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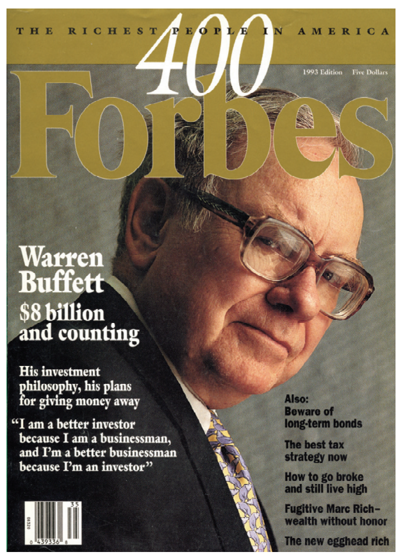
Warren Buffett's Idea of Heaven: "I Don't Have To Work With People I Don't Like"

WARREN BUFFETT THIS YEAR MOVES TO THE TOP OF THE FORBES FOUR HUNDRED. HEREIN HE EXPLAINS HOW HE PICKS HIS UNCANNILY SUCCESSFUL INVESTMENTS AND REVEALS WHAT HE PLANS ON DOING WITH ALL THAT LOOT HE HAS ACCUMULATED.

BY ROBERT LENZNER

On the night of Aug. 17 a steady stream of young baseball fans approached a middle-aged businessman wearing a red polo shirt who was sitting near the field at Omaha's Rosenblatt Stadium. Often shyly, always deferentially, they asked him to sign their scorecards. Warren Buffett accommodated them—in such numbers as to almost guarantee the famous financier's signature won't bring premium prices on the autograph market.



Except for the polite autograph seekers, there were no indications that this pale, slightly bulging Omaha native was the richest person in America and an investment genius on a scale that the world rarely sees. There were no fawning retainers or hangers-on, no bodyguards to drive off paparazzi and supplicants. Buffett is 25% owner of the Omaha Royals, minor league affiliate of the Kansas City Royals, and by all appearances that day you would have thought that is all he is. His close friend, Charles Munger, puts it this way: "One of the reasons Warren is so cheerful is that he doesn't have to remember his lines"—meaning that the public Buffett and the private Buffett are the same man.

Except for his company's private plane—more a business tool than a luxury—there is nothing of self-importance about him. He drives his own car, lives in a nondescript house, hardly ever vacations and just last month passed up an invitation from his close friend, former Washington Post chairman Katharine Graham, to dine with President Clinton on Martha's Vineyard. Buffett will travel a long way for good bridge game, but he'll scarcely bother to cross the street for the sake of rubbing shoulders with celebrities.

"I have in life all I want right here," he says. "I love every day. I mean, I tap dance in here and work with nothing but people I like. I don't have to work with people I don't like." Buffett caps the statement with a typically midwestern cackle.

That's Warren Buffett, living proof that nice guys sometimes do finish first. And we do mean first. FORBES figures Warren Buffett is now the richest person in the U.S.

This folksy, only-in-America character was worth—as FORBES went to press—$ 8.3 billion in the form of 42% of his investment company, Berkshire Hathaway, whose shares at $16,000 each are the highest priced on the New York Stock Exchange.

Berkshire Hathaway owns 48% of Geico Corp., a big insurance company; 18% of Capital Cities/ABC, Inc.; 11% of Gillette Co.; 8.2% of Federal Home Loan Mortgage Corp.; 12% of Wells Fargo & Co.; about 7% of the Coca-Cola Co.; 15% of the Washington Post Co.; 14% of General Dynamics; 14% of the voting power in Wall Street's Salomon Inc. We could go on, but we won't, except to add the *Buffalo News*, a newspaper he bought for $ 32.5 million in 1977 and that now throws off more cash before taxes each year than he paid for it.

With this broadly diversified mix, Buffett has in the current bull market squeezed past Bill Gates—net worth $ 6.2 billion—and John Kluge, at $ 5.9 billion, to take top spot on The Forbes Four Hundred.

There's an excellent chance he'll stay there for a good while. Most previous holders of the title—Gates, Sam Walton, John Kluge—made their fortunes in a single industry, and their fortunes are tied to that industry. But Buffett's Berkshire Hathaway has spread its investments across a broad range: media, soft drinks, manufacturing, insurance, banking, finance, consumer goods. As long as the economy grows, you can count on his fortune continuing to grow.

