thing. When I go to bed at night I figure that by the time I wake up 200 million Cokes will have been consumed. We've got some Gillette too, and every night I think about two billion plus men's hair growing and four billion women's legs with hair. It goes all night when I sleep.

So we buy businesses I can understand, whether all of them or small parts of them. We never buy anything that I don't think I can understand. I may be wrong about whether I understand it or not, but we've never owned a share of a technology company. There's all kinds of businesses I don't understand. I don't worry about that. Why should I (garbled). You mentioned Cities Service Preferred, I didn't understand that very well when I bought it. Ever since I met Ben Graham, I was 19, I read his book when I was 18, it made nothing but sense to me. Buy pieces of businesses you can understand when they're offered to you for quite a bit less than they're worth. That's all there is to it. That's what we try to do with 100% of the business, 7% of the business, or whatever. My partner Charlie Munger and I have been together for about 15 years, and that's all we do. And we'll never do anything else.

Mrs. B is that way. I couldn't have given her $200 million worth of Berkshire Hathaway stock when I bought the business because she doesn't understand stock. She understands cash. She understands furniture. She understands real estate. She doesn't understand stocks, so she doesn't have anything to do with them. If you deal with Mrs. B in what I would call her circle of competence... She is going to buy 5,000 end tables this afternoon (if the price is right). She is going to buy 20 different carpets in odd lots, and everything else like that [snaps fingers] because she understands carpet. She wouldn't buy 100 shares of General Motors if it was at 50 cents a share.

I would say that the most important thing in business, and investments, which I regard as the same thing, from our standpoint, is being able to accurately define your circle of competence. It isn't a question of having the biggest circle of competence. I've got friends who are competent in a whole lot bigger area than I am, but they stray outside of it.

In that book Father, Son & Co. [subtitle: My Life at IBM and Beyond] you may have read, that Tom Watson Junior recently wrote, he quoted his father as saying "I'm no genius. I'm smart in spots but I stay around those spots." And that's all there is to it in investments – and business. I always tell the students in business school they'd be better off when they got out of business school to have a punch card with 20 punches on it. And every time they made an investment decision they used up one of those punches, because they aren't going to get 20 great ideas in their lifetime. They're going to get five, or three, or sever, and you can get rich off five, or three, or seven. But what you can't get rich doing is trying to get one every day. The very fact that you have, in effect, an unlimited punch card, because that's the way the system works, you can change your mind every hour or every minute in this business, and it's kind of cheap and easy to do because we have markets with a lot of liquidity – you can't do that if you own farms or [real estate] – and that very availability, that huge liquidity which people prize so much is, for most people, a curse, because it tends to make them want to do more things than they can intelligently do.

If we can do one intelligent thing a year we are ecstatic. You can negotiate us down to one every two or three years without working very hard. That's all you need. You need very few good ideas in your lifetime. You have to be willing to have the discipline to say, "I'm not going to do something I don't understand." Why should I do something I don't understand? That's why I find it an advantage to be in Omaha instead of New York. I worked in New York for a few years, and people were coming up to me on the corner and whispering in my ear all the time. I was getting excited all the time. I was a wonderful customer for the brokers.

Let's talk about what you're interested in.

[Comment from audience]

That's a problem. It helps to have the efficient market out there. It's very nice to have people out there saying, "none of this does any good." It's a real advantage to have. I don't think it's as strong now, but you really had the revealed truths, for a decade or so, saying it didn't do any good to think. Investments presumably means businesses too. And once you say investments are all priced efficiently, you presumably have to go on and say businesses are priced efficiently, and you're just throwing darts all the time. If this group were a bunch of chess players, or a bunch of bridge players, and they were all convinced that it did not pay to think about what to do, you'd have an enormous advantage. We've had tens of thousands of students in business schools taught that it's [a waste of time to think].

You mentioned the five-sigma event; actually it was Bill Sharpe out at Stanford many years ago. My friend Charlie says that "as the record gets longer it's easier to add a sigma than it is to reevaluate the theory." Which is sort of true. I think it was Ken Galbraith that said "Economists are most economical about ideas. They make the ones they learn in school last a lifetime."

[Tape flipped here]

The market generally is pretty efficient. You take the 30 stocks in the Dow and a bunch of very smart minds all looking at them and having the same information and most of the time, not all of the time, they'll be priced efficiently. So what? You only have to be right a few times. Sometimes it's very strange things. Sometimes it's panic (garbled).

In '74 you could have bought the Washington Post when the whole company was valued at $80 million. Now at that time the company was debt free, it owned the *Washington Post* newspaper, it owned *Newsweek*, it owned the CBS stations in Washington D.C. and Jacksonville, Florida, the ABC station in Miami, the CBS station in Hartford/New Haven, a half interest in 800,000 acres of timberland in Canada, plus a 200,000-ton-a-year mill up there, a third of the *International Herald Tribune*, and probably some other things I forgot. If you asked any one of thousands of investment analysts or media specialists about how much those properties were worth, they would have said, if they added them up, they would have come up with $400, $500, $600 million.

Bob Woodward one time said to me "tell me how to make some money" back in the '70s, before he'd made some money himself on a movie and a book. I said "Bob, it's very simple. Assign yourself the right story. The problem is you're letting Bradley assign you all the stories. You go out and interview Jeb Magruder." I said "Assign yourself a story. The story is: what is the Washington Post Company worth? If Bradley gave you that story to go out and report on, you'd go out and come back in two weeks, and you'd write a story that would make perfectly good sense. You'd find out what a television station sells for, you'd find out what a newspaper sells for, you'd evaluate temperament." I said "You are perfectly capable of writing that story. It's much easier than finding out what Bill Casey is thinking about on his deathbed. All you've got to do is assign yourself that story."

"Now, if you come back, and the value you assign the company is $400 million, and the company is selling for $400 million in the market, you still have a story but it doesn't do you any good financially. But if you come back and say it's $400 million and it's selling for $80 million, that screams at you. Either you are saying that the people that are running it are so incompetent that they're going to blow the $400 million, or you're saying that they're crooked and that they're operating Bob Vesco style. Or, you've got a screaming buy when you can buy dollar bills for 20 cents. And, of course, that $400 million, within eight or 10 years, with essentially the same assets, [is now worth] $3 or $4 billion."

That is not a complicated story. We bought in 1974, from not more than 10 sellers, what was then 9% of the Washington Post Company, based on that valuation. And they were people like Scudder Stevens, and bank trust departments. And if you asked any of the people selling us the stock what the business was worth, they would have come up with an answer of $400 million. And, incidentally, if it had gone down to $60 or $40 million, the beta would have been higher of course, and it would have therefore been [viewed as] a riskier asset. There is no risk in buying the stock at $80 million. If it sells for $400 [million] steadily, there's much more risk than if it goes from $400 million to $80 million.

But that's all there is to business. But now you say "I don't know how to evaluate the Washington Post." It isn't that hard to evaluate the Washington Post. You can look and see what newspapers and television stations sell for. If your fix is $400 and it's selling for $390, so what? You can't [invest safely with such a small margin of safety]. If your range is $300 to $500 and it's selling for $80 you don't need to be more accurate than that. It's a business where that happens.

At the time we bought Coca Cola just two years ago, [we ended up buying] 7% of the company. We paid a billion dollars, so we were paying $14 billion, essentially, for the whole thing. You can sit down in five minutes – I mean, everybody here understands Coca Cola. If Philip Morris were to buy Coca Cola that day, they would have paid $30 billion. And they wouldn't have sold it for that. And you wouldn't have sold it for that. The company's actually repurchasing stock at the time. So, in effect, they're buying for you. They're buying out your partners, at 50 cents on the dollar or less, which is a magnificent sort of business, and there are no morals to it. It's an easy business. There's no doubt about it.

I don't know a thing now that I didn't know at 19 when I read that book. For eight year prior to that I was a chartist. I loved all that stuff. I had charts coming out my ears. Then, all of a sudden a fellow explains to me that you don't need all that, just buy something for less than it's worth.

[Question from audience]

The world, generally, is treated much more favorably in relation to buying businesses than we are because we're restricted now to buying big businesses, or pieces of big businesses. And that is a big disadvantage. As Charlie says "there could be worse things."

You'll find this interesting. At market, we've probably got $7 or $8 billion in equities. In 1970, Berkshire had about $15 million in equities. We owned more securities then than we own now. We do not have it solved by buying more things. Every now and then we find something. In our annual report this year [we disclosed that] we made two large purchases. Each one was $300 or $400 million. Every now and then you'll get an opportunity. And when they come, they come for 15 minutes [I think that's what he said]. Some days it's raining gold. Not very often, but when it is, you've got to be out there. And that will happen periodically. It'll happen, but you can't make it happen. In the meantime, you let the cash pile up if that's what happens.

[Question from audience about how many of his investment ideas are pitched to him by others.]

Practically none. The *Wall Street Journal* is my deal source. There are 1,700 or 1,800 of America's companies that I'm generally familiar with – a good many of them. And every day they move around the prices of them. So here's a business broker's office if you want to call it that. And sometimes they change them pretty dramatically, like October 19th of '87. But they change them dramatically. And that is a great start. Any business that I buy will be measured against the yardstick of that business brokers office in Section C of the *Wall Street Journal*.

In terms of deals, our standards are such that very few are going to meet it. We are much more likely to find one from an owner, who owns the business himself, who wants to sell it to someone like us, and if they want to sell to someone like us, we're the only one like us. I can promise them, a) since I control Berkshire, the only one who can double cross them or lie to them is me. If they start with the XYZ company, XYZ can be taken over tomorrow, the directors can get a new strategic [plan] tomorrow, they can have McKinsey come in and tell them to do something different tomorrow. And no one can really make them a promise there like I can make them a promise. I can tell them exactly what will and won't happen when I make a deal, and to some people that is very important.

It's important to me with Berkshire. I've got a lot of things in my will about (garbled) is better, and all kinds of things. I care where that goes, the same way I care about anything else I've spent my lifetime working on. When I run into somebody like that, we've got an advantage. To some extent, they know about us, and I'll hear about them, but not very many. They're very few. And they're usually older when it happens. Sometimes they've got other members of the family in the business that are inactive and want to take the money out. We've arraigned, in three of our businesses, with younger generations to take 18%, or 15%, or 20% of the equity. We can do a lot of things, in terms of meeting objectives, that some owners may [appreciate] although most owners [don't have complex requirements]. But it is not a question of answering the phone and taking an investment banker's call.

In terms of marketable securities or new offerings, we've never bought anything [that's been pitched to us by an investment banker or broker]. We don't pay any attention to investment bankers or brokers. It's not an efficient use of our time [to read their] reports. We read hundreds and hundreds of annual reports every year. I own 100 shares of everything. I find this much more reliable than asking to be put on a mailing list.

I was reading the Gillette report. I noticed that they'd bought in a bunch of stock. I'd known that before. Their net worth was below zero, which doesn't make a lot of difference, but I thought it might bother them, with the kind of history the company had. So I saw the name of a director that was a friend of mine, Joe Sisco. I called Joe and said "I don't know the people up there, but if they're interested in doing something in the way of financing I would be interested and, if they're not, I'll never bother them." Joe called me back in a couple of days, Coleman Mockler and I got together and we put $600 million in.

