

Why Warren Buffett Looks to Growth and Management When Investing
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Why Study Exception Like Buffett?
(a) To Learn (b) It is Interesting

How About Steve Jobs?



EXCEPTIONAL INNOVATOR

He was born to a teenage mother. He was adopted.
Spent one summer in an apple orchard -
He was so happy there that he later named his business "Apple."



Li-Ka-shing

EXCEPTIONAL SALESMAN

Quit school at age 15 to take care of family after his father died

He says:

"Seeking growth while maintaining stability" has always been my motto -
I [am] vigilant about maintaining a healthy debt to equity ratio. I am therefore less threatened by the 'ups and downs' in the market or the volatility of the global economy.

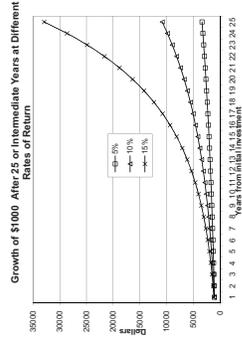


Wang Chaofu

He was born in a family of poor farmers.
His parents died when he was young.

In response to a question from Mr. Buffett:
He said, "We will never, never rest."

How Successful is Buffett?



Facts:
Annualized return over 45 years: 20%+ (off the chart)
Buffett is the CEO of **Berkshire Hathaway**

First Principle Buffett uses

VALUE INVESTING



Benjamin Graham

Invest only in Large, Prominent and Conservatively Financed Companies.

PRICE Vs. **VALUE**

In other words:

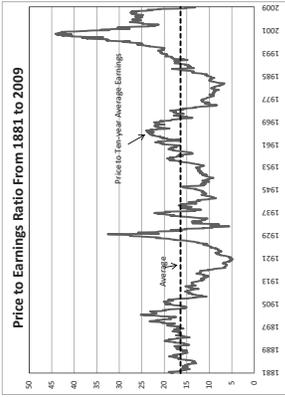
Be conservative. Use P/E ratio and other metrics.

Need to Learn:

ACCOUNTING, FINANCE, etc.

NO NEED TO LEARN COMPLICATED FORMULAS about Derivatives.

Does This Strategy Work?



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Table 3.1 - Evidence that Value Investing Works

Returns on portfolios of stocks based on P/E ratios		Returns on portfolios of stocks based on market-to-book (M/B) ratios	
Portfolio number	Return (% per year)	Portfolio number	Return (% per year)
Highest P/E stocks			
1	9.4	Highest M/B stocks	
2	10.4	1	11.5
3	12.1	2	12.3
4	11.8	3	12.6
5	11.3	4	12.0
6	12.9	5	12.5
7	14.4	6	13.5
8	14.2	7	13.5
9	13.8	8	14.5
10	15.9	9	14.5
Lowest		10	16.0
		Lowest	

Buffett's Latest Purchase: BNSF



P/E of 18 – Not a value investment

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Growth Investing

You need to think about the future growth.

Understand the business well and be good in forecasting. (Invest only in what you know.)

Buffett: If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes

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Buffett Investing =

Value Investing + Growth Investing

Think about Stocks owned by Buffett:

- Coca Cola
- Proctor and Gamble
- American Express
- Wal-Mart

Usually not cheap but they are also not expensive.

Buffett: It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.

Should you invest in companies like Apple, or Microsoft, etc.

NO. Why?

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Berkshire's Growth over Last 40 Years

Table 6.1 - Berkshire's Performance vs. the S&P 500

10-year periods	Annual Change		Berkshire's stock performance relative to S&P 500
	Book value per share	Stock price	
1969-79	20.5%	15.9%	3.1% (2)-(3)
1979-88	28.2%	40.4%	12.8%
1989-98	29.0%	31.0%	24.2%
1999-08	6.4%	3.3%	11.8%
40-years			4.7%
1969-08	20.7%	21.8%	8.9%
			12.9%

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Why Coca-Cola was purchased in 1988?

Table 4.1 - Growth in Coca-Cola's Earnings (and Book Value Before Berkshire's Purchase)

Year	Growth in earnings per share
1979	11.9%
1980	0.9
1981	6.1
1982	9.1
1983	3.8
1984	16.1
1985	8.2
1986	20.3
1987	17.4
1988	17.2
10-year average	11.1%

P/E at the time of purchase: 17

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Table 6.3 - BYD's Selected Financial Data
in millions of Chinese Yuan (RMB)
except earnings per Share and ratios.

	2008	2007	2006	2005
Revenues	26.79	21.21	12.94	6.5
Total assets	32.89	29.29	16.39	11.21
Debt (interest bearing)	9.16	8.12	5.73	4.03
Shareholders' equity	11.28	10.71	5.29	4.18
Net income	1.02	1.61	1.12	0.5
Earnings per Share	0.5	0.79	0.55	0.25
Debt/Total assets	0.28	0.28	0.35	0.36
Return on equity	9.0%	15.0%	21.2%	12.0%

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Where does growth come from?