It's almost equally certain that when this 63-year-old is called to his reward, he will have set the stage for the biggest charitable foundation ever, one that easily will dwarf the legacies of Rockefeller, Ford and Carnegie. Over the past 23 years Buffett's investments have compounded his wealth at an average annual rate of 29%. He probably can't keep that up. But give him 15%. If he lives another 20 years and does 15%, the Buffett Foundation will have well over $100 billion. If, as it is quite possible, he lives a good deal longer . . . well, you get the picture.

What would be the first thing most FORBES readers would ask Warren Buffett if they could have a few words with him? Of course: Warren, what do you think of the stock market?

We asked him, but knowing he hates the question, we did it in a slightly roundabout fashion. What would his hero and mentor, Benjamin Graham, say about the stock market today?

Not missing a beat, Buffett shot back with the response Graham gave when he appeared before the 1955 Fulbright hearings in Washington: "'Common stocks look high and are high, but they are not as high as they look.' And my guess is that he [Graham] would say the same thing today."

That's about the limit of the specific investment advice Buffett is willing to give: high but not too high. We suppose that would translate into brokerese as a "hold" rather than as a "buy."

In dodging the question, Buffett is not just being evasive. Like Graham and the famous British economist and brilliant stock market investor John Maynard Keynes, whose thinking he greatly admires, Buffett believes that all there is to investing is picking good stocks at good prices and staying with them as long as they remain good companies. He doesn't try to time the market or to catch swings as the George Soroses and Michael Steinhardts do. Buffett: "Keynes essentially said don't try and figure out what the market is doing. Figure out businesses you understand, and concentrate. Diversification is protection against ignorance, but if you don't feel ignorant, the need for it goes down drastically."

In a wide-ranging series of conversations with FORBES, Buffett expounded on his investment philosophy. His most basic rule is: Don't put too many eggs in your basket and pick them carefully.

Buffett: "I believe every business school graduate should sign an unbreakable contract promising not to make more than 20 major decisions in a lifetime. In a 40-year career you would make a decision every two years."

Buffett points out that he's not prescribing for all investors. Others can make money out of frenetic trading. "It's doing what you understand and what you are psychologically comfortable with. But I do not deny the genius of a Peter Lynch or a [Michael] Steinhardt."

Technology stocks are definitely not what Buffett feels comfortable with. "Bill Gates is a good friend, and I think he may be the smartest guy I've ever met. But I don't know what those little things do."

Except for a position in Guinness Plc., the international spirits concern, Berkshire owns no foreign stocks—ignoring as usual the latest Wall Street fad. "If I can't make money in a $4 trillion market [the U.S.], then I shouldn't be in this business. I get $150 million earnings passthrough from international operations of Gillette and Coca-Cola. That's my international portfolio."

Again, it's staying with what he feels comfortable with. "I wouldn't mind having a very significant percentage of our portfolio in U.K.-domiciled companies or German-domiciled companies, if I thought I understood the companies and their business and liked them well enough. If some guy owns the only newspaper in Hong Kong or Sydney, Australia and it's at the right price, I'm perfectly willing to buy it."

Those papers may be in foreign climes, but they are in a business he well understands. That gets close to the heart of the way Buffett, your quintessential midwesterner, thinks: not in concepts or theories but in intensely practical terms. Buffett doesn't buy stocks; stocks are an abstraction. He buys businesses—or parts of businesses, if the whole thing is not for sale. "I've no desire to try and play some huge trend of a national nature," is the way he puts it.

Buffett's disdain for trends, concepts and the slogans so beloved of Wall Street grows in part from a simple realization that neither he nor any other man can see the future. It also grows from his extreme inner self-confidence: He has not the psychological need for the constant wheeling and dealing, buying and selling that afflicts so many successful business and financial people. When he believes in something, he does not require immediate market upticks to confirm his judgement.

"What I like is economic strength in an area where I understand it and where I think it will last. It's very difficult to think of two companies in the world in important areas that have the presence and acceptance of Coke and Gillette," two of Berkshire Hathaway's core holdings.

Some smart investors like to say they invest in people, not in businesses. Buffett is skeptical. He says, in his wry way: "When a manager with a reputation for brilliance tackles a business with a reputation for bad economics, the reputation of the business remains intact."

