FT Magazine Warren Buffett

Warren Buffett: 'I'm having more fun than any 88-year-old in the world'

The legendary investor on luck, expectations and finding value in an overheated market

Robert Armstrong, Oliver Ralph and Eric Platt in Omaha 7 HOURS AGO

In the stock market, small margins separate success from failure. Ten per cent is a big difference in performance; 100 per cent, an oceanic one.

And then there is Warren Buffett. Over the past 54 years, shares in his company, Berkshire Hathaway, have outpaced the S&P 500 — a broad index of American stocks — by almost 2.5 million percentage points. The degree to which Buffett has outwitted successive generations of Wall Street rivals almost defies comprehension.

It is striking, then, that over the past decade Buffett has fallen behind. A dollar invested in Berkshire 10 years ago is worth about \$2.40; the same dollar in an S&P 500 tracker fund is worth \$3.20. More striking still is what Buffett says about this. Ahead of Berkshire's annual meeting, Buffett sat down in his office for a rare newspaper interview with the FT, lasting nearly three hours.

At the outset, he was asked which would be the better investment to put in a child's account — a share in Berkshire, or a share in the S&P? He did not hesitate: "I think the financial results would be very close to the same."

The statement was made without qualification. But it is hard not to wonder if Buffett, even at 88, is underplaying his ambitions. If he is an investing genius, Buffett is a public relations genius, too — cultivating an aw-shucks, Midwest-wholesome image of a man who has triumphed in the long game by practising a simpler, purer version of capitalism.

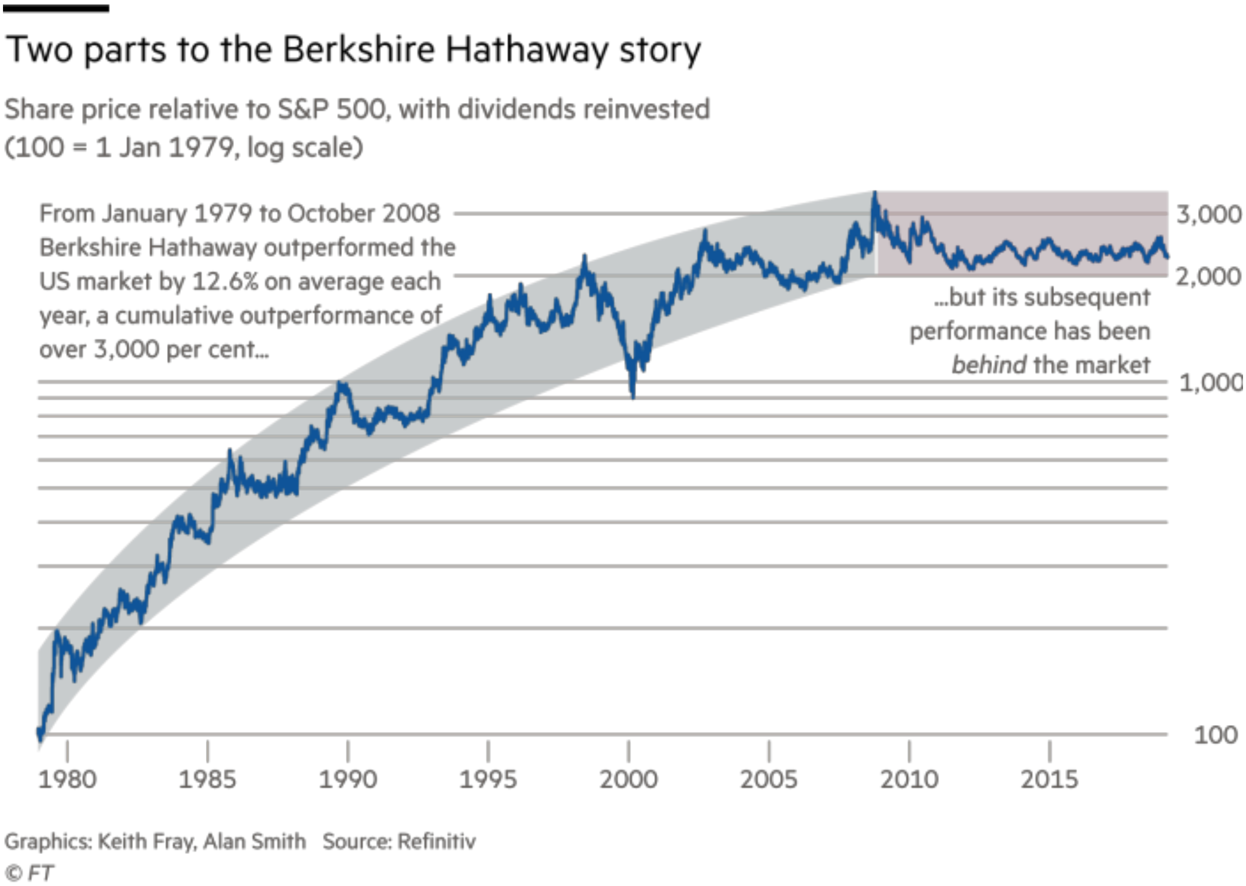
Buffett in Berkshire's offices in Omaha. Occupying a single floor in an unexceptional tower, they reflect Buffett's aw-shucks, Midwest-wholesome image: he still works at the same desk his father, a stockbroker, used 75 years ago © Bryan Schutmaat

