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The Value of Long-Term investing

Insight

Reflections from the 2019 Berkshire Hathaway Annual Meeting:

BERKSHIRE HATHAWAY AND AMAZON: TWO COMPANIES THAT HAVE MORE IN COMMON THAN YOU THINK

The Berkshire Hathaway annual meeting in Omaha, Nebraska is known as the Woodstock of capitalism. You know most of what Warren Buffett and Charlie Munger are going to say because their principles have not changed for decades, but it is uplifting anyway. That is the point and this year's meeting was no exception.

Tens of thousands of people come from all over the world and start queuing at 3 am to get the best seats when the doors open at 7 am. The person next to you can be a retired teacher who has invested in Berkshire all their lives, a fund manager or the CEO of a major business.

Some of them come for the 20% discount on the many goods and services Berkshire provides. They are all on show at the with a cavernous exhibition space adjacent to the auditorium. You cannot walk off with a Burlington Northern train, but you can buy Brooks shoes, Fruit of the Loom shirts, sign up for NetJets or renew your Geico car insurance.

One of the most colourful groups this year was the 'Millennium Mams', a group of female investors from Kolkata and Bangalore, most of them running their own substantial businesses, dressed in saris and on their first visit to Omaha.

Others are value investors like us, who come to meet likeminded investors from all over the world and participate in the many investment conferences and side-line discussions. The Stern family has been invested in Berkshire since the IPO in 1973 and it is the only 'industry convention' I attend.

All of them come to hear the highlight of the weekend, the annual meeting itself when Warren Buffett and Charlie Munger sit on a stage and answer any question thrown at them.

It borders on miraculous quite how Warren and Charlie can spend six hours (with a short break for lunch) answering questions and they are still going strong.

As much as we like the companies, it is hard to imagine the CEOs of Nestle, Diageo or United Technologies spending so much time talking to their shareholders about their company and their approach to business and life.

But the big news in Omaha this year was that Berkshire has finally bought Amazon.

At the meeting, Buffett said that success comes from changing your ways. One of Berkshire's principles is to keep learning. Munger has said that he likes to wallow in his mistakes and Buffett reminded people that Berkshire, with its $600 billion market cap, has its origins in a doomed textile manufacturer, a doomed department store and a doomed trading card business.

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Berkshire has underperformed the S&P 500 over the past five years, its own benchmark and the measure by which Ted Weschler and Todd Comps, the two investment managers investing part of its portfolio, are compensated.
Without being invested in digital technology it is hard to see how Berkshire can perform in line or better than the S&P, which after all represents the market-cap weighted range of American business.

Last year in Omaha, Buffett and Munger apologised to shareholders. They said that they should have caught Google because their own executives were telling them how much they spent on online advertising, but that Amazon was excusable because nobody could have foreseen Jeff Bezos' ability to create the business that he has.

Since then Berkshire has entered into a joint venture with Amazon and JP Morgan to provide better healthcare to their hundreds of thousands of employees. This year they announced that Berkshire has taken a stake. At the meeting Buffett said he was an idiot for not buying and Munger said they blew it (their words).

Still, Buffett made it clear that it was not his decision but rather one of the two other investment managers at Berkshire. This is how Buffett works. The first Apple stake was also bought when he had the opportunity and now it is the single largest equity position.

But Apple is not Alphabet or Amazon - it is a hardware company with a product cycle and not a platform with almost unlimited scale, and it may end up as a value trap by comparison.

Buffett and Munger spent much of the meeting extolling the strength of Amazon (as well as Alphabet), and it would not be surprising to see it becoming core positions in the portfolio.

That is not at all as surprising as people think because Berkshire and Amazon are much more similar companies than they appear.

Berkshire and Amazon are both completely unique companies. Their business models, scale and value creation are unprecedented in history. They were created from nothing by inspired founders and extraordinary entrepreneurs who are have changed the way business is down.

Both founders are fixated on taking a long-term view. The insight that competitive advantage is built over time, that investment needs patience and persistence, and that compounding over time yields the greatest returns has been integral to the staggering success of both businesses. There is hardly a statement from Buffett in which he does not extoll the importance of the long-term and Bezos has said that favouring short-term results over long-term opportunities is a firing offence.

Buffet's oft-quoted phrase "my favourite holding period is forever" perfectly captures his approach. It reflects an 'owner's' mentality and echoes Bezos, who once said "Owners are different from tenants. I know of a couple who rented out their house, and the family who moved in nailed their Christmas tree to the hardwood floors instead of using a tree stand... No owner would be so short-sighted. Similarly, many investors are effectively short-term tenants, turning their portfolios so quickly they are really just renting the stocks that they temporarily 'own'".

Like Buffett, Bezos practises what he preaches. It is worth noting that Amazon listed in 1997 with the statement that it did not expect to make a profit for four to five years. In the late

1990s, with internet companies listing at a prodigious rate, this was a bold declaration. Few shareholders thanked them for it at the time and were disappointed by the comparatively uninspiring short-term profit forecast. It was his confidence in his own plan that allowed Bezos and Amazon to weather the subsequent bust which cascaded through markets and sunk so many other internet stocks.

The reason Amazon was able to do that is another critical similarity it has in common with Berkshire. It is particularly pertinent today as we look at the many loss-making tech companies coming to market to raise cash they burn at staggering rates. After their IPOs, neither Berkshire nor Amazon ever had to return to the market to raise money to fund their growth.

In the case of Berkshire, it is part of its widely-known approach of buying cash generative companies and reinvesting the cash into new opportunities. In the case of Amazon, it is part of the far less widely known fact that while it may have been loss-making from an accounting perspective it has always been able to fund its very significant cash it generated through its e-commerce and other businesses. It could not be more different from the many tech unicorns, several of which have such negative cash flows at the point of IPO that it is highly likely that they will have to tap markets again in order to fund their growth.

Finally, both companies have created tremendous value for shareholders over many years despite being so different from other companies in their approach, structure and governance. It is the very fact that Berkshire's and Amazon's share prices have done so well that has given their founders the legitimacy to run their businesses however they choose. Both Buffett and Bezos have cited the approval of their shareholders, communicated though their rising share prices, as permission and justification for their actions, in particular when challenged about new initiatives or investments.

For Berkshire, Amazon is also part of a larger story. Berkshire is at the end of a long chapter of tremendous growth and wealth creation, and Buffett and Munger are actively helping to write the next chapter even before they have concluded the last one.

Some of Berkshire's great strengths has been to lean and to adapt, but the other is to delegate decisions. The core of its model is to buy great businesses and let their management get on with it. That is why other members of the team, including Weschler and Combs, have the ability to buy what they want, even if it is to invest in companies like Apple or Amazon.

To that end, this year it was striking how Buffett and Munger brought in Ajit Jain, the head of the insurance business, and Greg Abel, the head of Berkshire Hathaway Energy into the discussion at Omaha. Both are already Vice-Chairmen of Berkshire Hathaway. The discussion between the two veteran investors on the dais and the much younger managers in front of them gave a palpable sense of how decisions are made and how familiar they each are with their businesses and their thought processes.

Together with Bill Gates, one of Berkshire's largest shareholders, a board member and a close friend of Buffett's, it is likely that they will leave the company when it is time for someone to take over. It gives comfort to the idea that Berkshire will keep on adapting and that the company will be in good hands once the leadership changes, as it inevitably will.

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