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Who are you?



Our goal is to acquire either part or all of **businesses** that we believe we understand, that have good, sustainable underlying economics, and that are run by **managers** whom we like, admire and trust.

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Some Berkshire Managers (CEOs)

- Charles Munger
- David Sokol
- Ajit Jain
- Tony Nicely
- Many Entrepreneurs (Furniture Stores, Jewelry Stores, etc.)

Some Berkshire Businesses

- Insurance
- Railroad
- Electricity Companies
- Manufacturing
- Dairy Queen (similar to McDonald's)

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Buffett-style Investing:
Simple but not Easy.

Many Facets to Think About.
Here are some:

Let us discuss these briefly.

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Use Other People's Money: (BUT ...)

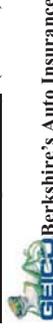
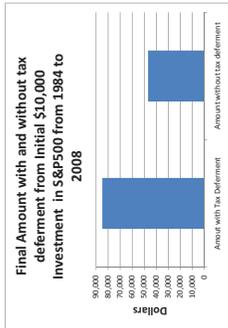


Table 7.1 - GEICO's Revenues, Float and Operating Profits
(Dollar amounts in billions)

	Revenues	Float	Operating profits as a percentage of revenues
1998	4.0	3.1	6.7%
2000	5.6	3.9	-4.0%
2002	6.7	4.6	6.2%
2004	8.9	5.9	10.9%
2006	11.1	7.1	11.9%
2008	12.5	8.5	7.3%

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Invest for the long term



One Advantage: Taxes

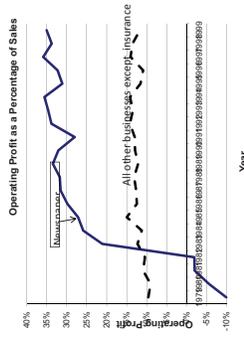
And,

You make better decisions.

Use Monopoly (Moat)

M = Monopoly = Money

Newspapers



Always Compute Intrinsic Value

Berkshire Hathaway

Table 5.2 - Data for Valuation

Year	Per-share Investments ('000)	Pre-tax earnings per share (non-insurance businesses)
2000	\$50.6	\$0.8
2001	47.0	1.3
2002	52.7	2.2
2003	62.2	1.9
2004	66.9	2.1
2005	74.1	2.4
2006	80.6	3.6
2007	90.3	4.0
2008	77.7	3.9

(a) **Managers**

2000-2008 compounded growth rate	5.50%	23.10%
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Think Profitability (Not Profits)

Table 10.1 - Profitability of Berkshire's Jewelry Business Compared to Tiffany's
(Dollar amounts in millions)

	1999	1998	1997	1996
Berkshire's Jewelry Business				
Revenues	\$486	420	398	392
Identifiable assets at year end	\$258	234	219	267
Operating profits before taxes	\$51	39	32	28
Operating Profit as a % of identifiable assets	20%	17%	15%	10%
Tiffany and Co.				
Revenues	\$1,461	1,169	1,018	922
Total assets	\$1,343	1,057	827	739
Operating Profits	\$257	161	133	109
Operating Profit as a % of identifiable assets	19%	15%	16%	15%

Think Reliability of Profits in the Long Run

Table 12.1 - Berkshire Hathaway Energy Sector (MidAmerican Energy Holdings)
(Dollar amounts in millions)

	2008	2007	2006	2005	2004	2003	2002	2001	2000
Property, plant, equipment, and other assets, net	\$36,290	33,917	30,942	16,037	15,597	14,862	14,177	8,987	8,008
Goodwill	5,280	5,591	5,548	4,156	4,307	4,256	3,639	3,673	
Total assets:	\$41,570	39,508	36,490	20,193	19,904	19,168	18,435	12,626	11,681
Total revenues	\$13,971	12,628	10,644	7,279	6,727	6,145	4,968	4,973	4,013
Earnings before interest and taxes (EBIT)	\$2,203	2,086	1,737	1,698	1,331	1,591	1,253	1,004	616
EBITTA (%)	5.4%	5.5%	6.1%	6.5%	6.8%	8.5%	8.1%	8.3%	5.3%

Recall: Where do profits come from?

(a) Managers

If so, what should managers focus on?

(b) ROE (or ROA)

Table 13.1 - Scott Fetzer Earnings and dividends

Year	Scott Fetzer Earnings (Dollar in millions)	Return to Berkshire as a percentage of initial investment
1986	\$40.3	13%
1987	48.6	15%
1988	58.0	18%
1989	58.5	19%
1990	61.3	19%
1991	61.4	19%
1992	70.5	22%
1993	77.5	25%
1994	79.3	25%
Average		20%