The third-richest man in the world, with an estimated worth of $86bn, says he stays at the helm of Berkshire because he wants to keep doing what he has loved since buying his first shares, in an Oklahoma oil company, at age 11. "I can't buy time, I can't buy love but I can do anything else with money, pretty much. And why do I get up every day and jump out of bed and I'm excited at 88? It's because I love what I do and love the people I do it with. I've got 25 people out here. We go to baseball games together. They try and make my life good, I try and make their life good."

The Buffett persona is reflected in Berkshire's office, which occupies a single floor in an unexceptional office tower in Omaha that bears another company's name. Its drop ceilings, narrow hallways and tired carpets would suit the administration of a community college better than a $700bn financial empire. The staff of 25 dress casually. Every desk is covered with family photos, greeting cards and tchotchkes. A sign hangs over the door from the anteroom: "Invest like a champion today!"

Buffett himself comes to collect his interviewers from the lobby, in a baggy pinstripe suit, sensible shoes and a red tie. "I buy expensive suits — they just look cheap on me," is one of his famous quips, and he is not wrong. A little stooped, he takes careful, shuffling steps, but his face is pink and flush with health. His eyes flash and twinkle behind his glasses as he talks, buoyantly and at speed.

Buffett's plain-dealer persona is an integral part of the Berkshire enterprise. The company plays in politically and financially volatile sectors such as energy and finance, and being capitalism's favourite grandpa has kept investors, politicians and regulators firmly on side.



A key element of this is careful management of expectations. After a bruising 1999, in which Berkshire's shares were trounced by the market during the tech boom, he did not predict that the pendulum would soon swing back to sensible investments. Instead, he said that he expected the growth in Berkshire's value to "modestly" exceed that of the S&P over the next decade. "We can't guarantee that, of course," he wrote in a letter to investors. "But we are willing to back our conviction with our own money."

Not promising too much is a constant theme. "The one thing that would ruin my life is people expecting more than I deliver," he says. "Now, I can do that by being short on delivery or I can do that by being long on expectations with them, but either one would make my life miserable."

And after promising little, he has often delivered much. In the 10 years following 1999, Berkshire's shares rose by almost 80 per cent while the S&P fell. Behind Buffett's personal warmth and old-timey aphorisms ("I don't want people to throw tomatoes at me when I think I deserve a bouquet, and I don't want a bouquet when tomatoes are called for," he assures the FT), there are sheets of cold competitive steel.

