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Part 2

By [Selena Maranjian](#) (TMF Selena)
 May 7, 2002

QUESTION: Regarding whether they'd consider cryonic suspension, to extend their lives.

BUFFETT: Just don't do it too early to me. There probably isn't much downside to it.

MUNGER: It would use a lot of electricity.

BUFFETT: We get electricity wholesale from MidAmerican. As long as I can lift the phone up, ours is a very easy business to conduct.

QUESTION: Regarding their philosophy of turnarounds.

BUFFETT: Fruit of the Loom got in trouble due to borrowing too much, among other things. Financially out of control, with operating problems, too. We were not going to inherit the existing operating system. We made a condition/proposal to the bankruptcy court -- we required John Holland to return to running the business. He'd run the company well before, and was willing to resume.

It's got big market share, is accepted by major retailers, has a good brand. It's a low-cost producer of apparel. We'd like to get more share in women and children...

It's a great business for us. A little like GEICO was for us -- mismanaged for a while, but with a great advantage.

MUNGER: Books I recommend: *Ice Age* [by John and Mary Gribbin, I believe]. The history of glaciation. The best book of scientific explanation that I've ever read. It's [available in the U.K.](#) [the link is to Amazon.co.uk] and will be published in the U.S. soon.





And also [How the Scots Invented the Modern World: The True Story of How Western Europe's Poorest Nation Created Our World and Everything in It](#) by Arthur Herman. A marvelous book.

BUFFETT: This is self-serving, but I recommend Bob Miles' [The Warren Buffett CEO](#). It talks about the people who are handling your capital. [The book profiles most of Berkshire's managers -- the people at the top of the various companies under the Berkshire umbrella. [We profiled it](#) earlier at the Fool.]

QUESTION: From a 12-year old, regarding how they remain friends and business partners and what advice they have for young people on friendship.

BUFFETT: We hit it off immediately. We've disagreed over the years, but we have never had an argument. It may have worked better because he's in California and I'm in Omaha [laughs].

MUNGER: Warren and I know many businessmen who have not a friend on earth -- and rightly so. Once you have friends and find friends, hang on to them.

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BUFFETT: What do you admire in others? See which such qualities you can adopt. Do so and you'll attract others to you. Whatever repulses you in others, will repulse others if you have it. Cultivate habits that attract people when you're young.

MUNGER: Ben Franklin went after that goal like you went after money.

BUFFETT: They're not mutually exclusive.

QUESTION: Regarding how great investors learn from others and experience.

WEB - A great IQ isn't needed at all [for successful investing]. I've learned from Ben Graham first -- in a very big way. From 11 to 19, I was reading every book on investing and didn't do well at it. I had no philosophy. I had fun, and tried lots of things. Then I read Graham -- the Rosetta stone -- and learned to think of a stock as a part of a business. It's so obvious. That was a great foundation to continue learning on. There are certain matters of temperament that help - it's very important to be realistic, to define your circle of competence, and know what you don't know. Don't be greedy, as it overcomes rationality. The books I read that molded my thinking still hold up -- [Graham](#) and [Fisher](#). I've seen little new that's as good.

Insulate yourself from popular opinion. It doesn't help and wastes time. Better to spend that time thinking. There were no analyst reports on custom frame makers. [In other words, he did just fine buying that company without referring to analysts' opinions.]

Read Graham and Fisher, read *lots* of annual reports -- and see which businesses you understand. Ignore those that you don't.

MUNGER: Ask *why* various things are happening.

BUFFETT: We've seen relatively little correlation between high IQs and investment success. It's more interesting to see why smart people don't succeed, and to avoid [those errors of theirs].

QUESTION: Regarding Coke losing some big contracts and PepsiCo ([NYSE: PEP](#)) gaining ground.

BUFFETT: Coke wants to be where people are happy -- sporting events, Disneyland, etc. Can you be everywhere at any price? No. Coke won Venezuela from Pepsi, which had 70% to 80% market share. It was a coup -- reversing the situation. They flew in 747s loaded with supplies, got the controlling family to switch brands.

[Regarding the University of Nebraska's pouring rates], Pepsi came in and offered lots more money than Coke would have. Sometimes when one loses a big contract, one may overbid on the next one.

Kodak ([NYSE: EK](#)) made a big mistake letting **Fuji** sponsor the Olympics. You can overpay for some contracts, but it's foolish to think of getting them all. Mountain Dew is what's really helping Pepsi. Carbonated soft drinks are really growing, and coffee is shrinking, despite Starbucks. Water is rising a bit. [Coca-Cola CEO] Doug Daft is a lot like [former CEO] Don Keogh.

There have been huge gains in Dasani recently. Coke is a very powerful marketing organization. I don't think they've lost their focus in any way. Try Vanilla Coke -- it'll be out next month.

QUESTION: Regarding whether economic moats, competitive advantages, are usually built slowly or quickly, and how they're built.