It's not that Buffett doesn't think managers matter. He does. "When [Chairman Roberto] Goizueta and [former president Donald] Keough came into [leadership at] Coca-Cola in the 1980s it made a terrific difference," Buffett says. He is a great admirer of Thomas Murphy of Capital Cities/ABC and Carl Reichardt of Wells Fargo, two big Berkshire holdings. But he doesn't invest on people alone. "If you put those same guys to work in a buggy whip company, it wouldn't have made much difference."

That last sentence is a typical Buffettism: He loves to express himself thus in pithy one-liners that are humorous expressions of common sense. Listen to him sum up his case for owning Gillette stock: "It's pleasant to go to bed every night knowing there are 2.5 billion males in the world who have to shave in the morning. A lot of the world is using the same blade King Gillette invented almost 100 years ago. These nations are upscaling the blade. So the dollars spent on Gillette products will go up."

Or how he thinks of himself as investing in businesses rather than in stocks: "Coca-Cola sells 700 million 8-ounce servings a day. Berkshire Hathaway's share is about 50 million."

His credo, though he doesn't call it that, can be expressed in something he told FORBES: "I am a better investor because I am a businessman, and a better businessman because I am an investor." He's saying a great deal in his seemingly cryptic statement: that business and finance are not two separate activities but intimately connected. A good businessman thinks like an investor. A good investor thinks like a businessman.

There's a fine line here, however. Buffett doesn't try to run the businesses he invests in. As he puts it, "The executives regard me as an investing partner. I'm somewhat involved, talking over leadership succession, potential acquisitions and other important matters. Managers know I think about these things and they talk to me."

To keep himself posted he relies very little on the gossip some people think is inside information. He does spend five or six hours a day reading, with lesser periods on the phone. He hates meetings. Berkshire Hathaway's board meets once a year. But Buffett does quite faithfully attend directors meetings at Gillette, Capital Cities/ABC, Salomon Inc., USAir Group and Coca-Cola each month.

While Buffett's character and investing style are all his own, they owe a lot to three influences. "If I were to give credit in terms of how I've done it in investments, my dad would be number one, and Ben Graham would be number two. Charlie Munger would be number three."

He credits his father, Howard Buffett, a stockbroker and one-time congressman, with setting an example of how to behave. "He taught me to do nothing that could be put on the front page of a newspaper. I have never known a better human being than my dad."

He credits Graham with giving him "an intellectual framework for investing and a temperamental model, the ability to stand back and not be influenced by a crowd, not be fearful if stocks go down." He sums up Graham's teaching: "When proper temperament joins with proper intellectual framework, then you get rational behavior."

Charles Munger is Buffett's sidekick, vice chairman of Berkshire Hathaway and, after Buffett and his wife, its largest shareholder, with 1.8% of the stock. He lives in Los Angeles, but he and Buffett are on the phone almost daily. "Charlie made me focus on the merits of a great business with tremendously growing earning power, but only when you can be sure of it—not like Texas Instruments or Polaroid, where the earning power was hypothetical. Charlie is rational, very rational. He doesn't have his ego wrapped up in the business the way I do, but he understands it perfectly. Essentially we have never had an argument, though occasional disagreements."

Disagreements? Munger says that there are times when he has to prod Buffett away from his old Ben Graham attitudes about what constitutes a bargain. Munger: "Warren was a little slower to realize that a very great business can sell for less than it's worth. After all, Warren worshipped Ben Graham, who waited to buy companies at a fraction of the liquidation value, and it's hard to go beyond your mentor. Sure, I convinced him we should pay up for good businesses."

Today Buffett realizes that "when you find a really good business run by first-class people, chances are a price that looks high isn't high. The combination is rare enough, it's worth a pretty good price." In almost every instance that pretty good price gets even better after he buys the stock. Coca-Cola is a prime example.

One thing Munger doesn't have to twist Buffett's arm on: They both believe you should never sell those great businesses as long as they stay great, almost regardless of how high the stock price gets. What would be the point? You would have to reinvest the money in something less great. As Omar Khayyam put it, and Munger/Buffett would certainly agree: "I often wonder what the Vintners buy half so precious as the stuff they sell."

Buffett says he is permanently attached to this three vintage media holdings, the Washington Post, Capital Cities/ABC and the Buffalo News. He analyzes these holdings: "Television networks are a business that's tougher but still very good with very good management. It generates a lot of cash. The Washington Post is a terribly strong newspaper property run by high-class people. Don [Graham], the new chairman, will be an excellent leader. It's one of the great stories of generations succeeding—three 7s in a row."