We bought Scott Fetzer (World Book, Kirby Vacuum, and all sorts of things). It had been mixed up for about a year and a half, being sort of in play. I'd never met Ralph Schey, never talked to him on the phone, never had any contact with him at all. And I wrote him a letter that said "here's our annual report. If you're interested in talking to me we'll pay cash, our check will clear, it will be a one-page deal. If you're not interested, I'll never bother you again, and you'll never hear again, and throw the letter out." He called me back, we met in Chicago on a Sunday and we made a deal that night, [signed the documents the] next week, and that was it.

[Question from audience: Wwhat was it about Gillette that appealed to you?]

I can understand (garbled) and shaving, the price flexibility, what I call the moat around the business. The most important thing with me in evaluating businesses is figuring out how big the moat is around the business. I want to know how big the capital is on the inside and then I want to know how big the moat is around it. What you love is big capital and a big moat. Obviously. World Book has a real moat. Kirby has a real moat. You can figure that out if you [studied] the distribution process and everything.

I've been in the textile business. We made half of the men's linings in the United States for 25 years.

[re: Gillette] It was the kind of business we'd put capital into on the right basis.

One of the biggest early things was American Express back in 1962 at the time of the salad oil scam. There was a guy named De Angelis in Bayonne, New Jersey.

American Express had a field warehousing company which was a tiny, tiny, little subsidiary, with $12 [million] in capital. The field warehousing company's job was to certify that inventories really existed. That was their job. They stuck their name on it, and you could take those certificates that said there was a given amount of whatever there was, and you could borrow against these certificates. Tino De Angelis had this tank farm about 15 miles from lower Manhattan. And the American Express field warehousing company authenticated the existence of salad oil in these tanks. And, at one time, they were authenticating the existence of more salad oil than the Department of Agriculture, in its monthly reports, was saying existed in the United States. But they never told us of that discrepancy. Late in 1962, right at the time Kennedy was assassinated, within a day or two, the thing blew. A couple of New York Stock Exchange firms went broke – Ira Haupt, (garbled), maybe one other – because they lent on these phony certificates.

And American Express, which never even thought of this little field warehousing operation, it was nothing, compared to their money order business, credit card, and travel, all of a sudden, they've got this little subsidiary, not the parent company, but the subsidiary, that was on the hook for tens and tens of millions of dollars, and nobody knows how much. And that is the nice thing about fraud (garbled)…

There was one other little wrinkle which was terribly interesting. American Express was not a corporation. It then was the only major publicly traded security that was a joint stock association. As such, the ownership of the company was assessable. If it turned out that the liabilities were greater than the assets, [then] the ownership was assessable. So every trust department in the United States panicked. I remember the Continental Bank held over 5% of the company and all of a sudden not only do they see that the trust accounts were going to have stock worth zero, but it could get assessed. The stock just poured out, of course, and the market got slightly inefficient for a short period of time.

The American Express Company was a unique company to understand. You could look at that credit card and you knew it was a winner. Diner's Club had been the first, Carte Blanche had come along, but the American Express Card was killing them. They had raised prices every time. Their retention rate was higher. And finally, they raised prices, and Diner's Club didn't go along, and their growth far outstripped Diner's Club even though they were selling at a higher price. So this was a dynamite asset.

The traveler's check business had 60% of the traveler's check business in the world while selling their checks at a higher price than the banks, B of A and what was then First National Citibank, which were the two main competitions. So here were two guys, B of A and First National City, undercutting them on price for 60 years and they still had 2/3 of the market. That is a moat around the business. I went out and did a little check to make sure this thing wasn't affecting them and we bought 5% of the American Express Company for $20 million, which means the whole company was selling for about $150 million at that time. The whole American Express Company, synonymous with financial integrity and money substitutes around the world. When they closed the banks, when Roosevelt closed the banks, he exempted American Express Traveler's Checks, so they substituted as US currency. It was not a business that should have been selling for $150 million, but everyone was terrified. It was very hard to tell how it would all come out in the end. But, probably, it was going to be between $60 and $100 million, and that was a lot more money back then in '62 than it is now. I just took the attitude that they'd declared a dividend of $75 million, sent it out and it got lost. Would that have caused a panic – somebody else gets your dividend but you don't.

No one would have argued about the value of American Express. They just didn't want to own it for a while. That's what you're buying periodically. They didn't want to own the Washington Post in '74. All you've got to do is find one, two or three businesses like that in a lifetime, load up when you do, and not do anything in between. There will be bigger whales in the ocean and they'll (garbled). There will be more of those as we go along. It's harder when you're working with more money, but there'll always be something.

[Question from audience]

Well, I would say this. If we were working with $25 million – so we could sort of look at the whole universe of stocks – I would guess that you could find 15 or 20 out of three or four thousand that you would find that were A) selling for substantially less than they're worth, and B) that the intrinsic value of the business was going to grow at a compound rate which was very satisfactory.

You don't want to buy a dollar bill that's sitting for 50 cents, and it demands positive capital, and it's going to be a dollar bill ten years from now. You want a dollar bill that's going to compound at 12% for [a long time]. And, you want to be around some competent people. Just the same thing as if you went in and bought a Ford dealership in South Bend. The same exact thought processes goes through you mind if some friend called you tonight and said "I'd like you to go into the Ford dealership" or whatever, is exactly the kind of thought as goes through mind about all the other businesses that are in Standard and Poor's.

When I was 20, I went through Moody's and Standard and Poor's page by page – twice – because that is it, that's the universe. The universe is much smaller now, unfortunately.

I found some strange things when I was 20 years old. I went through Moody's Bank and Finance Manual, about 1,000 pages. I went through it twice. The first time I went through, I saw a company called Western Insurance Security Company in Fort Scott, Kansas. They owned 92%, at that time, of the Western Casualty and Surety Company. Perfectly sound company. I knew people that represented them in Omaha. Earnings per share $20, stock price $16. (garbled) ... much more than that. I ran ads in the Fort Scott, Kansas paper to try and buy that stock – it had only 300 or 400 shareholders. It was selling at one times earnings, it had a first class [management team]...

[Tape ends here]

... Incidentally, I would say that almost everybody I know in Wall Street has had as many good ideas as I have, they just had a lot of [bad] ideas too. And I'm serious about that. I mean when I bought Western Insurance Security selling at $16 and earning $20 per share, I put half my net worth into it. I checked it out first – I went down to the insurance commission and got out the convention statements, I read Best's, and I did a lot of things first. But, I mean, my dad wasn't in it, I'd only had one insurance class at Columbia – but it was not beyond my capabilities to do that, and it isn't beyond your capabilities.

Now if I had some rare insight about software, or something like that – I would say that, maybe, other people couldn't do that – or biotechnology, or something. And I'm not saying that every insight that I have is an insight that somebody else could have, but there were all kinds of people that could have understood American Express Company as well as I understood it in '62. They may have been...they may have had a different temperament than I did, so that they were paralyzed by fear, or that they wanted the crowd to be with them, or something like that, but I didn't know anything about credit cards that they didn't know, or about travelers checks. Those are not hard products to understand. But what I did have was an intense interest and I was willing, when I saw something I wanted to do, to do it. And if I couldn't see something to do, to not do anything. By far, the most important quality is not how much IQ you've got. IQ is not the scarce factor. You need a reasonable amount of intelligence, but the *temperament* is 90% of it.

That's why Graham is so important. Graham's book [The Intelligent Investor] talks about the qualities of temperament you have to bring to the game, and that is the game. Now I can (garbled).

He may not know anything about a Coca Cola, or something of that sort, but that isn't what makes you the money. What makes you the money is your attitude going in, your attitude toward stock market fluctuations. There's two chapters in The Intelligent Investor, chapter 8 and chapter 20, they're more important than everything that's been written on investments, in my view, before or since. And there's no specific technical knowledge in those things. It just tells you what frame of mind to be in when you come to the game. And people just don't get it. But that is not because I'm particularly skillful. And bear in mind that I didn't have that (garbled). It's not like I was Mozart and sat down at five or something. I mean I was churning things, I was computing odd lot statistics, I mean I loved all that stuff because I always liked numbers and playing around with them. It was like baseball averages or something. But what I needed was a philosophical bedrock position from which I could then go out and look at businesses, and probe through that filter, and decide whether that's [a bargain or not]. And that's Ben Graham's contribution. And that's the game. You don't have to be that smart. You don't have to know advanced accounting. It may *help* if you know something, particularly accounting. But the fact that you don't know it may restrict your universe some.

[Garbled comment from audience]

It goes back to a debate I was having with Mike Jensen [a proponent of the efficient market theory who famously wrote in 1978 that "there is no other proposition in economics which has more solid empirical evidence supporting it than the Efficient Market Hypothesis"]. [I rebutted the efficient market hypothesis in] The [Super]Investors of Graham and Doddsville. It was an address I gave on the 50th anniversary of Security Analysis. Dave Dodd was there – 90 years old, marvelous guy. And in that room were a half a dozen or more of us who had gone on to study or work, or have some association with Ben Graham. We weren't all five-sigma types, but we've always gotten five-sigma, or three-sigma, or something results. So it isn't because he had carefully culled us out from all over the country, like the Notre Dame football team. We were there just because we kind of stumbled in. And we listened to the guy and then went out and applied it in different ways – totally different ways. I mean, Walter Schloss [has always] owned hundreds of different stocks. Walter is not a 150 IQ guy. Charlie Munger is. There were all different types of [people] with a common philosophical bond. They did not learn any little secrets of technique – they did not learn any systems.

Everybody wants a system. I mean they come to our annual meeting (garbled) the book guy, or the price/earnings, "do I buy them on Monday?" They all want some [system] that you can run through a computer and simulate it out. I mean I tell 'em if past performance were the key to it, the Forbes 400 would consist of librarians. Everybody would be looking it up. It doesn't work that way. They *want* it to work that way. It would be so nice if it did, but it is not that way. It's like picking out a basketball team. You look for guys who are seven feet tall, you look for a guy who can stay in school, there are a whole bunch of things. And there are certain things that point you toward getting the best five guys out there on the court. But I can't give them a formula. I can't say "here's a little formula and if you go to Emporia, Kansas and apply this formula without actually seeing the guys play basketball and working with them, you'll pick up the best basketball team." You won't.

[Garbled question from audience]

To me, it's absolutely fascinating that the teaching of investments has really retrogressed from 40 years ago, and I think it's probably because the teachers are more skillful. They learn all these huge mathematical techniques and (garbled) and they have so much fun manipulating numbers they're missing something very simple. And I think they have, on balance (aside: I say this at Stanford or Harvard), sent people off with the wrong message. And I get letters from students about it. I don't see what the reason for having an investment course is unless you teach people how to analyze the value of investments. If people thought there was nothing of utility that you could impart on the subject, except for the fact that there is nothing you can do useful, then I don't understand... And I know it isn't true because I've seen people teach other people how to make unusual returns over a 30- or 40-year T-Note.

Phil Caret wrote a book on investing in 1924. He's still alive, he's a shareholder of Berkshire, he's 92 or 93 years old. He writes me letters that say "I approve of your no dividend policy because when I get older, then I want to start getting dividends." But Phil Caret has got a record of 70 years. That is a *lot* of investments and it is a superior investment record. Not done exactly the same as Graham, but it's the same general approach. Even Keynes came to that view. He started out as a market timer. But in the '30s he [changed approaches]. [Keynes later said: "As time goes on, I get more and more convinced that the right method in investment is to put fairly large sums into enterprises which one thinks one knows something about."]

You can't teach people a formula. You can't come in at the start of the term, and when they get all through, understand E=MC squared. It's not like teaching geometry or something.