Things are different now, though. Never has Buffett had anywhere near as long a stretch of underperformance. And never has the competition for the kinds of assets he prefers — big companies that are easy to understand but hard to dislodge from their competitive positions — been fiercer.

Asked if his expectation of "modest" outperformance against the market has changed in the intervening 20 years, he adjusts his forecast by a single word: "very modest". "I think this: if you want to join something that may have a tiny expectation of better [performance] than the S&P, I think we may be about the safest." Surely, greater safety, over the cycle, will translate to higher returns? He doesn't bite: "If we got lucky," he says.

A portrait of Buffett taken in 1980. Now 88, he remains at the helm of his company because he still enjoys it: "Why do I get up every day and jump out bed? Because I love what I do and I love the people I do it with" © Lee Balterman/Getty

All of which raises a question. What is the point of Berkshire Hathaway, if it does not make its shareholders richer than they otherwise could be?

Having said that a young investor — in particular, the son of an FT journalist — would do as well in the S&P as in Berkshire, Buffett provides a clue: "I think your son will learn more by being a shareholder of Berkshire."

But what does the sage of Omaha want to teach us?

"Has Warren Buffett lost his touch?" is a theme that plays at regular intervals in the media, a perennial that blooms whenever one of the investments in Berkshire's portfolio goes wrong, as Kraft Heinz did recently, or IBM did a few years ago. It reflects a misunderstanding.

There was a time, in the 1950s and 1960s, when Berkshire was a machine for accumulating misunderstood and undervalued shares and companies. In a phrase that has entered lore, Buffett was buying dollars for 50 cents, or "picking up cigar butts" — such as Berkshire Hathaway itself, which was a struggling Massachusetts textile maker when Buffett bought into it.

Today, Buffett and Berkshire are superficially unchanged. Buffett lives in the same house he bought in the 1950s, when he ran a tiny investment partnership. He still works at the desk his father, a stockbroker turned Republican congressman, used 75 years ago (his father wasn't really that interested in finance, Buffett says; he got into the business because, coming from a family of grocers, he needed to make a living). And Berkshire remains in Omaha, a smallish city on the edge of the corn and cattle state of Nebraska, which is the size of Great Britain but has a thirtieth of the population.

Buffett as chairman of Salomon Brothers, a role he took on after the broker fell into crisis in 1991. "People get smarter but they don't get wiser. They don't get more emotionally stable." says Buffett. "You can teach all you want to them... but when they're scared, they're scared" © Getty

Yet Berkshire invests using a very different formula today. One: buy whole companies when they can be had for fair prices, sometimes financed with a form of very low-cost debt — the incoming premiums from Berkshire's vast insurance empire. Two: husband the cash those companies throw off, taking it out of portfolio companies that are not growing and investing it in those that are — all under the Berkshire holding company umbrella, so the transfers are not taxable. Three: invest some of the excess capital in publicly traded, blue-chip stocks. Four: hold the rest in treasuries and cash, a war chest for when the next deal presents itself.

The brilliance of the modern Berkshire, then, is that there is not really any “touch” to lose. The stock-picking involved hardly merits that description. Buffett’s latest big stock idea? Buying Apple, the most widely held equity there is. “What we see in the way of marketable securities, everybody in the world knows about them,” he says.

