Warren Buffett’s
billion dollar secrets

He’s worth $44 billion and has a devoted following in the financial industry. At MU, his legendary wisdom and teachings are being spread through the Buffett class.

Warren Buffett offers MU finance instructor Andy Kern some confidential advice. Kern, who describes himself as a Buffett disciple, teaches a one-of-a-kind course based on the investing philosophies developed by Buffett.
A ‘free lunch’ with Mr. Thrifty
Monday, 12:15 p.m., Gorat’s Steakhouse

A fall afternoon in Omaha, Nebraska. Gorat’s Steak House. Warren Buffett, the second richest man on Earth. He’s sitting next to me. Rather, rocking next to me. The 75-year-old rocks his wooden chair back and forth like a kid on caffeine, occasionally pausing against the mirrored wall behind us. He’s talking about taking a picture of his computer screen after scoring 3656 at “Helicopter” on addictinggames.com. Buffett, that folksy financier, corn-fed capitalist, the Oracle of Omaha and second richest man in the world, is sitting next to me.

Nine people, representing three generations of Buffett “disciples,” surround him along a long, rectangular table. They’re probably thinking the same thing I am: what to ask the most successful professional we’re ever likely to meet. We are all dressed in formal business attire because Buffett, who wears a black business jacket with gold buttons and a gold watch, said he prefers that students dress that way. Hot roast beef sandwiches and Cherry Cokes — Buffett favorites — clutter the table.

We are here because we are enrolled in a one-of-a-kind finance class at the MU College of Business that teaches the investing philosophy of Buffett. The “Warren Buffett” course, Finance 8001: Investment Strategies of Warren Buffet, is about one-fourth psychology, one-fourth finance and one-half common sense.

Despite Buffett’s enormous success in the financial world, the MU class is thought to be the only one in the country based solely on his techniques. And although chief executive officers around the world try to mimic Buffett’s methods, the philosophies he espouses are still heresy to many: The stock market isn’t efficient; don’t diversify (for diversity’s sake); buy businesses on a till-death-do-us-part basis.

But now, a new class of MU students is joining a small movement of business students embracing the Buffett way.

The class at MU began through the largess of first-generation Buffett acolyte and MU alumnus Harvey Eisen, a physically towering presence who sits to Buffett’s right at lunch. Eisen enrolled in MU, he said, because he “lived in state, had no money and bad grades.” He graduated in 1964, and, decades after employing Buffett’s investing philosophies, he’s wealthy and the chairman of Bedford Oak Advisors, an investing firm in Mount Kisco, N.Y. He established the class in 1997 by providing money to MU’s business college for an instructor to teach the Buffett course. His goal: to give business students “a real world experience, not to cram something down for a final that they can forget about while getting drunk afterward.”

Eisen also arranged and paid for the class trip to Omaha and the meeting with his friend and mentor.

Buffett disciple Andy Kern, a Ph.D. candidate in the MU business college, teaches the MU class. Employing senior doctoral students to teach the class serves another of MU’s goals: to spread the gospel. The hope is that the Buffett scholars will carry his teachings with them when they become professors at other schools.

Kern, who is sitting catty-corner from Buffett at lunch, is 26, has jet black hair, a face full of freckles and a Buffett-like way about him. He interrupts his own lectures with jargon-free asides: “Wait, did what I said make any sense?” Kern has pored through six books about Buffett, attended two of his shareholders meetings and has a framed personal letter from Buffett hanging in his living room, inviting him to bring the class back every year. He can practically recite it

ABOUT THE AUTHOR
Catherine Rentz Pernot was a graduate journalism student at MU. Before attending MU she analyzed government and business finances at Enron and the Gulf Coast Institute, a nonprofit in Houston. She has a bachelor of business administration degree in finance from the University of Texas at Austin.
from memory.
The rest of the table is filled with third-generation Buffett students, MU alumni and their children.

And me? I’m a journalism graduate student taking the class, but I wouldn’t call myself a Buffett disciple. I have too much scar tissue from my previous life at Enron to be a true believer in anything. I guess I’m more of a Buffett student who already knows how not to study businesses.

I graduated with a bachelor’s degree in business from the University of Texas in December of 1998 and went to work at Enron a month later. Enron was then ranked “Most Innovative Company in America” by Fortune magazine for the fourth year in a row. The magazine would go on to name Enron “No. 1 in Quality of Management” and one of the “25 best places to work in America.”