You shouldn't buy a stock, in my view, for any other reason than the fact that you think it's selling for less than it's worth, considering all the factors about the business.

I used to tell the stock exchange people that before a person bought 100 shares of General Motors they should have to write out on a [piece of paper:] "I'm buying 100 shares of General Motors at X" and multiply that by the number of shares "and therefore General Motors is worth more than $32 billion" or whatever it multiplies out to, "because ... [fill in the reasons]" And if they couldn't answer that question, their order wouldn't be accepted.

That test *should be applied*. I should never buy anything unless I can fill out that piece of paper. I may be wrong, but I would know the answer to that. "I'm buying Coca Cola right now, 660 million shares of stock, a little under $50. The whole company costs me about $32 billion dollars." Before you buy 100 shares of stock at $48 you ought to be able to answer "I'm paying $32 billion today for the Coca Cola Company because..." [Banging the podium for emphasis.] If you can't answer that question, you shouldn't buy it. If you *can* answer that question, and you do it a few times, you'll make a lot of money.

[From the audience: "Well, you bought it, how did you answer it?"]

Well, it was only $14 billion. I would say this: "If you added a penny to price of every Coca Cola sold in the world this year, that would add $2 billion to pretax earnings." Now you tell me whether you think there's a penny, worldwide, of price flexibility per serving of Coke. Well, the answer is "you *know* there is."

When they bought the Coca Cola Company, the Candler family bought it from Pembertons back in 1904 or 1906, they paid $2,000 for the company. If the Pemberton family had reserved a penny a serving royalty a serving, the Coca Cola company would be sending $2 *billion* to the Pemberton family every year and you wouldn't even see the difference in the figures. It's there.

Now that's not true when I was selling [men's suit] linings [Berkshire Hathaway's original business]. I sold men's suit linings for 20 years. We tried to raise our price a half a cent a yard, and on an 80-cent-a-yard product, people who'd done business with us for 80 years slammed the door in our face. (garbled) ... "but half a cent a yard"... Nobody ever went into a store and said "I'd like to buy a pinstripe suit with a Hathaway lining." Never. They say "I want a coat" all over the world.

Now in this country, Pepsi is, unfortunately, more or less coexistent with Coke. This is their weakest market. They make more in Japan, with less than half the people and way less per capita usage than they make in the United States. Around the world a guy says "I'll sell you an unmarked cola a penny cheaper" ... it isn't going to happen. That is the fastest test.

A couple of fast tests about how good a business is. First question is "how long does the management have to think before they decide to raise prices?" You're looking at marvelous business when you look in the mirror and say "mirror, mirror on the wall, how much should I charge for Coke this fall?" [And the mirror replies, "More."] That's a great business. When you say, like we used to in the textile business, when you get down on your knees, call in all the priests, rabbis, and everyone else, [and say] "just another half cent a yard." Then you get up and they say "We won't pay it." It's just night and day. I mean, if you walk into a drugstore, and you say "I'd like a Hershey bar" and the man says "I don't have any Hershey bars, but I've got this unmarked chocolate bar, and it's a nickel cheaper than a Hershey bar" you just go across the street and buy a Hershey bar. *That* is a good business.

The ability to raise prices – the ability to differentiate yourself in a real way, and a real way means you can charge a different price – *that* makes a great business.

I'll try this on the students later: What's the highest price of a daily newspaper in the United States? [Pause] The highest priced daily newspaper in the United States is the *Daily Racing Form*. 150,000 copies a day, $2.25 a copy, they go up in 25 cent intervals, and it doesn't affect circulation at all. Why? There is no substitute. If you go to the track, assuming you're a forms player, you don't want "Joe's Little Green Sheet", you want *The Form*. And it doesn't make any difference what it costs! There is no substitute. And that's why they've got a 65% pretax margin. It doesn't take a genius to figure it out.

There are products like that, and there are products like sheet steel. And they're night and day.

[From Audience: You said you only had to have a couple of good ideas, we at Notre Dame had a good one in having you here.] [Applause]

Lecture to MBA Students

I'll talk for a few minutes on some of the things that relate to this handout I've got, so if everybody has one, or looks with their neighbor, we'll get the (garbled) about how to make a lot of money in stocks as we go along.

Eddie Cantor had a problem with Goldman Sachs in the late '20s. [Cantor was a popular entertainer who lost his fortune in the crash.] He did not do very well in something he bought from them, so he worked them into his routine when he performed, and he told (garbled).

You know Wall Street is a place that people drive to in Rolls Royces to get advice from people who ride to work on the subway.

I'd like to talk to you for just a few minutes about what I regard as the most important thing in investments and also in terms of your career. Because in your career what train you get on makes a lot of difference. Because frequently, perhaps generally, when people get out of business school, they don't give enough thought to exactly what sort of train they're going to get on. And it makes a tremendous difference whether you get involved in a prosperous company, one that's going to really do well. On balance, you want to go with a company whose stock is going to be a good investment over the years because there's going to be much more opportunity, there's going to be more money made, you're going to (garbled). And if you get involved with some of the businesses I've been involved with like trading stamps (garbled).

[Buffett is warning students to stay away from declining businesses such as Blue Chip Stamps, though this was in fact a highly successful investment. In the book Damn Right!, Janet Lowe wrote: "During the late 1960s and early 1970s, Munger, Guerin and Buffett gradually acquired a controlling interest in Blue Chip Stamps. This small company issued trading stamps, which merchants distributed. Customers collected and redeemed the stamps for merchandise. The investors saw untapped potential in the company's float account – the difference between stamps issued and stamps redeemed. Using this pool of capital, Blue Chip's controlling investors acquired several other companies: Wesco Financial, See's Candies and The Buffalo Evening News."]

It does make a difference what kind of a business you get associated with. For that reason I've set forth in this little handout Company A and Company E. I'm not going to tell you for the moment what these companies are. I'm going to tell you one thing about the two companies. One of the companies, to the point of where this cuts off, lost its investors more money than virtually any business in the world. The other company made its owner more money than virtually any company in the world. So one of these two companies, Company A and Company E, has made one of its owners one of the five wealthiest people in the world, while the other company made its owners appreciably poorer, probably more so than any other company to that point in time.

Now I'll tell you a little bit about these companies (we're leading up to the question of whether the business makes a difference). Company A had thousands of MBAs working for it. Company E had none. I wanted to get your attention. Company A had all kinds of employee benefit programs, stock options, pensions, the works. Company E never had stock options. Company A had thousands of patents – they probably held more patents than just about any company in the United States. Company E never invented anything. Company A's product improved dramatically in this period, Company E's product just sat.

So far, based on what I've told you, does anybody have any idea of which company was the great success, and why?

If you get to buy one of these two companies, and this is all you know, and you get to ask me one question to decide on which one to buy. If you ask me the right question, you will probably make the right decision about the company's stock, and one will make you enormously wealthy.

[Audience asks questions]

Both companies make products used every day. They started as necessities, highly useful, nothing esoteric about either one, although company A does have all these patents. There's more technology involved in company A.

[How many companies compete with either one?]

Good question, very good question. In effect, neither company had any competition. And that might differentiate in some cases.

Well, I'll tell you a little more about it. Company A is known as company A because it was in agony, and Company E, as Company E, because it was in ecstasy. Company A is American Telephone and Telegraph. I've omitted eight zeros on the left hand side, and the American Telephone and Telegraph Company, at the end of 1979, was selling for $10 billion less than the shareholders had either put in or left in the business. In other words, if shareholder's equity was "X" the market value was X minus $10 billion. So the money that shareholders had put in, or left in, the business had shrunk by $10 billion in terms of market value.

Company E, the excellent company, I left off only six zeros. And that happens to be a company called Thompson Newspapers. Thomson Newspapers, which most of you have probably never heard of, actually owns about 5% of the newspapers in the United States. But they're all small ones. And, as I said, it has no MBAs, no stock options – still doesn't – and it made its owner, Lord Thompson. He wasn't Lord Thompson when he started – he started with 1,500 bucks in North Bay, Ontario buying a little radio station but, when he got to be one of the five richest men, he became Lord Thompson. I met him one time in England as a matter of fact, in 1972, and went up to see him. He'd never heard of me, but he was a very important guy. (I'd heard of him!)

I said, "Lord Thompson, you own the newspaper in Council Bluffs, Iowa. Council Bluffs is right across the river from Omaha, where I live, four or five miles from my house. I said, "Lord Thompson, You own the Council Bluffs [Daily Nonpareil?]. I don't suppose you'd ever think of selling it?" He said "I wouldn't think of it."

I said "Lord Thompson, you've bought this paper in Council Bluffs, and you've never seen the paper, never seen the town, but I do notice that every year you raise prices." (garbled)

He’s got the only way to talk to people – his was the only “megaphone” for merchants to announce commercial news in Council Bluffs. He said “I figured that out before you did.”

I said, “If you ever raise prices to the point where it’s counterproductive (garbled).”

Then [I said] “I’ve got only one other question: How do you figure out how much to charge people? You look like a man of awesome commercial instincts – you started with a $1,500 radio station, now you’re worth $4 or $5 billion dollars.”

He said “Well, that’s another good question. I just tell my US managers to try and make 45% pretax and figure that’s not gouging.” And as I got to the elevator, he said “If you ever hear of a newspaper you don’t want to buy, call me. Collect.”

I rode down and that was two years of business school. I mean, try to make 45% and call me collect if you ever find a paper you don’t want to buy.

The telephone company, with the patents, the MBAs, the stock options, and everything else, had one problem, and that problem is illustrated by those figures on that lower left hand column. And those figures show the plant investment in the telephone business. That’s $47 billion, starting off with, growing to $99 billion over an eight or nine year period. More and more and more money had to be tossed in, in order to make these increased earnings, going from $2.2 billion to $5.6 billion.

So, they got more money, but you can get more money from a savings account if you keep adding money to it every year. The progress in earnings that the telephone company made was only achievable because they kept on shoving more money into the savings account and the truth was, under the conditions of the ‘70s, they were not getting paid commensurate with the amount of money that they had to shove into the pot, whereas Lord Thompson, once he bought the paper in Council Bluffs, never put another dime in. They just mailed money every year. And as they got more money, he bought more newspapers. And, in fact, he said it was going to say on his tombstone that he bought newspapers in order to make more money in order to buy more newspapers [and so on].

The idea was that, essentially, he raised prices and raised earnings there every year without having to put more capital into the business.

One is a marvelous, absolutely sensational business, the other one is a terrible business. If you have a choice between going to work for a wonderful business that is not capital intensive, and one that is capital intensive, I suggest that you look at the one that is not capital intensive. I took 25 years to figure that out, incidentally.

On the next page, I’ve got a couple of other businesses here. Company E is the ecstasy on the left. You can see earnings went up nicely: they went from $4 million to $27 million. They only employed assets of $17 million, so that is really a wonderful business. On $17 million they earned $27 million, 150% on invested capital. That is a good business. The one on the right, Company A, the agony, had $11 or $12 million tied up, and some years made a few bucks, and in some years lost a few bucks.

Now, here again we might ask ourselves, “What differentiates these companies?” Does anybody have any idea why company E might have done so much better than Company A? Usually somebody says at this point “maybe company E was better managed than company A.” There’s only one problem with that conclusion and that is, Company E and Company A had the same manager – me!

