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Event Report

International Investing with the Oracle of Omaha

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On October 9, 2009, 27 Columbia Business School students visited legendary investor Warren Buffett at the Omaha, Nebraska headquarters of Berkshire Hathaway, the conglomerate holding company of which Mr. Buffett is chairman and CEO. Mr. Buffett spent more than two hours addressing student questions on a range of topics, including his career beginnings, political opinions, business philosophies, and investment experiences. This article highlights the international investing experiences and insights shared by the "Oracle of Omaha."

The recent announcement of Berkshire Hathaway's $34 billion acquisition of railroad giant Burlington Northern Santa Fe represented what Warren Buffet called "an all-in wager on the economic future of the United States." While much attention has been directed toward Mr. Buffett's investment in Burlington as well as other U.S. bellwethers—such as Coca-Cola, American Express, Wells Fargo, and Procter & Gamble—non-U.S. companies also fit within Mr. Buffett's investment philosophy. The applicability of Buffett-style investing abroad is reflected in two of his holdings: Daehan Flour Mills, a South Korean miller of wheat flour and frying powder, and BYD, a Chinese battery, mobile phone, and electric car company.

At the core of Mr. Buffet's investment philosophy is the "moat"—that is, a durable competitive advantage that prevents competitors from stealing customers and profits. Mr. Buffet suggests that there is little difference between buying a farm and buying a stock. Buying a farm requires assessing the land, calculating how many bushels f soybeans, corn, etc. could be grown per year, making an estimate of average future prices for those products, and calculating the costs of hiring a tenant farmer. There's no need to worry about whether it will rain next week, next month, or next year. There's no need to get a quote on the value of the farm every day or a chart on historical prices and volumes of farms traded over time. One simply needs to focus on buying the asset at a discount to the value it is likely to yield over the long term.

Mr. Buffet adhered to this investment philosophy even in the early days following his graduation from Columbia University in 1951. He would refer to a series of 3,000-page Moody's manuals, turning page by page until he found an investment that jumped out at him. On one occasion, he found his investment on page 1,433: Western Insurance Securities, a Nebraska property casualty insurance company. The common stock had earned $29 per share that year and $24 per share the prior year. Over the prior year, the stock price traded from $3 to $13. To grow comfortable with the fundamentals of the business, Mr. Buffett interviewed Western's agents and poured through examination and convention reports at the state insurance office in Lincoln. By the time he was ready to buy, the shares had traded up to $16, still representing a compelling 45% discount to trailing earnings.

One may argue that these opportunities are not as prevalent today as they were 50 years ago. On the contrary: Mr. Buffett has proven that such opportunities continue to exist and many can be found abroad. Mr. Buffett retrieved a 1,500 page manual on South Korean companies, reminiscent of the Moody's manuals where he first found Western Insurance Securities. He spent one Sunday afternoon with the manual, turning page by page in what he called an attempt to "relive his youth." Mr. Buffett identified about 20 companies selling at a depressed multiple of three times earnings in the wake of the financial difficulties experienced in 2002. Daehan Flour Mills, a miller of wheat flour and frying powder, stood out in particular.

Mr. Buffet admitted that he couldn't even pronounce the name of the company or its CEO, but he saw that Daehan held an impressive 25% market share of wheat flour produced in South Korea, and he liked the company's valuation metrics even better. The company had earnings per share of 18,874 won, book value of 200,000 won, and 100,000 won in cash and securities, while the shares were trading at just 38,000 won. Thus the shares were priced at two times earnings, 40% of cash assets, and 20% of book value. Mr. Buffett was comfortable investing in this security without doing as much due diligence as he had with Western Insurance Securities, because his ownership was relatively small and he was diversifying his investments among two dozen other South Korean companies, all trading at bargain prices. Mr. Buffett advised that, whether screening domestic or international securities, one must pay particular attention to small and obscure stocks that can at times trade at steep discounts to their intrinsic value.

Mr. Buffet's international investing extends beyond Daehan Flour Mills. The idea to invest in Build Your Dreams (BYD)—a Chinese battery, mobile phone, and electric car company—came from Mr. Buffett's long-time partner Charlie Munger. The investment rationale was simple: BYD was a remarkable company because its founder Wang Chuanfu was a remarkable man.

"I would not bet against this guy," Mr. Buffet professed. "He just keeps coming up with things." Muhtar Kent, chairman and CEO of The Coca-Cola Company, suggested the possibility of a solar-powered vending machine to Wang Chuanfu during the last Berkshire Hathaway shareholder's meeting. Within a day or two, Wang Chuanfu had bought several vending machines, torn them apart, reverse-engineered them, and outfitted them with solar technology. This inventive capacity has driven Wang Chuanfu to manufacture every part of his cars except the tires and glass, reflecting his wish to avoid the perils of Detroit's Big Three carmakers and be independent of auto part manufacturers.

In 1995, Wang Chuanfu started BYD at age 29 with $300,000. Today the company is one of the largest manufacturers of cell phone batteries in the world, employing over 130,000 people. BYD also makes the best-selling car in China, a considerable accomplishment considering that this company was not even in the car business five years ago. Going forward, Mr. Buffet believes BYD will be the leader in battery technology, making electric cars that will be able to run 250 miles on an overnight plug-in charge. The combination of Wang Chuanfu's inventive capacity and his keen business practicality is the cornerstone of Mr. Buffet investment rationale.

Because corporate governance concerns are amplified when investing abroad, integrity is key. In September of 2008, Mr. Buffett agreed to buy 10% of BYD for $230 million, or at HK$8 per share. Because of the bureaucratic approval process of the Chinese government, Mr. Buffett could not actually deliver a check to Wang Chuanfu in exchange for a stock certificate until August 2009. During this period, BYD share price more than quintupled. Given this dramatic rise, every financial incentive existed for Wang Chuanfu to use the bureaucracy to manipulate the terms of the deal, particularly since up until this point Mr. Buffet did not own a BYD stock certificate nor did Wang Chuanfu have Berkshire funds in hand. Nonetheless, Wang Chuanfu fulfilled his promise, delivering BYD shares at HK$8 despite trading at above HK$40. Ultimately, the bet was a bet on Wang Chuanfu, and this was a bet Mr. Buffet was more than comfortable making.

Mr. Buffet has found investing success through opportunities both domestic and international. The beauty of investing, Mr. Buffet professes, is that only a handful of good ideas are needed to make a lot of money. In the world of investing, one need not be smart every day. In essence, the stock market is a no-called-strike game. “You don’t have to swing at everything and you can wait for the right pitch.” As Mr. Buffet has shown, international stocks can be great places to look for home runs.

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