When Enron collapsed, my skepticism in traditional business teachings and practices escalated. Business schools across the nation, including at UT, celebrated the energy company. Graduates of elite business schools had populated Enron’s floors; CEO Jeffrey Skilling had graduated in the top 5 percent of Harvard Business School. These were not stupid people. But I came to realize that our extreme focus on numbers — the stock price, the stock market, the end result, the formula — was insane.

Now, in the Buffett philosophy class, I’m learning more about evaluating business than I ever did in business school. That’s not to slam UT. The problem of not learning about business at business schools is widespread.

But more about that later. Back to my Buffett day.

To hard-core financial geeks, this lunch was a meeting with The Man. Omaha is capitalism’s Mecca and Buffett is their dollar god. Each year, thousands trek to Omaha, bearing Buffett bobble-head dolls, Buffet kaleidoscopes and other Buffett thingamabobs, to hear Buffett hold forth at the annual shareholders meeting of Berkshire Hathaway, his holding company. Berkshire Hathaway owns such diverse and banal companies

**Buffettisms**
From “Warren Buffett Speaks” by Janet Lowe

“Never ask a barber if you need a haircut.”

“It’s only when the tide goes out that you learn who’s been swimming naked.”

“People would rather be promised a (presumably) winning lottery ticket next week than an opportunity to get rich slowly.”

“The fact that people will be full of greed, fear or folly is predictable. The sequence is not predictable.”

“Tell who your heroes are and I’ll tell you how you’re going to end up.”

“Current finance classes can help you do average.”
as GEICO Auto Insurance and International Dairy Queen. Its steady-but-sure companies have garnered generous profits for the shareholders and their rock-star-status CEO.

Indeed, hard-core shareholders, or “owners” as Buffett calls them, line up like fans to a rock concert as early as 2 a.m. the day of the annual meeting. When the doors open at 7 a.m., they rush in to snag a good seat and listen for hours, rapt, to their financial sage. If they are lucky, they might get to meet him in passing. But few ever get the full-blown Buffett day that I’m having. Not only am I having lunch with their guru — an honor that was recently auctioned off for $351,100 on eBay — but he was paying. And he chauffeured me to lunch in his own car, right after spending 90 minutes letting me and my classmates pick his brain. All this sandwiched between tours of his Omaha-based businesses.

This kind of access would have surely sold for a million to someone somewhere in the world. So what did I learn? What did he say? What nasty thing was in his car?

More about all that later. Back to our tour with Buffett.

Berkshire Hathaway owns 8.4 percent of the Coca-Cola Company, and Buffett is big on pushing product. He’s been reported to chide visitors with: “I don’t care if you drink ’em, but open the can, will ya?”

We each pick our preferred type of Coke and take a seat. He enters through a side door. The students applaud, and he opens with a joke about Nebraska football. Everyone laughs. He makes sure we’ve all found the Coca-Cola products. He then moves on to his open-the-can-of-Coke joke. More laughter. Someone asks him if he wants a Coke. Sure, he says, a Cherry Coke. No Cherry Coke. What to do? MU finance department chair Dan French disappears in search of a Cherry Coke. Buffett then tells us Coca-Cola makes more money off of Diet Coke than Classic Coke because Aspartame is cheaper than sugar.

The once-in-a-lifetime business lesson has begun.

“What are your investment strategies?”

“Do you invest in IPOs?”

“Why are you buying utilities?”

The questions of the eager, unplucked business men and women slowly take off, and the Thomas Paine of finance fires back with straight-forward investing lessons expertly sprinkled with analogies and interlaced with jokes, handling the crowd like a professional pitchman who’s been giving the same spiel for the past 20 years.

As a former businesswoman plucked at a young age by Enron, I was most curious about the things Buffett is skeptical of, such as business education. So my first question to him was why he once said, “It has been helpful to me to have tens of thousands (of students) turned out of business schools taught that it didn’t do any good to think.”

He said those words 20 years ago. However, Buffett’s angst with business education began much earlier. He dropped out of the Wharton School at the University of Pennsylvania, the world’s first collegiate business school, after his sophomore year because he didn’t feel like he was learning much. He finished college in
his home state, at the University of Nebraska at Lincoln, and while there read a book that defied traditional business thought. It was the key that unlocked Buffett’s brain.