The company E is our candy business, See’s Candies out in California. I don’t know how many of you come from the west, but it dominates the boxed chocolate business out there and the earnings went from $4 million to $27 million, and in the year that just ended they were about $38 million. In other words, they mail us all the money they make every year and they keep growing, and making more money, and everybody’s very happy.

Company A was our textile business. That’s a business that took me 22 years to figure out it wasn’t very good. Well, in the textile business, we made over half of the men’s suit linings in the United States. If you wore a men’s suit, chances were that it had a Hathaway lining. And we made them during World War II, when customers couldn’t get their linings from other people. Sears Roebuck voted us “Supplier of the Year.” They were wild about us. The thing was, they wouldn’t give us another half a cent a yard because nobody had ever gone into a men’s clothing store and asked for a pin striped suit with a Hathaway lining. You just don’t see that.

As a practical matter, if some guy’s going to offer them a lining for 79 cents, [it makes no difference] who’s going to take them fishing, and supplied them during World War II, and was personal friends with the Chairman of Sears. Because we charged 79½ cents a yard, it was “no dice.”

See’s Candies, on the other hand, made something that people had an emotional attraction to, and a physical attraction you might say. We’re almost to Valentine’s Day, so can you imagine going to your wife or sweetheart, handing her a box of candy and saying “Honey, I took the low bid.”

Essentially, every year for 19 years I’ve raised the price of candy on December 26. And 19 years goes by and everyone keeps buying candy. Every *ten* years I tried to raise the price of linings a fraction of a cent, and they’d throw the linings back at me. Our linings were just as good as our candies. It was much harder to run the linings factory than it was to run the candy company. The problem is, just because a business is lousy doesn’t mean it isn’t difficult.

In the end, I like to think anyway that if Alfred P. Sloan [the legendary CEO of General Motors during its heyday] came back and tried to run the lining business, it wouldn’t make as much money as a good business. The product was undifferentiated. The candy product is differentiated. (Garbled story of Hershey Bar and Coke versus unbranded but modestly cheaper products).

You really want something where, if they don’t have it in stock, you want to go across the street to get it. Nobody cares what kind of steel goes into a car. Have you ever gone into a car dealership to buy a Cadillac and said "I'd like a Cadillac with steel that came from the South Works of US Steel." It just doesn't work that way, so that when General Motors buys they call in all the steel companies and say "here's the best price we've got so far, and you've got to decide if you want to beat their price, or have your plant sit idle."

I put one business in here, CBS versus Cap Cities in 1957, when my friend Tom Murphy took over Cap Cities. They had a little bankrupt UHF station in Albany. They ran it out of a home for retired nuns. And it was very appropriate because they had to pray every day. At that time CBS was the largest advertising medium in the world: $385 million in revenues whereas Cap Cities had $900,000 in revenues. Cap Cities made $37,000 a year and they paid my friend Murph $12,000 a year. CBS made $48 million pretax. Cap Cities was selling for $5 million in the market and priced on the come, while CBS was selling for $500 million.

Now, if you look at the two companies, Cap Cities has a market value of about $7 billion and CBS has a market value of about $2 billion. They were both in the same business, broadcasting. Neither one had, certainly Cap Cities didn't have, any patents. Cap Cities didn't have anything that CBS didn't have. And somehow CBS took a wonderful business that was worth $500 million, and over about 30 years they managed a little increase – peanuts – while my friend Murphy, with exactly the same business, with one little tiny UHF station in Albany, (bear in mind that CBS had the largest stations in New York City and Chicago) and my friend Murph just killed them. And you say "how can that happen?" And that's what you ought to study in business school. You ought to study Tom Murphy at Cap Cities. And you also ought to study Bill Paley [who was the CEO] at CBS.

We have a saying around Berkshire that "all we ever want to know is where we're going to die, so we'll never go there." And CBS is what you don't want. It's as important not to do what CBS did, and it is important to do what Cap Cities did. Cap Cities did a lot of things right, but if CBS had done the same things right, Cap Cities would have never come close.

They had all the IQ at CBS that they had at Cap Cities. They had 50 times as many people, and they were all coming to work early and going home late. They had all kinds of strategic planners, they had management consultants. They had more than I can say. Yet they *lost*. They lost to a guy that started out with a leaky rowboat, at the same time the other guy left in the QE II. By the time they got into New York, the guy in the rowboat brought in more cargo than the QE II did. There's a real story in that. And you can understand broadcasting, so it's really worth studying what two people in the same field did, and why one succeeded so much and one failed.

I couldn't resist kicking in the last page: the only public offering Cap Cities ever made, back in 1957 which raised, as you can see, $300,000. And this was when they were going to buy the station in Raleigh/Durham. The only public offering of stock the company's every made (aside: they sold us a block of stock when they bought ABC). And if you look very carefully you'll see that the underwriting commission – they took two firms to get this sold – the total underwriting commission was $6,500 bucks.

The last thing I want to show you, before we get onto your questions, is an ad that was run June 16, 1969, for 1,000,000 shares of American Motors. This is a reproduction from the *Wall Street*

Journal of that day. Now does anybody notice anything unusual about that ad?

[Guesses from audience.]

Everybody in that ad has disappeared. There are 37 investment bankers that sold that issue, plus American Motors, and they are *all* gone. Maybe that's why they call them tombstone ads. Now the average business of the New York Stock exchange in 1969 was 11 million shares. Average volume now is *fifteen* times as large. Now here's an industry whose volume has grown 15 to 1 in 20 years. Marvelous growth in the financial world. And here are 37 out of 37, and those are some of the biggest names on Wall Street, and some of them had been around the longest, and 37 out of 37 have disappeared. And that's why I say you ought to think about [the long-term durability of a business?] because these people obviously didn't.

These were run by people with high IQs, by people that worked ungodly hard. They were people that had an intense interest in success. They worked long hours. They *all* thought they were going to be leaders on Wall Street at some point, and they all went around, incidentally, giving advice to other companies about how to run their business. That's sort of interesting.

You go to Wall Street today, and there's some company the guy hadn't heard of two weeks before and he's trying to sell you. He will lay out this computer run of the next 10 years, yet he doesn't have the faintest idea of what his own business is going to earn next week!

Here are a group of 37. And the question is, how can you get a result like that? That is not a result that you get by chance. How can people who are bright, who work hard, who have their own money in the business – these are not a bunch of absentee owners – how can they get such a bad result? And I suggest that's a good thing to think about before you get a job and go out into the world.

I would say that if you had to pick one thing that did it more than anything else, it's the mindless imitation of one's peers that produced this result. Whatever the other guy did, the other 36 were like a bunch of lemmings in terms of following. That's what's gotten all the big banks in trouble for the past 15 years. Every time somebody big does something dumb, other people can hardly wait to copy it. If you do nothing else when you get out of here, do things *only* when they make sense to you. You ought to be able to write "I am going to work for General Motors because ... "I am buying 100 shares of Coca Coals stock because..." And if you can't write an intelligent answer to those questions, don't do it.

I proposed this to the stock exchange some years ago: that everybody be able to write out "I am buying 100 shares of Coca Cola Company, market value $32 billion, because ...." and they wouldn't take your order until you filled that thing out.

I find this very useful when I write my annual report. I learn while I think when I write it out. Some of the things I think I think, I find don't make any sense when I start tying to write them down and explain them to people. You ought to be able to explain why you're taking the job you're taking, why you're making the investment you're making, or whatever it may be. And if it can't stand applying pencil to paper, you'd better think it through some more.

People in that ad did a lot of things that could not have stood that test. Some *major* bankers in the United States did a lot of things that could not meet that test. One of the bankers in the United States, who's in plenty of trouble now, bragged a few years ago he never made a loan. And, from the way things are starting to look, he's never going to collect on one either.

You should not be running one the major banks in the United States without having made loans. I mean, you learn about human nature, if nothing else, when you make loans.

[Question and Answer With Students]

That jewelry store, it's an interesting story, I'll take an extra minute. We bought a furniture store about five or six years ago. We bought it from a woman who was 89 [Rose Blumkin, the legendary Mrs. B]. That woman came to this country with a tag around her neck from Russia. She walked out of Russia, and the Red Cross truck got her in Seattle and (garbled) then Fort Dodge, Iowa and sent her there. And she saved money. She sold used clothes and that sort of thing, and she brought over seven siblings, plus her mother and father. She sent over $50 bucks at a time to get the rest of the family over here.

In 1937, she would have been 44 at the time, she started a store with $500, a home furnishings store. That's all the money she ever put into it. Last year it made $18 million, pretax. It's become the largest home furnishings store in the country. And she put everybody out of business. She doesn't know accounting, she's never had an audit, she doesn't know what accruals mean, she doesn't know what depreciation means, but she knows how to run a business. And, unfortunately, two years ago she got mad at her grandchildren and she went out and quit and started competing with us, which shows you how stupid I was not to get a non-compete agreement from an 89-year-old woman! She is now in business right across the street, and works seven days a week at 97 years of age. And if you tell her that this room is 27 by 31, she will tell you how many square yards it is just like that, at $6.99 a yard, and how much that comes to plus tax. She can do it just like that. She cannot read or write. She has never been to school a day in her life. But she knows how to run a business.

One of the sisters she brought over, also to Omaha, was a woman named Rebecca. She went through Latvia, and the border guard took the money when she got to Latvia, and she had to sit in Latvia for a year until her sister got another $50 bucks to bring her over here. They got over here, and it took them 20 odd years to get enough money to buy into a tiny little jewelry store. And I bought that business a couple of years ago from the Friedman family, which is Mrs. B's sister. Incidentally, Mrs. B is 97, and her three other (garbled).

In any event, in that jewelry store last year, the sales were up 18%. I believe it's the second largest jewelry store in the United States, next to Tiffany's main location, and it uses *exactly* the same formula the furniture store used in building up the largest home furnishings store. The people that run them never went to business school, and they stress the things that Ben Franklin would stress. Essentially, their business is pure Ben Franklin. Tell truth and give people service. Ben Franklin said "take care of thy shop and it will take care of thee." Now that's old fashioned in terms of the phraseology, but it's that simple. And, the truth is that family... If you were at our jewelry store last Saturday like I was, Ike Friedman who is 65, 66, was there. His mother, Mrs. Friedman, came in – she's 89 years old – *Wall Street Journal* under her arm. You've got his son there, his only son, two sons-in-law, two daughters in there, they're all busy. The family's worth tens and tens and tens of millions of dollars. They don't do it 'cause they have to, they do it 'cause they like to.

The one thing we've done well in buying businesses is the people who sold them were in love with their business and not in love with money. If they're in love with money we can't do it, but if they're in love with their business we get along very well because we leave them alone.

Actually Fran Blumkin, the wife of Louis Blumkin, who's now Chairman of the Furniture Mart, comes in on Saturday, and works Tuesday, to help out Louis' cousins. And she sells jewelry all the time there. It's a great business. Berkshire bought a great business. It gets better, and better, and better. And *no-one* can knock 'em off.

That's one of the things I always ask myself: If you give someone hundreds of millions of dollars, or billions of dollars, [can you hurt a particular business?] You can't hurt the Furniture Mart or Borsheim's.

[Question: When you look at a company, how do you value it, how do you decide how much to pay for it, and after that, would you say how much you'd sell it for.]