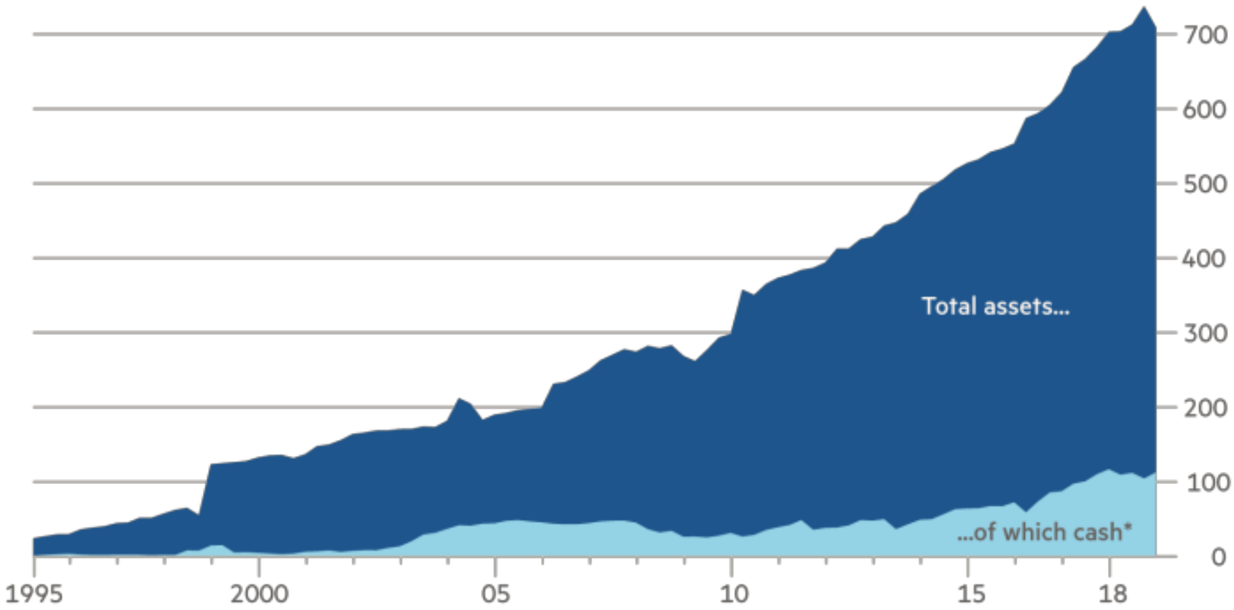
The tricky part of buying out private companies, similarly, is not picking good ones — it is waiting until a good one comes up for sale.

Buffett thinks that he has built a business in Berkshire that shares the key characteristic of the companies he likes to buy: it does not require a genius to run it. “I’ve got an interesting business. It’s simple enough,” he says. “I always tell people: if they’ve got more than 130 points of IQ, sell the rest because you’re not going to need it in this business. It may hurt you.”

Buffett is confronting not the waning of his genius but the consequences of success. It is the fairy tale of the magic porridge pot. A hungry girl receives a porridge pot from a kindly old witch; at the utterance of a magic phrase it produces all she needs to eat — but she forgets the words that will make it stop, and soon her house, her street and her town are flooded with porridge.

The rise and rise of Berkshire Hathaway

$bn



*Cash and cash equivalents
Source: Bloomberg
© FT

Every working day, $100m rolls into Berkshire — cash from its subsidiaries, dividends from its shares, interest from its treasuries. Something must be done with it all. The porridge is starting to overrun the house.

With $700bn in assets, $112bn of that in cash and cash-like investments, only vast investments can meaningfully improve Berkshire's profits. The publicly traded stocks Buffett can sensibly buy number no more than 100, he says. Buying companies outright is no easier. A billion-dollar company that immediately increases in value by 50 per cent hardly helps at all: "Making $500m sounds great and $1bn sounds like a big investment, but [$500m is] less than a tenth of a per cent" as a contribution to Berkshire's assets, Buffett notes.

Further shortening the list of possible investments, he rules out buying companies that need help. The owners have to be selling for personal reasons. "Maybe once in 50 years a family is going to want to sell for some reason — taxes, they don't get along, whatever it may be — and that's when they have to think of us. I don't try and sell anybody on doing business. I just had a woman come in a week ago and my advice [was], if you've got a business, keep it."

Berkshire has the muscle to buy large listed companies in their entirety, but that game is getting harder too, due to the rise of private equity, which has put an over-funded, debt-happy competitor in the game. Buffett reckons that PE firms have roughly $1.2tn in commitments from investors that can be doubled with the use of debt.