He'll never sell the lucrative Buffalo News. Aren't newspapers becoming obsolete? Buffett: "I don't think they're technically obsolete, but I don't think it's as good a business as it used to be."

Buffett has received FTC permission to raise his stake in Salomon Inc. from 14% to 25%, even though Salomon shares have already more than doubled since its Treasury bond scandal. Why did he wait so long to increase his stake? He felt it wasn't fair to buy more shares when he was involved in turning the company around.

Are great investor/businessmen like Buffett made or born? In this case the verdict would have to be the genetic one. As a kid he traded on a small scale, buying Coca-Cola from his grandfather's store and reselling it to neighbors. When he was 20 and a student at Columbia University, he started studying the insurance industry. His hero and professor, Benjamin Graham, was chairman of Geico, Government Employees Insurance Co., based in Washington, D.C. Wanting to know more about a company Graham had invested in, one Saturday Buffett paid a cold call on Geico, and was treated to a five-hour sermon by Lorimer Davidson, then vice president of finance, on how the insurance business worked.

Buffett then had about $ 9,800 in capital. He proceeded to invest three-quarters of it in Geico stock. "It was a company selling insurance at prices well below all the standard companies, and making 15% profit margins. It had an underwriting cost than of 13% or so, whereas the standard companies had probably 30%-to-35% cost. It was a company with a huge competitive advantage, managed by the guy that was my God."

In those days Buffett was devouring financial tomes the way most people his age consumed the sports pages or mystery novels. While working for his father's brokerage firm in Omaha, he would go to Lincoln, Nebr., the state capital, and read through the convention reports, or statistical histories of insurance companies. "I read from page to page. I didn't read brokers' reports or anything. I just looked at raw data. And I would get all excited about these things. I'd find Kansas City Life at three times earnings, Western insurance Securities at one times earnings. I never had enough money and I didn't like to borrow money. So I sold something too soon to buy something else."

Jumping back to the present for a moment, he comments: "I was overstimulated in the early days. I'm understimulated now." Stock prices are many times higher now, and when you have billions to invest rather than thousands there's a lot less around to stimulate you.

Even though his lack of capital sometimes led him to sell too soon, Buffett prospered. Geico and Western Insurance Securities were huge winners.

In the early days of his career he followed Graham's quantitative guidelines obsessively. Graham figured you couldn't lose and would probably gain if you bought a stock for less than the value of its working capital alone. "I bought into an anthracite company. I bought into a windmill company. I bought into a street railway company, or more than one." But these cheap stocks were cheap for a reason; the businesses were dying.

Buffett soon realized that instead of seeking sure-thing statistical bargains, he would have to find companies that were undervalued for reasons that might not appear on the balance sheet—things like valuable brand names or strong market positions. As a professional money manager he began to make spectacular returns for his clients, with killings in such stocks as American Express and Disney.

But in 1969 he took down his shingle, returned his partners' money and concentrated on his own investments. In retrospect the timing was brilliant. The first post-World War II bull market had essentially ended, though few people realized it. Although a handful of stocks continued to rise until 1973 and 1974, the bull was exhausted.

Aha! So Buffett really is a market timer? No, he says. He simply couldn't find any stocks he wanted to buy at those prices. If it comes to the same thing either way, you can see that Buffett thinks in terms of companies, not in terms of markets. "I felt like an oversexed guy on a desert island," he quips, "I couldn't find anything to buy."

But after the crash of 1974, which gook the DJI down nearly 50% from its previous high, he had plenty of stimulation in his search for bargains. Reversing the quip, in November 1974 he told FORBES he felt "like an oversexed guy in a harem."

In the mid-1960s he had bought control of a down-at-the-heels textile operation in New Bedford, Mass. It looked cheap in that he paid less than the book value of the assets. Only it turned out those assets weren't worth what the books said they were. Says Buffett: "I thought it was a so-so textile business, but it was a terrible business."

Yet, ever the opportunist, Buffett used the base as a vehicle for slaking his passion for stocks in a market where the Dow Jones industrial average was well below 1000. Of Berkshire Hathaway he says: "We worked our way out of it by growing the other capital, but in the late 60s half our capital was in a lousy business, and that is not smart."

Gradually Buffett moved away from pure Ben Graham to modified Ben Graham. It was then that he made his fat payoff investments in companies like the Washington Post that were then undervalued, not because they had lots of cash and physical assets but because they had valuable franchises that were not recognized by the market. He describes the change in parameters: "Ben Graham wanted everything to be a quantitative bargain. I want it to be a quantitative bargain in terms of future streams of cash. My guess is the last big time to do it Ben's way was in '73 or '74, when you could have done it quite easily."