Well, we won't sell it. We just don't sell businesses. If we had a business that would permanently lose money, or we had a manager lie to us, or cheat us, or (garbled). But we will never sell a business just because we get a wonderful offer for it. My house isn't for sale. The children aren't for sale. The businesses aren't for sale. I tell shareholders that. That may make me crazy, but that's who they're getting in with, and they might as well know it. It is not a game we're playing, like gin rummy, where we pick up one card and discard another.

And I think good human relationships... I work with nothing but people I like. There's not one person I work with that causes my stomach to churn in the least. In fact, I feel like tap dancing. I work with nothing but people I like. Well, just think how fortunate you are if you're 60 years of age and that's the way you're going to be able to spend your life. These people are wonderful to work with. I mean, Ike Friedman...we never disagree. Charlie Munger, my partner, and I have never had a disagreement in 30 years. And, why in the world [would I sell businesses run by people I like] so that I can be worth 110% of X, instead of X, when I die? It will all be in the foundation anyway. Why should I go around discarding people like that who are in the business, for some people who might not turn out so well? So I'm not interested in selling at all.

Now, in terms of buying, a) I've got to like the people. I'm just not interested in marrying for money. That might have been great when I was 12, but it would be crazy now for me to marry someone for money. Why should I marry in business for money? It just doesn't make sense. I get associated with these people, so I want to buy the people I like, and I want to buy businesses I understand, and then I don't want to think too much. And, paying too much simply comes out.

If you can tell me what all of the cash in and cash out of a business will be, between now and judgment day, I can tell you, assuming I know the proper interest rate, what it's worth. It doesn't make any difference whether you sell yo-yo's, hula hoops, or computers. Because there would be a stream of cash between now and judgment day, and the cash spends the same, no matter where it comes from. Now my job as an investment analyst, or a business analyst, is to figure out where I may have some knowledge, what that stream of cash will be over a period of time, and also where I don't know what the stream of cash will be. I don't have the faintest idea of where Digital Equipment will be in next week, let alone the next 10 years. I just don't know. I don't even know what they do. And I never would know what they did. Even if I thought I knew what they did, I wouldn't know what they did. Hershey bars I understand.

So, my job is to look at the universe of things I can understand – I can understand Ike Friedman's jewelry store – and then I try to figure what that stream of cash, in and out, is going to be over a period of time, just like we did with See's Candies, and discounting that back at an appropriate rate, which would be the long term Government rate. [Then,] I try to buy it at a price that is significantly below that. And that's about it. Theoretically, I'm doing that with all the businesses in the world – those that I can understand.

Every day, when I turn to the *Wall Street Journal*, back in the C Section, that's like a big business brokerage ad. It's just like a business broker saying "you can buy part of AT&T for this, part of General Motors for that, General Electric..." And unlike most business broker's ads, it's nice because they change the price every day. And you don't have to do business with any of them. So you just sit there, day by day, and you yawn, and you insult the broker if you want to, and talk to your newspaper, anything you want to, because someday, there's going to be some business I understand selling for way less than the value I arrived at. It doesn't have anything to do with book value, although it does have to do with earnings power over a period of time. It usually relates, fairly closely, to cash [flow]. And, when you find something you understand, if you find five ideas in your lifetime and you're right on those five, you're going to be very rich.

You know I always tell business students that if you got a punch card when you got out of here, and it only had 20 businesses on it, and every time you made an investment decision they took a punch, and when the 20 were gone you were all done, it would be wonderful. You're not going to get more than 20 investment ideas in a lifetime. I'm not going to get more than 20 great ideas. And the important thing is that you recognize them when you see them, and that you do something about them.

So, when we find something we understand, if we're buying all of the business, I want to like the people. If we're buying part of the business, it's less important. We want to buy things we understand, and we want to buy them very cheap. If we don't understand them, we don't buy them. If they're not cheap, we don't buy them. If we can buy them with Tom Murphy, my friend, at an attractive price, we do that in a second.

We bought 5% of the Walt Disney Company in 1966. It cost us $4 million dollars. $80 million bucks was the valuation of the whole thing. 300 and some acres in Anaheim. The Pirate's ride had just been put in. It cost $17 million bucks. The whole company was selling for $80 million. Mary Poppins had just come out. Mary Poppins *made* about $30 million that year, and seven years later you're going to show it to kids the same age. It's like having an oil well where all the oil seeps back in. Now the [numbers today are] probably different, but in 1966 they had 220 pictures of one sort or another. They wrote them all down to zero – there were no residual values placed on the value of any Disney picture up through the '60s. So [you got all of this] for $80 million bucks, and you got Walt Disney to work for you. It was incredible. You didn't have to be a genius to know that the Walt Disney company was worth more than $80 million. $17 million for the Pirate's Ride. It's unbelievable. But there it was. And the reason was, in 1966 people said, "Well, Mary Poppins is terrific this year, but they're not going to have another Mary Poppins next year, so the earnings will be down." I don't care if the earnings are down like that. You know you've still got Mary Poppins to throw out in seven more years, assuming kids squawk a little. I mean there's no better system than to have something where, essentially, you get a new crop every seven years and you get to charge more each time.

$80 million dollars [sigh]. I went out to see Walt Disney (he'd never heard of me; I was 35 years old). We sat down and he told me the whole plan for the company – he couldn't have been a nicer guy. It was a joke. If he'd privately gone to some huge venture capitalist, or some major American corporation, if he'd been a private company, and said "I want you to buy into this. This is a deal," they would have bought in based on a valuation of $300 or $400 million dollars. The very fact that it was just sitting there in the market every day convinced [people that $80 million was an appropriate valuation]. Essentially, they ignored it because it was so familiar. But that happens periodically on Wall Street.

I wanted to go see Mary Poppins, to see if she'd be recycled, and she was showing at the Loews Theater on 45th and Broadway in New York, and here I am with a briefcase at 2:00 in the afternoon heading in to see Mary Poppins. I almost felt like I had to rent a kid.

[Question from audience.]

There's very little relationship between Walt Disney and Salomon. In Salomon we have lent them, in effect, $700 million on a preferred which matures in five equal installments, starting five years from now, which is also convertible. And this is primarily a fixed income investment with an interesting conversion privilege attached to it. But it is not primarily an equity investment. We get a 9% dividend which, because of the corporate dividend tax credit, converts to something over 7% on an after-tax basis. It's a form of lending money. It's an alternative to municipal bonds or something of that sort. It is *not* an investment like Coca Cola, or the Washington Post, or Cap Cities, which are pure equity investments.

We would rather, and this is nothing negative on Salomon, buy more things like Coca Cola. You know, those are the things that really cause excitement, because those are super businesses as far as the eye can see. Salomon is a perfectly decent business, but it's just not the same kind of business. Neither is Champion Paper or US Air, which we've done the same thing for. If we had way less money, we wouldn't be doing those things, as opposed to the Coca Cola thing. It's because we can't find more of those. And we should own some fixed income investments because of our [insurance business].

[Question from audience.]

Well, I started out when I was 20. I had just finished Ben Graham's course. And I took Moody's Manuals – they had investment manuals – and I took Standard and Poor's, where they put them all together, and do them all alphabetically, and I went through them all page by page. And things jumped out at me. I saw Western Insurance Services, in Fort Scott, Kansas, looking in Moody's Bank and Finance Manuals. I'd never heard of Western Insurance Services until I turned that page that said Western Insurance Services. It showed earnings per share of $20 and the high was $16. Now that may not turn out to be something you can make a lot of money on, but the odds are good. It's like a basketball coach seeing a guy 7'3" walk through the door. He may not be able to stay in school, and may be very uncoordinated, but he's very large. So I went down to the Nebraska Insurance Department, and I got the convention reports on their insurance companies, and I read Best's. I didn't have any background in insurance. But I knew I could understand it if I worked at it for a while. And all I was really trying to do was disprove this thing. I was really trying to figure out something that was wrong with this. Only there wasn't anything wrong. It was a perfectly good insurance company, a better than average underwriter, and you could buy it at one times earnings. I ran ads in the Fort Scott, Kansas paper to buy this stock when it was $20. But it came through turning the pages. No one tells you about it. You get 'em by looking.

I read hundreds of annual reports every year. I don't talk to any brokers – I don't want to talk to brokers. People are not going to give you great ideas. On the other hand, getting them is not that difficult. If you'd read the Disney report in 1966, believe me, you'd have known as much about Disney then as now. You wouldn't have Michael Eisner, you'd have Walt Disney running it. And you could have multiplied, at two million shares outstanding (garbled).

Cap Cities at that time was an act of faith. You had to believe in Tom Murphy. You could not see (garbled).

(Garbled) and some of you will be stars, and some of you will be less than stars. But it won't correlate with your IQ at all. But you have it already. And everybody in the room has it. I'll give you a little question. Let's think about this. Let's say that everyone here got a bonus when they left Notre Dame. Let's say for $25,000 you could buy a 10% interest in the income of any one of your classmates that you wanted to. Now, what are you thinking about? You can take anybody in this room, and for $25,000 buy a 10% interest in their income for life. If they make $25,000 the first year, you make $2,500. If they're unemployed, you don't get anything. If they get stock options, you get 10% of the stock options. What are you thinking about as you look around? Are you thinking about which ones are the smartest? It's interesting what ingredients you think now are what's going to produce that in the classroom. I would suggest that you start thinking about, assuming you have a 10% interest, what qualities you want to have. I know I would take Tom Murphy. Why? Well, he's got an IQ, there's no question about that. But, that's something one or two others might have as well.

Think about why you picked him or her, and how much of that is transferable to you. And it usually won't be anything you can't attain yourself. But if it's qualities of character, or qualities of enthusiasm, or whatever it may be, most of those things you can pick up.

[Question from audience.]

Well, we will do that anytime we feel that a dollar we retain in the company is not going to be worth more than a dollar in market price. And that can happen. I mean, as we get bigger, it's more likely to happen. But so far, every dollar we've kept in the company has translated into more than a dollar in market price, so that anybody who wanted to take $10 a share out, or $50 a share out, is better off having us keep the $50, having at appraised in the market at $60, $70, or $80 and selling a little piece. They actually come out dollars ahead by doing that. But, when we can't use the money for any extended period, not for a month or three months, but a period of years, when we find out that we don't have ways to use money in a way that creates more than a dollar of market value for each dollar reinvested, then we won't.

I couldn't attend the 50th birthday of one of my friends so I sent him a telegram "may you live until Berkshire splits." That doesn't apply to cash dividends. It will be a market failure but, nevertheless, that may be what happens.

[Question from audience.]

Well, I won't comment too much on that. The question is whether Security Pacific and Wells Fargo, two of the four largest banks in California, were in talks late last year, and a story appeared in the *Wall Street Journal* talking about this a week or two ago. They were in talks last year about merging. And that excited some people because Wells had done a particularly good job when they took over Crocker four years ago, or so. And then the deal, the Security Pacific/Wells Fargo thing, did not happen. And then the story leaked out so it's in the paper. Security Pacific is probably an $80 billion bank. Wells Fargo, I know, is a $50 billion bank. It would have created what would have been the second largest bank in the country, next to Citicorp.

My guess is there will be some bank mergers in the next few years, but they may be more suicide pacts than mergers. There's going to be a lot of action, not all good by a long shot, in banks, simply because there's so much trouble there. The big problem in merging two banks these days is that you don't know what's in the other guy's loan portfolio – because too often *he* doesn't know. And people didn't used to worry about that five or 10 years ago, and they worry about it a whole lot now because, if they merge with the wrong bank, they can go broke.