Buffett appearing in a video message to shareholders at the start of the Berkshire Hathaway annual meeting, May 2010. The company does not pay dividends, so the loyalty of its shareholders is the foundation of everything Buffett does: he can only be the lender or insurer of last resort because he has been able to hold on to so much of his investors' capital © Bloomberg

"It's very, very, very hard to make deals in a world where you've got $1tn-plus of money, plus just the normal animal spirits of corporate leaders and everything else, and accessibility to extraordinarily cheap money," he says. "If somebody else is going to look at their return based on borrowing 75 per cent of a deal, and I'm going to look at return based on all equity — which I do, unless it's in the utility business or something where it's very specific to an asset — we're just going to lose."

Faced with these obstacles, a few years ago Buffett sought help in the form of Jorge Paulo Lemann, a founder of the private equity group 3G. Berkshire and 3G teamed up to buy Heinz in 2013, and merged the ketchup maker with Kraft two years later.

The partnership made excellent returns for a few years by doing things that were alien to Buffett's usual approach: borrowing heavily and laying off thousands of employees. But as 3G slashed costs to boost its profits and focused on a doomed $143bn bid for rival Unilever, the partners failed to anticipate a shift in the market, away from big-brand packaged foods like Kraft's and towards ostensibly healthier options and artisanal brands.

Retailers suddenly had the upper hand over Kraft Heinz, prices and volumes fell, and Berkshire took a $3bn writedown on its investment (Kraft Heinz replaced its CEO this week).

Buffett touring the floor of the New York Stock Exchange in 2011. Over the past 54 years, shares in his company have outpaced the S&P 500 by almost 2.5 million percentage points © Bloomberg

The struggles of Kraft Heinz have led many to suggest 3G's leaders put short-term profits over the long-term health of its businesses. Does Buffett agree with this criticism of them? "Let's say we, not they. I'm not the operator [but] I'm their partner." After making sure not to distance himself from 3G, he says the problem was not under-investment, but overestimating the strength of the Kraft Heinz brands and their power with retailers.

Along with the usual in- and out-trays, there is a third one on Buffett's desk marked in big letters: "too hard". He won't say what is in it, but Kraft Heinz may land there before long.

If the problem is too much money, a natural response would be to get rid of some. Companies do this all the time: they pay dividends or sell off business units. Why not get smaller, so that Berkshire can get back to producing outsized returns?

Buffett agrees that he could do much better with less. "I think that if I was working with $1m or if Charlie [Munger, Berkshire’s vice-chair] was working with $1m, we would have no trouble earning 50 per cent a year,” he says.

But he waves off the idea of a dividend. Berkshire compounds capital — it does not give it away. “I like the businesses we have, I like the people that run them, I like the shareholders we have. We have a very special — well, it’s a partnership. And Charlie feels that way, I feel that way, our directors feel that way.”

In 2014, Berkshire’s shareholders rejected a proposal that the company should start paying a dividend. But at the time, the company had a far smaller cash pile than today. And analysts wonder if stockholders would vote the same way if Buffett were no longer in charge.

The only way Buffett will countenance reducing the company’s massive pile of shareholder equity is to buy back shares when they are selling at a price he thinks is lower than their true value. This amounts, in his view, to buying out a partner at an attractive price. He says the time may come when the company buys back as much as $100bn of its shares (it bought back $1.3bn last year).

But what happens when Berkshire’s shares are trading at a fair price, and companies and stocks look expensive too? “That’s my nightmare,” Buffett says.

Those who think Berkshire can still beat the market argue that all it needs is the inevitable arrival of the next crisis. In 2008 and 2009, Buffett made a series of lucrative deals to provide capital to financial institutions including Goldman Sachs, which sold Berkshire $5bn in preferred shares — a debt-like instrument that paid a 10 per cent yield. Goldman’s debt now sells with a yield of 4 per cent. In the insurance industry, where Buffett does much of his business, Berkshire is known as a provider of “Friday-night money” — a place that struggling insurers can turn to for backing when everyone else has gone home.