“I thought then that it was by far the best book about investing ever written,” he wrote in the 1973 preface of the book’s 4th edition. “I still think it is.”

Buffett’s teacher

“Someone's sitting in the shade today because someone planted a tree a long time ago.”

The book was “The Intelligent Investor” by Benjamin Graham. After reading it, Buffett went to graduate school at Columbia University where Graham taught. He earned his master’s degree in 1951. He can still list and locate the lessons from Graham’s book, as he does during our Q-and-A: Think of a stock as a business not “things that wiggle around” (Chapter 8); let the markets serve you, not instruct you (also in Chapter 8); buy with a margin of safety (Chapter 20).

“Those three concepts are really all I know about investing,” Buffett says to our class. “I’ve built everything on that structure. Those were the ones that applied in 1949, those are the ones that still apply today and will apply 100 years from now.”

Graham’s book was to Buffett as Buffett’s letters in his annual reports are to his shareholders: The framework.

Nebraska Furniture Mart vice president Bob Batt and a store employee hold up a Warren Buffett poster at the store. Berkshire Hathaway is Warren Buffett’s holding company and it owns 90 percent of Nebraska Furniture Mart. Batt says the store sells hundreds of “Berkshire Mattresses” during Buffett’s annual shareholder’s meeting in Omaha.
And Graham was to Buffett as Buffett is to his followers: The teacher.

Buffett has said Graham eclipsed all men but his father in influencing his life. The “value investors” who follow Buffett and Graham’s investing philosophy refer to Graham as “the father of value investing” and Buffett as one of his leading “disciples.”

The late William Ruane, founder of the super-investment group **Sequoia Fund Inc.**, was Buffett’s classmate at Columbia. In “Warren Buffett Speaks” author Janet Lowe quotes Ruane, “(Graham) wrote what we call the Bible, and Warren’s thinking updated it. Warren wrote the New Testament.”

**The business school problem**

“I’d be a bum on the street with a tin cup if the markets were always efficient.”

Graham’s lessons were simple and practical. They taught you how to make money. Elite business schools have been criticized of late for their lack of practicality. “Harvard Business Review” published a report in May 2005 titled, “How business schools lost their way,” scolding upper-tier programs for failing to teach needed practical and ethical lessons. Its authors, University of Southern California management professors Warren G. Bennis and James O’Toole, wrote that rather than concentrating on students’ success in the business world, top business schools are focusing on fancy formulas and scientific research, little of which helps actual business practices.

One of the most popular of the conventional templates is the Efficient Market Theory. Efficient market theorists assume it is nearly impossible to beat the market; investors absorb all publicly-known information and instantaneously price it into stocks. It implies that a chimp could have as much success in picking a stock as a hard-working MBA graduate; the market is all-knowing and trying to get ahead of it by analyzing stocks is futile.

But if Buffettites had a dartboard full of fancy theories, the Efficient Market Theory would be the bull’s-eye. Buffett tells our class that subscribing to the Efficient Market Theory is as dated as believing the world is flat. He says teaching in a business school 20 years ago was like living in “Galileo’s time ... when you had to say the world was flat, and if you didn’t, they’d stone you.” In modern words, deny you tenure and promotion.

But the fact is that if the markets were so efficient, there would be no Buffett. He has made his fortune on others’ missteps. While the S&P 500 Index gained an average annual return of 10.3 percent between 1965 and 2005, Berkshire Hathaway gained 21.5 percent. While others invested in profitless, paper Internet companies, Buffett invested in Banalville. He bought companies such as Benjamin Moore Paint and Justin Industries, a brick and Western-style boots manufacturer.

Buffett’s time-tested belief: Investors don’t always act rationally, the market isn’t always efficient and bargains can be made. Competing with Efficient Market theorists, he says, is like playing bridge against opponents who were taught it does no good to look at the cards.

So what kind of things would Buffett teach? “I wouldn’t teach option theory,” he says. “What the hell good is that going to do anybody?” He says you don’t have to worry about whether you buy a 90-day option or a 20-day option when you invest in a company; you just buy the stock. “I would have two courses: how to think about stocks and how to value a business.”