C&S, the Citizens and Southern Bank of Atlanta, merged with Sovereign earlier this year. Sovereign has got a lot of real estate problems in the Washington D.C. area, and that merger took place less than 12 months ago.

Al Lerner merged his Equitable Trust Company in Baltimore into the old Maryland National. Al Lerner is a very, very, smart fellow. And he merged his own company, which he had a lot of his own money in, her merged it in with MNC and in six months MNC was in huge trouble. The stock was 10% of what the value was when he merged it six months ago. And Al just got in with something where he didn't know how bad it was. But that was easy to do. So, everybody is super careful about that, and this is why there's a problem, because to look at a Wells Fargo with assets of $50 billion, and Security Pacific with $80 billion, and if there's $2 or $3 billion in there that's no good, that wipes out equity. That's a tough decision to make.

[Question from audience.]

Right now, in property/casualty insurance, generally speaking, prices are lousy, which means business is terrible. We have found a few things to do that will be in our annual report. We've found a few things that are OK, they're not like they were four or five years ago, but they're keeping us out of bars. And that's what we look for in times like this. But that is a *very* interesting business. When that guy was predicting an earthquake near New Madrid we wrote a two month policy against a $3 billion earthquake for some crazy rate as a percentage of everything. We ought to keep that guy out there.

We've had a chance to do some very interesting things in insurance. It's a very tricky business. We are getting in claims on policies we wrote in 1970. We're not getting in any premium, we're just getting in claims. They tell the story in insurance ...

> [Told burying dad in a rented suit story. From the 2001 Berkshire Hathaway annual letter:
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> > Even when companies have the best of intentions, it's not easy to reserve properly. I've told the story in the past about the fellow traveling abroad whose sister called to tell him that their dad had died. The brother replied that it was impossible for him to get home for the funeral; he volunteered, however, to shoulder its cost. Upon returning, the brother received a bill from the mortuary for $4,500, which he promptly paid. A month later, and a month after that also, he paid $10 pursuant to an add-on invoice. When a third $10 invoice came, he called his sister for an explanation. "Oh," she replied, "I forgot to tell you. We buried dad in a rented suit."
> >
> > There are a lot of "rented suits" buried in the past operations of insurance companies. Sometimes the problems they signify lie dormant for decades, as was the case with asbestos liability, before virulently manifesting themselves. Difficult as the job may be, it's management's responsibility to adequately account for *all* possibilities. Conservatism is essential. When a claims manager walks into the CEO's office and says "Guess what just happened," his boss, if a veteran, does not expect to hear it's good news. Surprises in the insurance world have been far from symmetrical in their effect on earnings.]

We literally will pay hundreds of thousand of dollars for things that happened years back. On the other hand, overall, it can be a good business if you're disciplined. We have a rule, we're very Japanese in that, we never lay off anybody. We tell them, in times like this where we're writing way less than we were writing a few years ago, we tell them that under no conditions will they be laid off for lack of business because otherwise they'll go out an write some business. I mean, it's the easiest thing in the world to do. And we tell them we'll buy them golf memberships, country club memberships, if they'll promise to play golf during business hours, because we don't want them in the office during business under terms that are generally available these days. So we occasionally run into a good big deal, and we keep busy that way, but we are operating at 1/4 speed. We have a lot of people that are doing crossword puzzles, which is fine. It beats whatever else they'd be doing. You do not want energetic people in a lousy business.

[Question from audience.]

I read all kinds of business publications. I read a lot of industry publications. Coming in today on the plane (garbled). I'll grab whatever comes in the morning. American Banker comes every day, so I'll read that. I'll read the *Wall Street Journal*. Obviously. I'll read Editor and Publisher, I'll read Broadcasting, I'll read Property Casualty Review, I'll read Jeffrey Meyer's Beverage Digest. I'll read everything. And I own 100 shares of almost every stock I can think of just so I know I'll get all the reports. And I carry around prospectuses and proxy material. Don't read broker's reports. You should be very careful with those.

[Question from audience.]

I think the *Wall Street Journal* is essential. I spend 45 minutes a day with the *Wall Street Journal*. Actually, I got up the night before, about 11:00... I frequently read it at night. But I'll read anything. Actually, I probably spend five or six hours a day on reading. We have no meetings at Berkshire. We have a directors meeting once a year, after the shareholders meeting, at lunch. And at the end, I say "I'll see you next year." It's a very economical operation. We don't have a slide projector. We don't have a calculator. We do not have meetings on anything. If I take Ike Friedman, and bring him to a meeting, I've probably lost $20,000 or something. He should be out there selling. There just isn't anything to meet about. He's having meetings in his head all the time about the jewelry store. I'm having meetings in my head about what to do with the money.

[Question from audience.]

We don't attend any seminars, or trade things. I get all this stuff about how to incorporate in the Cayman Islands or how to never write a check to the IRS. We don't do any of that stuff. There's not much goes on at the place, and that's probably just as well. Every now and then we get a chance to do something and we do it as best as we can.

When Coca Cola got to where it was attractive, for seven or eight months we bought every share of Coca Cola we could. We bought what, on the old stock, 23 million shares, we probably bought that on 150 trading days, that's 160,000 shares a day. You gotta do it when the time is right to do it.

[Question from audience about the possibility of buying British companies.]

I look at them. I read the Financial Times every day. We've looked at, and we've come close, very close, to one deal. There's another proposition I've got right now from somebody. But so far, we haven't done anything. But I don't rule it out.

If Coca Cola were located in London, and was an English company, and did business exactly like they do, it would be worth slightly less than [if it were a US company]. But overall, I'd do it. Obviously.

We’ve looked at a lot [at foreign companies]. [But] we’ve got a $3 trillion pond in terms of market value in this country. And if I can’t make money in a $3 trillion pond, I can’t make money in an $8 trillion pond. We tend to look in the $3 trillion pond mostly.

[Question from audience.]

Usually they won’t. And I tell them, almost always, they shouldn’t. I’m going to have a letter in the annual report this year which I’ve sent many times to possible sellers of businesses. And the one thing I tell them is you’re not richer when you sell a business. You’ve got a wonderful asset that will be worth more money later on. I wouldn’t be talking to you if I didn’t think this was the case. If it takes care of a specific problem you have, and you want somebody that meets these certain parameters, we’ll talk. If it doesn’t, that great. You’ve got something better than I’ve got, because I’ve got cash, and I’ve got a problem, and you’ve got a good business, and you don’t have a problem.

Mrs. B wasn’t richer when she sold me the business. She did have one son and, at that time, three grandsons in the business, and she had three daughters and their husbands, and a bunch of their children who weren’t in the business, and everybody owned 20% of it. So she thought there would be some sort of problem when she died. She was a strong enough matriarchal figure that there weren’t and problems when she lived – she told them what to do, and that was it. But, when she was gone, she could see trouble. You saw it down at the Louisville Courier/Journal a couple of years ago with the Bingham family. You get a lot of money, but somebody gets unhappy. Sometimes the in-laws get unhappy. Some people prefer to solve that problem themselves, when they’re alive, rather than have some trust department try and solve it when they dead. But, I don’t want people selling to me because they think they’re getting richer, I want them selling to me because it solves some particular problem, and I can help them solve it.

I can do things that other companies can’t do. I can arrange the transfer of some of the ownership of the business to another generation. I can promise them it won’t get resold. Virtually no other American company can do that. If the XYZ company goes out and buys See’s or Borsheim’s, the President of XYZ company can say “we’re not going to sell it” but he may be taken over himself, his board of directors may tell him to do something, McKinsey may come in next week and say “get out of this business and get into some other business.” You can get double crossed in a lot of ways that there’s no moral stigma attached to, but that’s just the way the cards fall. With me that can’t happen. The only thing that can happen bad to them is if I double cross them. So they have to make a judgment whether I’m lying to them. I can’t come back to them later and say the board’s told me we’ve got to get out of the jewelry business, there’s this great offer that’s come in, I’ve got this fiduciary responsibility, blah, blah, blah, blah. That won’t happen.

[Question from audience.]

They’re rich because they’ve already gotten rich by having the company. All they’re going to do, if they take money from me, is they’re going pay some taxes, and they’re going to invest in some other business. They might buy Berkshire, they might buy General Motors, they might buy government bonds, but they already had a good business. And they don't have to pay the taxes. So they are not getting richer.

I can help them with some problems. When Ike at Borsheim's came to me I said "look, I will pay you X, and I will show you how to get more money than that, and here is how you can do it." He said "I'm not interested."

[Question from audience.]

We don't want what I call the used cigar butts, where you get one free puff and that's it (garbled comment from audience). Well, partly I don't have the people to stick in anyway. And I don't want to go through the human travail that's involved in that.

I don't want to go through it, basically. And, if you have your choice, we'll just think in terms of looks now, but marrying some gal that's the girl of your dreams and having another one and saying "If I send her to the psychotherapist for five years and have some plastic surgery" well maybe it will work [tape ends].

Lecture to Undergraduate Students

[Tape picks up in middle of lecture.]

...we let the operating managers run their businesses, and we have them send the money to Omaha. And then we try to buy more businesses. And sometimes we can buy all of a business, and sometimes we can only buy part of it. But we're the largest shareholder of the Coca Cola Company, we're the largest shareholder of Capital Cities/ABC Broadcasting, we're the largest shareholder of Gillette Company, and then probably Champion Paper, Geico, the insurance company, the Wells Fargo bank. There's quite a few.

We buy entire businesses, or we buy tiny pieces of businesses called "stocks" and we have the same approach to it. And if the capital comes in, we're willing to do either one. In this year's annual report, in answer to the question of what I do, I tell the story of my granddaughter's birthday party...

[Told Beemer the Clown story again]

I sit there in Omaha and wave my magic wand. But, I've got all these Beemers out there, running businesses. They run them exceptionally well. Our businesses are generally characterized by unusual market strength and terrific continuity of management. Almost everybody that works for us is independently rich because we've usually bought their business. And they've received a lot of money from us. And one of the main parts of my job is to figure out, when I'm sitting across the table from John Smith and I'm going to hand him a check for $50 or $100 million, I have to decide whether he's going to get out of bed the next morning. And it's very important to me that he is just as interested in running his business, and he thinks of it as his business, the next day, and the next year, and the next decade, as he was when he owned it all himself. With a lot of people, there's no way to buy that. You can't set up an incentive compensation scheme that accomplishes that because they've already got all the money they need. You really have to make a judgment as to whether they run their business because they love business or because they love money. If they love money, we don't have a chance. We can pay them a lot of money, but they've already got a lot of money. They never need to come to work another day in their life after they sell out to us, and yet virtually all of them works harder now than they've ever worked before. The main reason for this is that they're that type – that is the way they're put together.

Secondarily, we try to provide an environment for them which is exactly like what we'd want if we were running a business. The main thing we would want is we would not want a lot of second guessing, we would not want a lot of home office meetings, we would not want a lot of supervision from some group Vice President at headquarters. We just would not want a lot of nonsense. We would like to run our own business in our own way. If you were a great golfer, and let's just say, going back to my generation, you were Arnold Palmer, you'd basically play golf because you like to play golf. But if he was playing golf, and we were doing it for money, and in some way I owned him, and I kept saying "why don't you use a four iron instead of a five iron, and why don't you aim a littler further to the right" after a while he'd wrap the club around my neck. And rightly so. If you get really talented people, you've got to give them a chance to do their own thing.