At an Omaha Royals baseball game in 1997; Buffett was a minority owner of the team between 1991 and 2012, and still enjoys attending games with his employees: "I've got 25 people out here. We go to baseball games together. They try to make my life good, I try and make their life good" © Getty

Buffett is confident that the time will come again when good companies will need capital, and have to buy it from Berkshire, on Berkshire's terms. "We will get the calls again. This is a place that can commit $10 or $20 or $30bn, and it's done.

"People get smarter but they don't get wiser. They don't get more emotionally stable. All the conditions for extreme overvaluation or undervaluation absolutely exist, the way they did 50 years ago. You can teach all you want to the people, you can tell them to read [Buffett mentor] Ben Graham's book, you can send them to graduate school, but when they're scared, they're scared."

The walls of Berkshire's office are covered with memorials to this truth: a newspaper front page from the day of the great crash of 1929; another front page announcing Buffett's arrival as chairman of Salomon Brothers, after the broker fell into crisis in 1991; a telegram he sent offering to buy the assets of Long Term Capital Management, the hedge fund that almost brought down Wall Street's banks in 1998 (the deal got away, to his lasting regret).

Yet after the last crisis, Berkshire's outperformance was real but not exceptional. Measured from the pre-crisis peak in 2007, Berkshire beat the market of the next decade. Measured from the bottom in 2009, it did not.

And there is another point. Crises do not come along frequently, and when the next one does, someone else might be running Berkshire Hathaway.

"I'm not bothered by the thought of my death," Buffett says. His frankness prompts one of his FT interlocutors to knock on wood, and he is unimpressed: "I'm not big on superstition — that can be expensive."

He wears hearing aids and has given up driving at night, but endurance does not appear to be a problem. He answers questions for nearly three hours without even a glass of water, an enviable performance from a man who says he lunches on McDonald's chicken nuggets at least three times a week and has, since childhood, taken a quarter of his caloric intake in the form of Coca-Cola.

He is in no mood to quit. "I'm having a vacation every day. If there was someplace else I wanted to go, I'd go there. This is the pleasure palace here — you're sitting in it now. I have more fun here than I think any 88-year-old is having, virtually, in the world."

Yet the tricky matter of how much Buffett personally brings to Berkshire remains. He has long been a fan of strong brands, and he is a brand himself, perhaps the strongest in all of finance.

Who will take over from Buffett?

© Bloomberg

Ajit Jain (left) and Greg Abel are both seen as potential successors

Was part of the reason Goldman paid so much for Berkshire's money that it was branded by a man personifying wisdom and honesty? Will a successor — perhaps Greg Abel, who is responsible for all of Berkshire's non-insurance businesses — be able to ask for as much?

Similarly, will business owners be as willing to sell to a conglomerate that is no longer led by capitalism's biggest star — or will they take that higher offer from the private equity bosses, with their slick suits and reorganisation plans?

Buffett dismisses the idea that Berkshire is powered by his brand. For him, Berkshire's only edge is its unparalleled financial strength and the speed with which it can put money to work. After he is gone, he expects there will be a "parade" of investment bankers peddling "bullshit" ideas for spin-offs, "but no one will have to succumb to that pressure here for a long time".

There is also the question of Berkshire's relationship to regulators. No other company runs so much money or makes such big decisions from an office of 25 or with a board half-filled with staff, and friends and family of the chairman.

In a report, the proxy adviser Glass Lewis, guardian of corporate governance, shrugs hopelessly at the situation: "We draw attention to several ways in which the company does not follow many governance 'best practices' . . . [but] we do not believe that shareholders have any concerns."

Will investors or regulators have concerns when the company is no longer led by the most famous and most trusted of American capitalists? Buffett here repeats his fundamental view: regulators and investors like Berkshire because it plays by the rules, is wildly overcapitalised and makes sure its subsidiaries, from insurance to power generation, are overcapitalised too.

"We will behave well, and we can afford to behave well. Whether we behave well because we're rich or whether we're rich because we behave well, we'll never know."