More academics are acknowledging the weakness of Efficient Market Theory and the need for more practical classes. And pockets of Buffett-like thinking can be found in business curricula around the country.

MU finance professor Stephen Ferris helped Eisen establish the Buffett course at MU and pushed for a more practical focus to the business curriculum. Business school Dean Bruce Walker says the school is getting students into the “real world” as much as possible through internships.
and field trips. It also brings successful professionals like Eisen to campus through advisory boards and to serve as “professors for a day.”

By the mid-1990s, Columbia had reinstituted a value-investing class modeled after the one Graham taught there in the 1950s. At the University of Florida, alumnus O. Mason Hawkins, a wealthy investor, endowed a series of Buffett/Graham courses on value investing in the late 1990s.

In the absence of a formal curriculum, some business students have started their own Buffett education. At the University of Chicago, two first-year MBA students started “The Buffett Club” in 2004, complete with its own Web blog at thebuffettblog.blogspot.com.

Buffett estimates there are a handful of other schools teaching value-investment classes, but none quite as focused on his philosophies as MU. When he was asked at his 2001 shareholder meeting which business schools he would consider now, he said Columbia, the University of Florida and MU. And he’s spreading his own gospel directly. He meets with groups from about 15 business schools per year.

MU instructor Kern agreed: “While the other classes teach you how to price bonds, this one teaches you how to make money off of bonds.”

Buffett’s tenets cover the “softer side” of valuing businesses, Kern said. His class spends as much time on qualitative measures as quantitative. For example, one assignment includes valuing a company. But my classmates and I do not simply look at the financials to come up with a price tag. We also have to assess qualitative measures, including the candidness of management. Does management admit mistakes? Are the financials understandable, or do they read like a foreign language? Are they trying to hide something?

The simplicity and applicability of the exercise is mind-boggling. It derives from Buffett’s habit of reading hundreds of annual reports a year. Reading five years of seemingly innocuous annual reports can tell you an amazing amount about a company, especially if you look for what’s left out.

For example, if management goes several years without admitting a single mistake — painting a picture of Pleasantville — it’s a good bet something is up. Business speak will always be rah-rah, but if management admits mistakes and works to resolve them, you know its collective brains aren’t too far in the clouds.

In the following excerpt from Berkshire Hathaway’s 2004 Annual Report, Buffett talks about his management of cash for the year, which he said was to blame for the company’s unusual situation of not beating the S&P 500: “I didn’t do that job very well last year. My hope was to make several multi-billion dollar acquisitions that would add new and significant streams of earnings to the many we already have. Berkshire therefore ended the year with $43 billion of cash equivalents, not a happy position. Charlie and I will work to translate some of this hoard into more interesting assets during 2005, though we can’t promise success.”

It’s difficult to imagine many CEOs saying

**Buffetology**

“You should invest in a business that even a fool can run, because someday a fool will.”

What exactly are these young Buffettites learning? MU’s Buffett class is built around “The Warren Buffett Way,” by Robert G. Hagstrom, senior vice president of Legg Mason Capital Management, a Maryland investment firm. Hagstrom identifies four basic tenets used by Buffett in evaluating businesses: business, management, financial and value. With each tenet comes several questions: “Is the business simple and understandable? Is management rational? What is the return on equity?” Hagstrom said learning the “Buffett Way” focuses on a holistic business valuation rather than just a stock valuation.
“I didn’t do that job very well last year.” Or “we can’t promise success.” In Enron’s 2000 annual report, the last before declaring bankruptcy in December 2001, the executive letter to shareholders had not one word of negativity. Instead, it pledged: “At a minimum, we see our market opportunities companywide tripling over the next five years.”

In business school, I drank the false Kool-Aid of the certainty of formulas: price to earnings, the Black-Scholes option pricing formula, bond pricing, interest coverage and funds flow. I learned to string numbers together to create financial equations, but didn’t thoroughly understand the philosophy or quality behind such numbers. Buffett’s class has given me the framework to better analyze the qualitative aspects behind businesses, an incredibly important factor as public companies become more complex.

Ryan Dobratz, a 2003 MBA graduate from MU who took the course before me, counts it as his favorite. “On a scale of 1 to 10, with 10 being the most useful, this class was certainly a 10,” he said. He said he credits it with helping him land a job at Morningstar, an investment firm whose founder and CEO, Joe Mansueto, is a Buffett devotee.

