

## **Celebrate value investing . . . with a good investment**

By Whitney Tilson

Published: May 4, 2006

Omaha's 17,000-seat Qwest Center will be filled to capacity this weekend as Warren Buffett and Charlie Munger preside over the Berkshire Hathaway annual meeting. While it is in part a celebration of the company whose stock has made thousands of people millionaires, it is more broadly a celebration of value investing. While Benjamin Graham remains value investing's patron saint, Buffett and Munger are most certainly its spiritual leaders and most accomplished practitioners, so not surprisingly value investors from around the world flock to Omaha every year.

As a dyed-in-the-wool value investor – as well as co-editor of Value Investor Insight newsletter and co-founder of the Value Investing Congress conference – I wouldn't miss it for the world.

I have encountered thousands of value investors over the years and am constantly struck by their differences – and their similarities. Allow me to explain.

Some value investors invest primarily in small-cap stocks while others stick to large-caps; some invest mostly overseas while others stick to U.S. markets; some run concentrated portfolios, while others are more diversified; some are activists while others never are; some invest only on the long side, others are long-short, and some only short stocks.

But while styles may vary, the fundamental characteristics that unite value investors are many.

- We tend to buy what is out of favour rather than what is popular.
- We focus on intrinsic company value and buy only when we are convinced we have a substantial margin of safety, rather than trying to guess where the herd will go next.
- We understand and profit from reversion to the mean rather than projecting the immediate past indefinitely into the future.
- We understand beating the market requires a portfolio that looks different from the market and we recognise that truly great investment ideas are rare. Thus, we invest heavily in our handful of best ideas and don't hide behind the "safety" of closet indexing.
- We are focused on avoiding permanent losses and on absolute returns, rather than outperforming a benchmark.

- We typically invest with a multi-year time horizon rather than focusing on the month or quarter ahead.
- We pride ourselves on in-depth and proprietary analysis in search of what Michael Steinhardt calls “variant perceptions”, rather than acting on tips or relying on Wall Street analysts.
- We spend much of our time reading – business publications, annual reports, and so on – rather than watching the ticker or the television.
- We focus on analysing and understanding micro factors, such as a company’s margins and future growth prospects, and not trying to predict the direction of interest rates, oil prices, the overall economy, and so forth.
- We cast a wide net, seeking mispriced securities across industries and types and sizes of companies rather than accepting artificial limitations on market capitalisation or other criteria.
- We make our own decisions and are willing to be held accountable for them and do not just seek safety in whatever everyone else is buying or decision making-by-committee.
- We admit our mistakes and seek to learn from them.

None of this is easy, of course, and, as with any investing discipline, some are better at it than others. But if it were easy everyone would be doing it – which would make investing a lot less interesting ... and profitable.

In light of these criteria, what stock might represent great value today? None other than my largest position, Berkshire Hathaway. Nearly all the company’s big businesses are firing on all cylinders and its intrinsic value has grown substantially, yet the stock has been flat for two years. Part of the reason is that 2005 was the worst year ever for super-catastrophe events in the insurance industry, thanks primarily to hurricanes Katrina and Rita. As the world’s largest reinsurer, Berkshire paid out billions in claims, which temporarily masked the company’s prodigious earnings power, but this state of affairs is unlikely to repeat itself.

Using a number of different valuation techniques, I conservatively estimate that the stock is worth \$125,000 per A share (or \$4,167 per B share) vs. today’s price of about \$90,000 (\$3,000). This 25-30 per cent discount to intrinsic value approaches the largest discount I have seen for this stock. As the company’s earnings power becomes apparent, I expect the stock to respond.

An important bonus is that Berkshire is one of the safest (if not the safest) companies in the world. It is one of the few with a AAA rating, and it is sitting on more than \$40bn of cash. If you agree that at some point the massive complacency that characterizes markets around the world is going to be shaken, Berkshire’s financial strength and liquidity – to take advantage of any market correction – makes it one of the first stocks you want to own.