The question around succession cannot be fully resolved until the time for succession comes. Buffett himself acknowledges this, noting that after a certain interval, his successors are on their own; they will have to "prove that the system works".

What is remarkable about questioning Buffett about succession, and about whether the firm can continue to thrive, is how unperturbed he is about either issue. What really matters to him is the concept that Berkshire has become a community of like-minded people.

"Very few managements now write annual reports to what they'd write their next-door neighbour," he reflects. "They don't talk as manager to owner, and I think that's important." He looks around the table: "Let's say we buy a McDonald's franchise. We want to all be on the same page, whether we're going to retain the earnings or buy another one, assuming the first one works out. We want to be in sync."

It is easy to see why Buffett likes the idea. The loyalty of Berkshire's shareholders is the foundation of everything he does. Buffett can only be the lender or insurer of last resort because he has been able to hold on to so much of his investors' capital. That is partly because Buffett has limited the influence of Wall Street institutions, which might agitate for a dividend or break-up. He wants loyal individuals on his shareholder list, rather than fickle market players.

Buffett's "plain-dealer persona” is integral to Berkshire’s success, prompting speculation about how the company will fare when it is no longer led by him. While he anticipates a “parade” of investment bankers peddling “bullshit” ideas for spin-offs, he insists that “no one will have to succumb to that pressure here for a long time” © Bryan Schutmaat

“There’s only 1,645,000 seats in our church,” he says, referring to the “A” shares where voting power is concentrated. "Why in the world, if we've got the right people in those seats that are in sync with us, why would I want to go and get a bunch of people that have target prices for stocks? . . . We try and do everything to make sure that our congregation is the right congregation and we'll keep doing it."

Over time, of course, the individual shareholders who once made up Berkshire's shareholder base sell, as they must given the lack of a dividend, if they need the money. Still, at a time when capitalism is widely thought to be in crisis, Berkshire may offer a different model. Not because it invests for the social good — Buffett thinks social goals are for governments rather than companies to pursue — but because it eschews the gospel of "total shareholder return" in favour of the idea that shareholders and management form a community of interest.

The faithful will gather next weekend in Omaha for Berkshire's annual meeting. Tens of thousands of shareholders will travel hundreds or thousands of miles to attend something akin to the Lollapalooza of capitalism. They will get discounts on goods from Berkshire's - companies, from Nebraska Furniture Mart to Borsheims Fine Jewelry. They will see old friends. They might even be permitted a glimpse of Greg Abel, or Ajit Jain, the other publicity-shy potential successor to Buffett.

"If you look at those 40,000 people or whatever there may be at the meeting and ask them how it has done versus the S&P over three years, five years, 10 years, they are not going to answer overwhelmingly. What they are going to say is that essentially every one of them has had a profit . . . they know they're exactly in my shoes and Charlie's shoes and they like owning, really, part of America."

At the centre of it, on a simple stage, Buffett will sit with Munger, and they will preach the old lesson: keep the faith. Don't worry about the ever-growing pile of cash. Opportunities will come. And if some investments don't pan out — that's part of the game.

"If you played golf and you hit a hole in one on every hole, nobody would play golf, it's no fun," he says. "You've got to hit a few in the rough and then get out of the rough . . . That makes it interesting."

Warren Buffett: key moments

AUGUST 30 1930

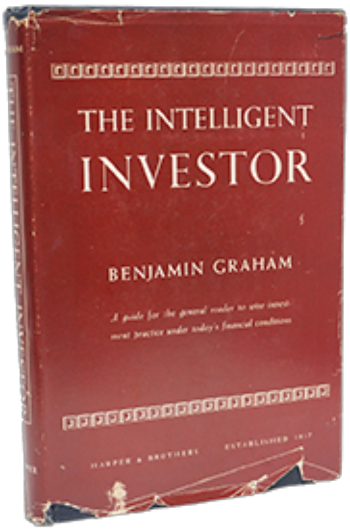
Warren Buffett is born in Omaha, to Leila and Howard Buffett. He is the second of three children