Thomas Lindsay, former provost of Seton Hall University, reformed the business curriculum there to focus more on soft-side thinking. Both there and in his previous job at the University of Dallas, he said he injected philosophy, government, ethics and literature lessons into business brains.

“It’s an unfit education tool and unnatural to say ‘I’m going to spend 95 percent of my time making money and 5 percent on ethics,’” Lindsay said. He said he wants to give his students exposure to moral dilemma decision-making that will make them better leaders.

“If you look at the great business leaders, it wasn’t their technical expertise taught in school that made them great,” he said. “It was their vision.” For example, he said, Howard Hughes never graduated from high school.

Buffett regularly expresses weariness about the obsession with numbers. When a classmate at our lunch table asks about the Long-Term Capital Management multi-billion dollar hedge fund collapse, his reply is blunt: “They relied on their formulas too much.”

Not that he’s without technical expertise. Off the top of his head, he can tell you the story of Rose Blumkin, one of his star managers who owned Nebraska Furniture Mart. Blumkin — or Mrs. B, as she was called — emigrated from Russia at the age of 23 and began selling furniture out of her basement. She never went to school and didn’t know how to read. But her grandson, Bob Batt, who is vice president of Nebraska Furniture Mart, said, “She could calculate a carpet bill given the dimensions of a room off the top of her head faster than a salesman could do on his calculator.”

The question of heroes

Monday, 8:30 a.m., Nebraska Furniture Mart

Mrs. B’s former business is our first stop on Buffett day. Nebraska Furniture Mart is now a megaplex of furniture, electronics and appliances that sprawls over 77 acres in Omaha, and has stores in Kansas City, Mo., and Des Moines, Iowa. Batt shows us around after we are given green neck tags proclaiming “Woodstock of Capitalism,” which is what followers call the Berkshire Hathaway annual meeting in Omaha.

Though Batt’s grandmother died in 1998 at the age of 104, she is still everywhere. A picture of her hangs in the store over her motto, “Sell cheap and tell the truth.”

“Mrs. B is our image,” Batt says. “It’s a funny deal to have a grandmother as a legend. You’re 57 and still referred to as Mrs. B’s grandson.”

Batt says he knows the value of legends in business. Downstairs, in the mattress section, he unrolls a poster ad that drives Buffettites wild: Warren Buffett, the mattress model. On top of a
Berkshire Mattress draped with gold silk sheets and pillows lies Buffett on his side. He wears a black suit jacket, gray pants, burgundy tie and his signature thick glasses. “Dream big.” is written across the top of the ad. Batt says his company sells hundreds of Berkshire Mattress sets during the annual shareholders meeting. “Absolute, total credibility,” he says of Buffett. “He’s their pitchman.”

Seeing Buffett on the bed got me thinking about the pros and cons of heroes. I’ve seen my former heroes carted away in handcuffs. They’re now on trial for fraud, among other charges. Is it worth being led, only to be let down?

I put the question to Lindsay. He responded with Machiavelli’s comparison of hero worship and archery.

When you’re trying to hit a faraway target in archery, Lindsay said, you have to aim your arrow high for it to go the distance and eventually fall to the target. You don’t actually end up higher, but you do hit your target. “We study heroes not because we’re going to be an Abe Lincoln, but because we want to go in that direction,” Lindsay said.

The greats, he said, stand out from the rest not so much because of their success, but because of the number of times they have failed and recovered.

O’Toole, the business professor at USC, has his students compare the actions of opposite leaders rather than focus on any one. For example, he’d pit Jack Welch, the former CEO of General Electric, against Warren Buffett and have students debate which one makes the best decisions.

I can’t help but do my own comparison of Buffett and Jeff Skilling, the fallen Enron CEO.
Both had, at different points in my life, influenced my business education. But now I think about their cars and their license plates, and what they say about the men at the wheel.

I've never been inside Skilling's car, but I used to walk past it every day at Enron. He drove a black luxury car with a license plate that read WLEC. Translation: World's Leading Energy Company.

Buffett's car is the antithesis of Skilling's, a fact I get to observe firsthand during a cruise down Omaha's streets.

**Riding in cars with Buffett**  
*Monday, 12 p.m., Omaha streets*

Warren Buffett has just offered to drive some of us to lunch at Gorat's. He has four spots for students; we'd have to duke it among ourselves to select who gets the seats, but he says, “Let the journalism girl go.”