We bought a uniform company in Cincinnati five years ago, a $100 million company. I've never been to Cincinnati. I've never seen a factory of theirs, I don't know what their offices look like. I know the people quite well.

We've got a candy company, See's Candies in California. We sold 13.5 million tons of boxed chocolates last year and made $39 million before taxes. The fellow that runs it has been running it from the day we bought it 19 years ago. We made a deal with him, and in 30 seconds worked out an incentive compensation agreement. In 30 seconds. Never wrote it down, never had a lawyer. That deal is still the same deal 19 years later. He's been to Omaha exactly once. Last year he came to the annual meeting to see whether their really was a Berkshire Hathaway in Omaha. We've never had a group meeting of any kind. We don't force anything on them. We actually moved the headquarters of the company from Los Angeles to San Francisco because his wife liked living in San Francisco better than she like Los Angeles. Instead of having a guy with a wife that was considerably less happy living in LA, it was a lot easier to move the business to San Francisco, so that's where it comes from now.

We have no retirement age. We had a woman running a business for us, we'd bought her business when she was 89, and she was Chairman of the Board, and she ran it for us until she got mad two years ago and left at 95, because, foolishly, I'd forgotten to get a non-compete agreement from this 89-year-old woman when we made the deal. She now competes with us across the street. She works seven days a week. We've never let anybody go because of age. We had one fellow, ran a savings and loan for us in Pasadena [Wesco Financial], he kept trying to get me to get somebody else, he was 75 years old. [He'd say] "you've got to get another guy in here" and I'd say "Louis, how's your mother?" She lived to be 93 and that ended the conversation.

So we have a business with very few rules. The only rules the managers have is to basically think like owners. We want those people thinking exactly like they own those businesses themselves. Psychologically, we don't even want them to think there is a Berkshire Hathaway. They know they will never get sold. They don't have to sit around and wonder if there's going to be a takeover raid on Berkshire.

Let's talk a little bit about what you're interested in . This is a little bit different group than I usually talk to, its almost always been MBAs in the past, and its quite refreshing to get a mixture of liberal arts people in, so you can throw anything at me that you care to – nothing's off limits.

[Question from audience.]

They hardly get richer because they sell to me. I tell them "If you come to me, and you've got a wonderful business, I can't make you richer than you are. If you sell to me for $100 million, it's only because your business is worth $100 million. And you'll pay a lot of taxes and you won't have $100 million. If you take the remainder after-tax and buy General Motors and AT&T you'll have a lot of businesses you don't understand, instead of one you do understand. There's no reason to sell to me to get richer. I always tell people the only reason I'm buying is because I think it's going to be worth more. If they are selling to me simply to stick a lot of money into their own pocket, it's the wrong reason. But frequently....

One woman was 89 when she sold to me. She had four children. One worked in the business, three didn't work in the business. She had multitudes of grandchildren. three of them worked in the business, two of them didn't. The stock was divided equally, 20% with each branch, plus 20% she kept. As long as she was around, she was an enormously strong personality, there weren't going to be any problems because she was going to tell people what he answers were. The day she died, she felt that there would be a developing situation where people didn't work and wanted to get the money out of the business and that the people who did work would resent the fact that the people who didn't work were cashing in. You get a lot of that as families move along. So she preferred to solve it herself by getting cash for the members of the family that weren't involved in the business, and then I moved the ownership of the remaining people down to the lowest generation of the ones that were in the business. That happens a variety of times.

The uniform company we own in Cincinnati had an LBO some years earlier and there were four or five venture capital firms there and they just wanted to take a quick profit. The guy who ran it realized he'd made a mistake when he sold out to a group like that in the first place, so he steered it to us. He wrote me out of the blue.

I've got a little ad in my annual report every year. We're in advertising businesses (garbled) and this year it's under the section "Help, Help." I tell them the kinds of businesses we want to buy. This fellow had seen that in Cincinnati, wrote me a letter and said "I'm your guy." And I looked at him and said "You are my guy." We bought out all the venture capitalists, but we kept the family in. And they run the business. It's that kind of thing that comes along.

The Scott Fetzer company, which is 20 other businesses, World Book, Kirby, 20 others, Campbell Hausfeld, almost a billion of sales. They had been a New York Stock Exchange company and there was a takeover attempt, even Ivan Boesky was involved, they had a whole raft of things. I'd never met the fellow then. I wrote him a letter, I said "Dear Mr. Schey: Here's what we are..." I sent him an annual report and said "If you want to do businesses with someone whose checks will clear, who won't bother you, here's all the shoes that will drop (I told him all the bad things about us), a one-page letter. Sent it. (Kind of difficult to get all the bad things about us on one page.) I said "If you want to talk about it, I'll meet you, and if you don't, throw the letter away." He called me up, we met on a Sunday in Chicago, made a deal that night and, in a week, the deal was done. That was five or six years ago – I've been to Cleveland twice, not because I needed to be. He runs that business exactly like he [owned it himself]. $97 million pretax earnings.

[Question from audience.]

I don't know if everybody could hear that. In that past, at least in some departments, you've heard that there is no such thing as buying an undervalued stock, or making money in stocks, that the market is efficient, and that everything is priced right at all times relative to the known information about it. Therefore, there's no use thinking. And, of course, from my standpoint I'd like to have everyone believe that, because it's a terrific advantage to be in a game where your opponent has been taught not to think. I wish the people I played bridge would. An appreciable percentage of the money in Wall Street is managed by people who believe that. It's the old story that if there's a $20 bill on the floor there's no sense picking it up because it can't be there. That thinking, I would say, prevailed extensively 10 years ago. I would say there's a little less of it now. All I can tell you is it simply isn't true.

The last class I told of how, in 1966 or so, we bought 5% of the Disney company for $4 million. The whole company was selling for $80 million! They'd written off all their films, Snow White, Three Little Pigs, Fantasia, all 220 some of them, written down to zero. You got 300 acres down in Anaheim and all of Disneyland for zero. The Pirate Ride had just been put in that year – $17 million it cost, yet the whole company was selling for $80 million. It was a joke. Mary Poppins made $30 million that year. They were going to recycle Mary Poppins seven years later, they were going to recycle Snow White seven years later. It's like an oil field where the oil seeps back in, and every seven years a new crop of kids comes along and they all want to see Snow White. And they drive their parents crazy until they get to see it. Well, that whole company was selling for $80 million. You don't have to be a financial analyst, you don't have to be finance major, to know that's a ridiculous valuation. Eleven million people a year go to Disneyland. That's seven bucks a person and you get the (garbled) thrown in free. It was a joke. And Walt Disney would tell you, if you went out to see him, would tell you all about the values, and what he had planned. It just happens occasionally in securities.

Now, an efficient market theorist would tell you that $80 million is the correct value on the Walt Disney company. And he's wrong. You do not have to have very many like that in a lifetime. It's not very esoteric, it does not require some insight into what's going to cure AIDS, or what's going to be the best computer five years from now, or the best software manufacturer – it doesn't require anything like that. It just requires figuring out whether people will be eating Hershey bars or drinking Coca Cola.

This company [Coke] you could have bought one share of stock for $40 in 1919, when they went public. If you reinvested the dividends, you'd be worth a million now. There are 150 countries in the world where they sell this and in every single one of them per capital consumption goes up every year. It's not that complicated. The Chairman of your [Notre Dame's] Board, Don Keough – I don't know if you're familiar with that; he is also the President of Coca Cola – used to live across the street from me in Omaha in 1960. He was a coffee salesman for Butternut Coffee, making $200 a week. And if you knew Don Keough there was no way that, if you put Don Keough together with Coke, you were going to miss. There really isn't any way they won't be selling a lot more Coca Cola products five years from now than they are now. And, they'll be making more money on each one. If you raise the price of each one of these a penny, it's $2 billion a year.

[Question from audience.]

The question is whether LBOs and junk bonds and so on have hurt the country in some fundamental way in terms of its competitiveness vis-à-vis the world. I wouldn't go that far, but I think on balance it's been a huge minus on the financial scene. Extreme leverage has been, generally speaking, a net minus. The analogy has been made (and there's just enough truth to it to get you in trouble) that in buying some company with enormous amounts of debt, that it's somewhat like driving a car down the road and placing a dagger on the steering wheel pointed at your heart. If you do that, you will be a better driver – that I can assure you. You will drive with unusual care. You also, someday, will hit a small pothole, or a piece of ice, and you will end up gasping. You will have fewer accidents, but when they come along, they'll be fatal. Essentially, that's what some of corporate America did in the last 10 years. And it was motivated by huge fees. And it was motivated by greed.

The most extreme case I saw was a television station. About three years ago, a television station in Tampa sold for an amount where, when they had to borrow the money, the interest amounted to more than the total sales of the station. If everybody donated their labor, if they donated their programming, if they donated their utilities, they still wouldn't have enough to pay the interest. They went crazy. And you can buy those bonds at 15 cents on the dollar. Charlie Keating's enterprise [Lincoln Savings and Loan Association in California, which became the nation's largest thrift failure] had a bunch of them too. There's a lot of crazy stuff that went on in the last five or six years. The fees on that deal, they paid $365 million for the station, they borrowed $385 million and you can guess where the extra money went. It went into the pockets of the people who put the deal together.

[Question: Is it comparable to say the same thing about companies and our government debt?]

No, it really isn't comparable. The important thing on government debt is how much is owed externally. If this group landed on an island someplace, we were stranded, and the only person we could do business with was another islander, and we all went to work producing rice, and we worked hard eight hours, and we had just enough rice to stay alive. If we worked out some internal system where some people worked 10 hours a day, and some other people worked six hours a day, and the people who worked six hours a day "borrowed" two hours worth of rice daily from the people who worked 10 hours a day, as an island we wouldn't be getting poorer. We might have some class that owed future rice, plus interest, to the people that had saved, but we would not be any worse off. We would consume all the rice we produced each day, it's just that some of us would have claim chits on each other.

If, on the other hand, we all decided to quit working, because people on the other island would work 16 hours a day, and they would ship over eight hours a day of rice to us, so we would just eat and mail them IOU's (we'd send over a guy in a canoe each night with the IOUs, they'd send over rice every day), we'd all just sit around, but the little IOUs we sent them drew interest, and then after 10 years they said "we would just as soon quit producing rice the next 10 years and you guys work 16 hours a day." That won't work so well, particularly if it's a different generation that's being asked to work the 16 hours a day later on to pay back the rice from the first generation.

External debt, something our country owes the rest of the world, is a whole different question than internal debt. The national debt is largely held internally, but the game is changing as we run a trade deficit. So the trade deficit is a threat, essentially, to living as well as we live now. We are, essentially, selling off a little piece of the farm every day, as we run a trade deficit in order to finance our own consumption. We've got a very big rich farm, so we can sell a little piece of that farm for a long time without hardly noticing it. It's a lot like eating a little too much over time. You never see it in any one day. You don't all of a sudden get up, all of your buttons pop, and people say "God, you look fat!" It just doesn't happen. What happens is you just keep doing it so pleasantly until, after a while, you've got a helluva waistline. And that is, essentially, the situation in our trade deficit. We are giving the rest of the world claim checks on us. That has consequences over time.

In fact, we sold our building to the Japanese, but it doesn't make any difference whether it's the Japanese or anybody else. We sold our buildings at ABC two years ago for about $175 million. That was equal to one day's trade defect with Japan. They sent up a bunch of VCRs and things, and we sent them the title to 54th Street and 6th Avenue. And we use up the one thing and they've got the other.