1942

Buys his first stock, age 11: three shares of Cities Service preferred

1949

Reads Benjamin Graham’s *The Intelligent Investor* — and later takes his class at Columbia



1952

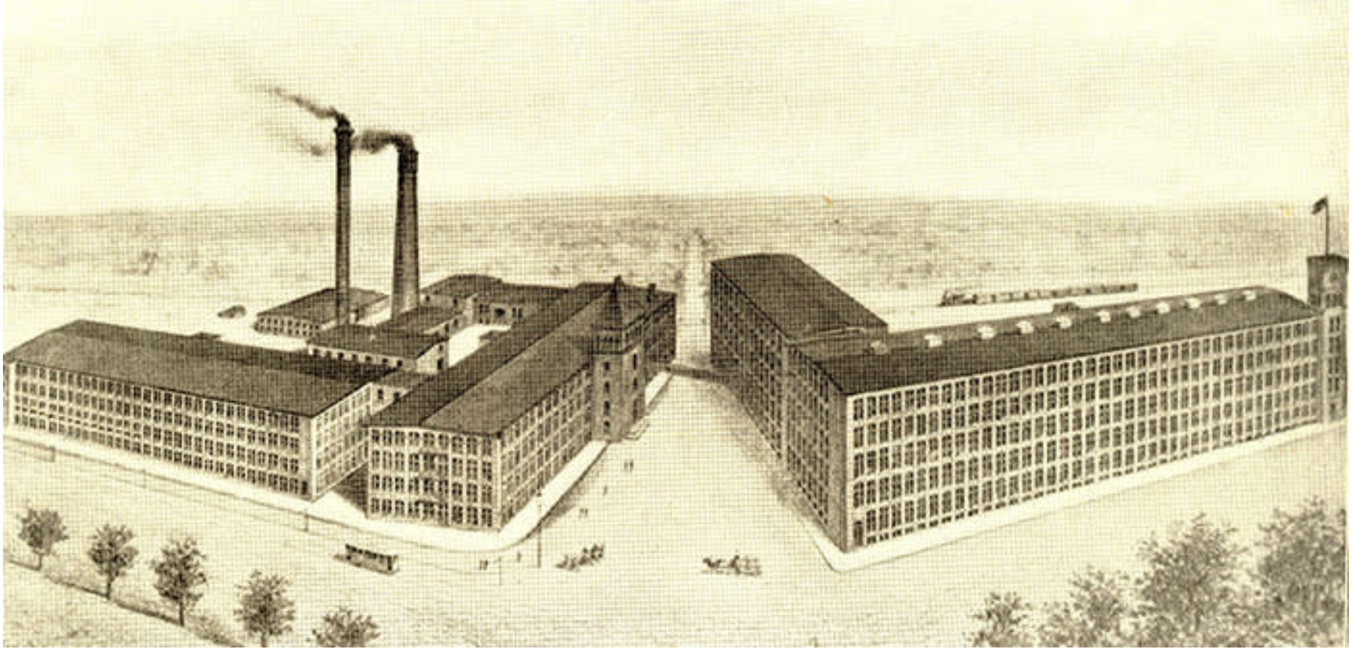
Marries Susan Thompson. They go on to have three children: Susan, Howard and Peter

1956

Begins a partnership in Omaha with seven investors

1965

Takes control of Berkshire Hathaway, a struggling New England textile business



1978

Charlie Munger joins Berkshire Hathaway as vice-chairman. The two men had been friends since 1959

1991

Steps in as chairman of investment bank Salomon Brothers in the middle of a crisis

1996

Buys Geico, an insurance company he had been following since 1950

2006

Pledges to give away 85 per cent of his wealth. Marries Astrid Menks (his first wife, Susan, died in 2004)

Robert Armstrong is the FT's US finance editor; Oliver Ralph is the FT's insurance correspondent; Eric Platt is the FT's US mergers and acquisitions correspondent

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