Is Warren Buffett infallible? No way. He readily concedes he left $2 billion on the table by getting out of Fannie Mae too early. He didn't buy as much as he set out to and sold too early.

IF YOU'RE IN THE LUCKIEST 1 PER CENT OF HUMANITY, YOU OWE IT TO THE REST OF HUMANITY TO THINK ABOUT THE OTHER 99 PER CENT.

Why? He shakes his head. "It was easy to analyze. It was within my circle of competence. And for one reason or another, I quit. I wish I could give you a good answer."

He also sold part of Berkshire's position in Affiliated Publications, the owner of the *Boston Globe* newspaper, because he did not fully grasp the value of Affiliated's big position in McCaw Cellular. He is less miffed about this mistake than about the FNMA one. "I missed the play in cellular because cellular is outside of my circle of competence."

What does Buffett think of politics? Buffett was a registered Republican, like his father, but he switched parties in the early 1960s. "I became a Democrat basically because I felt the Democrats were closer by a considerable margin to what I felt in the early 60s about civil rights. I don't vote the party line. But I probably vote for more Democrats than Republicans."

If Buffett is a bit cagey about his politics, he isn't cagey in expressing his opinion about some U.S. corporate management. "If you have mediocrity and you have a bunch of friends on the board, it's certainly not the kind of test you put a football team through. If the coach of a football team puts 11 lousy guys out on the field, he loses his job. The board never loses their job because they've got a mediocre CEO. So you've got none of that self-cleansing type of operation that works with all the other jobs."

There's a general impression that Buffett plans to cut off his three children, forcing them to fend for themselves. Nonsense, he says. "They've gotten gifts right along, but they're not going to live the life of the superrich. I think they probably feel pretty good about how they've been brought up. They all function well, and they are all independent, in that they don't feel obliged to kowtow to me in any way." He puts modest amounts each year in the Sherwood Foundation, which is used by his children to give money away in Omaha. Another family foundation gives $4 million a year to support programs promoting population control.

Beyond that, Buffett has sometimes been criticized for not giving away bigger chunks of his great fortune—even when pressed by friends and associates. He explains: "I wouldn't want to transfer Berkshire Hathaway shares to anyone while I'm alive. If I owned a wide portfolio of securities I could give them away. But I don't want to give up control of Berkshire Hathaway."

But when death does force his hand, his legacy is gong to be a whopper. He plans to leave 100% of his Berkshire Hathaway holding to his separated but not estranged wife, Susan. He has no written contract with Susan that the shares will go into a foundation, but that is the understanding between them. Says he: "She has the same values I do." The deal is whoever dies last will leave the Berkshire Hathaway shares to a foundation with no strings attached.

Buffett: "I've got this fund that's not yet activated, and it is building at a rate greater than other endowments, like Harvard's. It's growing at a rate of 25% to 30%.

"When I am dead, I assume there'll still be serious problems of a social nature as there are now. Society will get a greater benefit from my money later than if I do it now." Any hints as to where he'd like to see the money go? Control of nuclear proliferation is very much on his mind. "Who knows how many psychotics in the world will have the ability to do something with nuclear knowledge that could wreak havoc on the rest of the world?"

It's a little hard to see how money can deal with that problem, but Buffett points out that money could do a lot for what he regards as another major problem: excessive population growth.

"I have got a very few superhigh-grade, very intelligent people in charge of deciding how to spend the money. They [will] have total authority. There are no restrictions. And all they are supposed to do is use it as a smart high-grade person would do under the circumstances that exist when it comes into play, which I hope is not soon."

The trustees of his will include his wife, Susan, his daughter Susan, his son Peter, Tom Murphy, chairman of Capital Cities/ABC, and *Fortune*'s Carol Loomis.

It's very much in harmony with his pragmatic nature that Buffett plans on putting few strings on the money. Just so long as they don't turn it into a conventional bureaucratic foundation. "If they build an edifice and become traditional I'll come back to haunt them," he declares. F

SHOULD YOU FIND YOURSELF IN A CHRONICALLY LEAKING BOAT, ENERGY DEVOTED TO CHANGING VESSELS IS LIKELY TO BE MORE PRODUCTIVE THAN ENERGY DEVOTED TO PATCHING LEAKS.