It's got sort of a poetic justice to it. As a matter of fact, in 1626 I think, Peter Minuet handed a bunch of trinkets to the Indians and they paid him the island. And now, people are handing us the trinkets, and we're giving them the island. It happens every day. The trade deficit will be $100 billion plus, and that means we are giving out IOUs to the rest of the world that will draw interest, which are claims of future production of everybody in this room.

Now the internal debt, that's an entirely different story. That person helps, but the help is commensurate with the hurt. When it goes abroad, the equation is not the same.

[Question from audience.]

The question is whether we just invest domestically or also abroad. The answer to that is, in terms of buying securities, everything we've bought, almost, has been domestic. It's not that I rule out other investments. We almost bought a pretty good sized investment in England a year or two ago, and we look at things elsewhere.

The United States is a $3 trillion equity pool, a $3 trillion pool of equity investments. If you can't make money in a $3 trillion pool, you're probably not going to make money in a $6 trillion pool.

Now, Coca Cola earns 80% of its money abroad and we hold 7% of that. Our 7% share is roughly $100 million. Of that, roughly $80 million comes from abroad. Coca Cola is spending an enormous amount of money in East Germany in the next year. They were in there big in March of 1990. Interestingly enough, the first Coca Cola they sold in East Germany, you may be too young for this, but it was shipped from Dunkirk where the Germans, essentially, drove the English into the sea 50 years ago. For a while all the Coca Cola was going from our big bottling plant in Dunkirk to East Germany. Now, the infrastructure has been built up within East Germany tremendously, and it will be a good market for Coke.

Coke is also in McDonald's in Moscow. The Moscow McDonald's is doing $235,000 in business a day, 50 times the average McDonald's in this country. You think of 50 McDonald's opening and that's how much business that Moscow McDonald's has done. That's a lot of people buying Coke.

[Question from audience.]

The question was, "Have I changed my ideas over the years as my bank account has increased?" The truth is, I used to have more ideas than money and now I've got more money than ideas. You've put your finger on that particular problem, but there are worse problems.

The only ideas we're interested in now are big ideas. We are not interested in anything that we do not think we can put at least $100 million into, usually quite a bit more. We own fewer stocks now, with $7 or $8 billion, that we owned back when we had $15 million in 1970.

We do not try and buy more and more of everything. I call that the Noah's Ark approach to investing – have two of everything. We've got a very selective ark, and we only want a couple of specimens on there. It makes it more difficult, but you don't need very many good ideas. If we get one good idea a year, that would be terrific. And if you negotiate with me, you'd get me down to one every two or three years. That's all you need. You do not have to keep hitting home runs all the time. That's one of the nice things about this business. If you make one decision on something like that, it takes care of a lot.

I always tell classes that, in the investment world, if you had a punch card when you got when you got out of school, and there were only 20 punches on it, and when that was done, you were all done investing, you'd make more money than having one with unlimited punches. You'd make sure you used them for the right things.

The big things are not what you do, they're what you don't do. Basically, we've had very few things we've lost money on. We've had no more good ideas than other people. But we've not made big mistakes – that I learned from Ben Graham. He used to say there are two rules in investing. The first: don't lose. The second: don't forget the first.

[Question from audience.]

The first question was, "Does the current recession change our attitude toward investing?" It doesn't change it a nickel's worth. If something comes along tomorrow that's interesting, I will do it tomorrow. And it will be by exactly the same yardsticks I used whenever the business cycle was at its peak. We don't care what businesses are doing. If the Chairman of the Federal Reserve called me tonight and said "I am really panicking and things are terrible," I don't care. We will do exactly what we were going to do tomorrow morning. The truth is, on balance, we will do more business when people are pessimistic. Not because we like pessimism, but because it makes for prices that are much more attractive. If you all have filling stations to sell in South Bend, I want to do business with whomever is most negative about filling stations. And that's were I'm going to make the best buy. Times are really good and times are really bad, over a period of time. We don't quit selling candy in July just because it isn't Christmas. We pay *no* attention to economic forecasts. I don't read anything [along those lines]. I read annual reports, but I don't read anybody's opinion about what's going to happen next week, or next month or next year.

The second question is whether there are any special industries we favor. The only thing we favor is industries we can understand. And then, we like businesses with what I call “moats” around them. We like businesses that are protected in some way from competition. If you go in the drugstore and say “I want to buy a Hershey bar” and the guy says “I’ve got an unmarked chocolate bar that’s a nickel cheaper,” you’ll buy the Hershey bar or you’ll go across the street.

One of the interesting things to do is walk through a supermarket sometime and think about who’s got pricing power, and who’s got a franchise, and who doesn’t. If you go buy Oreo cookies, and I’m going to take home Oreo cookies or something that looks like Oreo cookies for the kids, or your spouse, or whomever, you’ll buy the Oreo cookies. If the other is three cents a package cheaper, you’ll still buy the Oreo cookies. You’ll buy Jello instead of some other. You’ll buy Kool Aid instead of Wyler’s powdered soft drink. But, if you go to buy milk, it doesn’t make any difference whether its Borden’s, or Sealtest, or whatever. And you will not pay a premium to buy one milk over another. You will not pay a premium to buy one [brand of] frozen peas over another, probably. It’s the difference between having a wonderful business and not a wonderful business. The milk business is not a good business.

In our candy business, Valentine’s is coming up, and See’s candy on the West Coast is a very desirable item, and very few men will want to hand their girlfriend, or wife, or whatever, and say “Here honey, I took the low bid.” It just doesn’t sell. We want things where they’re not terribly price sensitive. And if you’re going to go out and buy a car this afternoon, you’re not going to say “I’d like that red job there, but I want to be sure it has steel that came from Bethlehem steel.” You don’t care where the steel came from. And, therefore, Bethlehem’s got nothing to say to General Motors, or Ford, except what wonderful guys they are. And General Motors says “We know you’re wonderful guys, and so, if Y sells it for X dollars a ton and you’d better be $5 under them.” Anything that differentiates your product – those are the businesses we like to be in.

We like to be in businesses I can understand. There are all kinds of businesses I don’t understand, but we’re not going to own them. Thomas Watson Sr., of IBM, in that book “Father, Son, and Company, that his son wrote, quoted his father as saying “I’m no genius, but I’m smart in spots, and I stay around those spots.” The real trick is knowing what you know, and what you don’t know. It isn’t how much you know, it’s whether you can define it well, so you know when you can take a swing at the ball, and you know when you’ve got no business swinging.

[Question from audience.]

The durability and strength of the franchise is the most important thing in figuring out [whether it’s a good business]. If you think a business is going to be around 10 or 20 years from now, and that they’re going to be able to price advantageously, that’s going to be a good business. And if somebody has to have a prayer session every time they want to raise the price a dollar a pound on whatever they’re selling, that’s not going to be a good business.

What’s the highest priced daily newspaper in the United States? Most of you are familiar with it. The highest priced daily newspaper in the United States, with any circulation at all, is the *Daily*

Racing Form. It sells about 150,000 copies a day, and it has for about 50 years, and it's either $2.00 or $2.25 (they keep raising prices) and it's essential. If you're heading to the racetrack and you've got a choice between betting on your wife's birthday, and Joe's Little Green Sheet, and the *Daily Racing Form*, if you're a serious racing handicapper, you want *The Form*. You can charge $2.00 for *The Form*, you can charge $1.50, you can charge $2.50 and people are going to buy it. It's like selling needles to addicts, basically. It's an essential business. It will be an essential business five or 10 years from now. You have to decide whether horse racing will be around five or 10 years from now, and you have to decide whether there's any way people will get their information about past performances of different horses from different sources. But you've only got about two questions to answer, and if you answer them, you know the business will make a lot of money. *The Form* has huge profit margins, incidentally. Wider than any other newspaper. They charge what they want to basically. It's an easy to understand business – so easy to understand.

Snow White is going to show up every so often, and when she shows up, millions of kids are going, and they'll make their money, and they don't have to make the picture again. Made back in 1937 or so. It's a perpetual royalty on youth. And that's not a bad business.

[Question from audience.]

Where did Donald Trump go wrong? The big problem with Donald Trump was he never went right. He basically overpaid for properties, but he got people to lend him the money. He was terrific at borrowing money. If you look at his assets, and what he paid for them, and what he borrowed to get them, there was never any real equity there. He owes, perhaps, $3.5 billion now, and, if you had to pick a figure as to the value of the assets, it might be more like $2.5 billion. He's a billion in the hole, which is a lot better than being $100 in the hole because if you're $100 in the hole, they come and take the TV set. If you're a billion in the hole, they say "hang in there Donald."

It's interesting why smart people go astray. That's one of the most interesting things in business. I've seen all sorts of people with terrific IQs that end up flopping in Wall Street or business because they beat themselves. They have 500 horsepower engines, and get 50 horsepower out of them. Or, worse than that, they have their foot on the brake and the accelerator at the same time. They really manage to screw themselves up.

I tried this with the last class. Let's say each one of you could buy 10% of the earnings, forever, of anybody else in this room, except me. Let's charge $50,000. And that means that if somebody gets out of here and earns $30,000 you get a $3,000 royalty off them. But, if they do extremely well, and become President of Coca Cola like Don Keough did, you'll make a fortune.

How are you going to think, in terms of the rest of the people here, of which one you want to buy the 10% of? Let's say we had Donald Trump here, and my friend Tom Murphy, who runs ABC, or Don Keough, and you're really betting on the lifetime of each of them, and let's say they're all in equally good health. Would you give them an IQ test? Well, you'd want to be certain they have a certain amount of IQ. Would you want to measure how strongly motivated they were, how much they wanted to get rich? Donald Trump wanted to get rich. That might not be a great qualifier. What would you do to select that one person out of this whole crowd here, because there will be a huge difference in results here. There's not a huge difference in IQ. But there will be a huge difference in results. I would venture to say, I don't know how well this group knows each other, you come from two different schools, so I'd break it down into two groups, I would venture to say that your guesses would not be bad. They'd be better if you'd had more experience with the group, and if you've had more experience generally, but they will be way better than flipping coins. You would probably relate it to a lot of qualities, some of which would be straight from Ben Franklin – I would suggest that the big successes I've met had a fair amount of Ben Franklin in them. And Donald Trump did not.

One of the things you will find, which is interesting and people don't think of it enough, with most businesses and with most individuals, life tends to snap you at your weakest link. So it isn't the strongest link you're looking for among the individuals in the room. It isn't even the average strength of the chain. It's the weakest link that causes the problem.

It may be alcohol, it may be gambling, it may be a lot of things, it may be nothing, which is terrific. But it is a real weakest link problem.

When I look at our managers, I'm not trying to look at the guy who wakes up at night and says "E = MC 2" or something. I am looking for people that function very, very well. And that means not having any weak links. The two biggest weak links in my experience: I've seen more people fail because of liquor and leverage – leverage being borrowed money. Donald Trump failed because of leverage. He simply got infatuated with how much money he could borrow, and he did not give enough thought to how much money he could pay back.

You really don't need leverage in this world much. If you're smart, you're going to make a lot of money without borrowing. I've never borrowed a significant amount of money in my life. Never. Never will. I've got no interest in it. The other reason is I never thought I would be way happier when I had 2X instead of X. You ought to have a good time all the time as you go along. If you say "I'm taking this job – I don't really like this job but in three years it will lead to this," forget it. Find one you like right now.

[Tape runs out]