Had I nagged Eisen enough for him to arrange the escort? Whatever, this girl was about to take a trip with the big guy. Buffett would be my chauffeur. My chauffeur.

Buffett, Kern, two MU business students and I make small talk on the walk out to his beige Lincoln Town Car. The license plate reads THRIFTY.

Inside, there is no compact disc player, just a tape player which holds a gray tape. (No, I didn’t look and yes, I wish I had.) A small black umbrella rests on the floor of the passenger side. In the back seat is a “nasty old Kleenex box” as Kern, one of the back-seat occupants, described it later.

I consider the implicit business lessons of the men's license plates. Skilling’s WLEC was about being the best, the greatest, the top company. Buffett’s THRIFTY is about being economical, prudent, cautious.

While Buffett refuses to play the earnings expectations game, much less predict stock prices, Skilling had no problem predicting earnings and citing the exact dollar he thought Enron's stock should be. During February 2001, 10 months before bankruptcy, while Enron's stock hovered at $80, Skilling argued that it should be $126. Perception was reality.

In Buffett's world, students are learning the opposite. Perception is not reality. The stock price is not everything. There is more to business than a formula.

**The Buffett effect**

And when this new breed of Buffett students goes out in the business world, what will they carry with them? Kern says they’ll have at least one question in the back of their heads: “What would Buffett do?”

“It’s not only good business for the student,” he said. “It’s a good ethical framework.”

And for more and more business students, “Buffett” could become the name of choice to insert in the what-would question. He has invited students from MU and other business schools to

---

**Books According to Buffet**

Books recommended by Warren Buffett to business students:

- “The Intelligent Investor”  
  by Benjamin Graham

- “Poor Charlie’s Almanack”  
  by Charles T. Munger  
  (Buffett’s business partner)

- “Common Stocks and Uncommon Profits”  
  by Phillip A. Fisher

- “Paths to Wealth Through Common Stocks”  
  by Phillip A. Fisher

---

**Books According to Buffet**

Books recommended by Warren Buffett to business students:

- “The Intelligent Investor”  
  by Benjamin Graham

- “Poor Charlie’s Almanack”  
  by Charles T. Munger  
  (Buffett’s business partner)

- “Common Stocks and Uncommon Profits”  
  by Phillip A. Fisher

- “Paths to Wealth Through Common Stocks”  
  by Phillip A. Fisher
continue to meet with him in the future, where he will preach his gospel to a new generation of capitalists.

When I ask him why he answers the same questions from students over and over and spends so many hours in front of his THRIFTY license plate or Gorat’s restaurant patiently posing for pictures, he simply says: “Because Graham did it for me.”

Yet as powerful as these meetings are, they seem like brief currents in the heavy stream of business consciousness that prizes flashing red ticker tape and rattling off Black-Scholes at a cocktail party. Such is apparent on the bus ride to Omaha, when students watch the movie “Boiler Room” about fast cars, poker and getting rich quick. It draws far more interest than the Buffett documentary we also watch. Sex, hedge funds, fancy theories, stock charts — it all sells, at least in the short run. Dairy Queen’s chicken fingers and the painstaking study of hundreds of annual reports — not so much.

Perhaps a fitting quote for my classmates and me on that bus comes from a man who declared the world was round so long ago, “You can not teach a man anything; you can only help him discover it in himself.”

That might also be an appropriate quote to describe Buffett. For all his talk of heroes, he’s an independent thinker through and through. It is an independent mind that learned finance on his own and dropped out of Wharton and sought out Graham. It is an independent mind that has tweaked Graham’s methodology over time to suit his own investing and blow away his mentor’s success.

It is an independent mind that amassed the second-largest fortune in the world, and once dared to compare the halls of business schools to the flat world of Galileo’s time.

**Warren Buffett Way**

“The Warren Buffett Way” outlines four tenets to evaluate businesses. Students of MU’s Buffett course evaluate two businesses using these four points.

**Business**
Is the business easily understandable? How consistent are its earnings?

**Management**
How rational is management? Is management paying out dividend when it should reinvest in the company?

**Financial**
Buffett looks at several financial measurements, including return on equity and profit margins.

**Value**
Given the company’s cash flows, what is its value?