BUFFETT: Sometimes you can develop them quickly -- look at Microsoft. But with See's, it couldn't be done sooner than decades. Wal-Mart did a fabulous job in quite a short period. There could be things in new industries -- look at NetJets. We have an advantage there and the industry was born in the mid-1980s.

With Coke, it took decades, and going through lots of competitors. In World War II, Eisenhower wanted Coke for servicemen, so bottling plants were built around the world. That was a powerful [development], but it was 60 years after the company's start.

Disney built a solid moat quickly in animated films.

MUNGER: You can also lose the advantage very fast -- look at Arthur Andersen. It was a very good name not so long ago.

BUFFETT: Snickers has been the top chocolate bar for decades. How do you displace it? It's tough. My guess is that it will still be No. 1 in 10 years. If you were chewing spearmint years ago, you're probably chewing it still.

If a company can gain an advantage quickly, you have to worry about it losing the advantage quickly.

QUESTION: Regarding whether Coke and Gillette are still "invincibles" and regarding American Express (NYSE: AXP), as well.

BUFFETT: I think I used the term "inevitables." I referred to the products, not the companies. Blades and razors... Gillette has 71% market share in the world. Five to 10 years from now, I'd be amazed if their share changes significantly. Coke is gaining yearly. When you have half the world and the world's population is growing at c. 2% annually... It's crazy to think that earnings will grow at 15%-18% per year when you have half the world already.

People get carried away by Wall Street and even company pronouncements. Most large companies can't grow that fast -- including Berkshire. Duracell wasn't a great acquisition for Gillette.

MUNGER: That's often the case. Two-thirds of the time, a great company buys another business that's not as good.

BUFFETT: Even GEICO did it, buying companies that weren't as good as it was. It's human to want to do that. Charlie and I have no urges like that. We don't want to prove our manhood like that.

Cigarette companies often bought businesses and fell on their faces.

MUNGER: A lot of people rise to the top of companies and it's natural to think in that position that you think you know everything.

QUESTION: Regarding how Darwin would write down anything he ran across that was contrary to what he thought, lest his mind immediately push it out, and what feedback systems have been developed at Berkshire.

BUFFETT: It's valuable to have a partner to say "you're not thinking right." We're not perfect. We've made big mistakes because we've not looked afresh at things. The annual report preparation process is valuable. You want a partner who's not subservient.

The typical corporate organization is designed so the CEO's beliefs are reinforced at every turn. That's not going to produce helpful contrary thinking. If a CEO wants to buy a company, sycophants will help support his thinking, making him think he's smart. Very few boards of directors are successfully stand up against the CEO.

We've got a pretty good system -- most corporations don't have them.

[The following might be a response to a new question.]

MUNGER: It's perfectly obvious to me that to say that derivative accounting is sewage is an insult to sewage.

BUFFETT: [These might possibly be Munger's words] We're getting out of General Re's derivative book. You're seeing derivative accounting unwound at Enron.

No place is as good for creating fake income as in derivatives. So we decided to bite the bullet and report a related loss. If we didn't, we wouldn't have had that loss.

We've got a 40-year contract - the guy that put it together probably got paid that day. It takes a while to get out of it -- a little like hell: easy to get into, hard to get out of.

[Lunch break. Followed by Buffett showing a graph of Blue Chip Stamps revenues climbing steeply since he became director in 1971 -- from \$46,000 to \$120 million annually. Then he points out that the slide is reversed. Revenues actually fell from \$120 million to \$46,000.]

QUESTION: Regarding their philanthropy, the questioner salutes them.

BUFFETT: A lot of shareholders are doing a lot of good. A lot of good things have come out of Berkshire. Someone's working on a book on that.

QUESTION: Regarding their thoughts on pharmaceuticals and whether they'd still recommend buying a basket of such companies.

BUFFETT: As an industry, it's been very good over time. We did make a mistake [in not buying into it heavily]. We did buy a tiny bit in 1993, but that's almost worse than doing nothing. If we did get into it today, the basket approach would be a good way to go.

MUNGER: We failed to get it right last time and we'll probably fail at it again.

BUFFETT: [Remarking on Munger's pessimism] What did he have for lunch??

QUESTION: Regarding regulatory issues for Coke bottlers.

BUFFETT: Certain bottlers became very leveraged over time -- like **Coca-Cola Enterprises** ([NYSE: CCE](#)). It can take on debt because its cash flow is stable.

It's a fairly capital-intensive business. You spend on average 5%-6% of revenues just to keep in place. It's true for Pepsi bottlers, too. It's why I like the syrup business more -- less capital-intensive. But the bottling business isn't bad, either.

Bottlers will do okay over time. They need to earn enough to keep going, and shouldn't pay too much for other bottlers. Nobody's going to run out of money at "big Coke," nor at the bottlers.

MUNGER: Ideally, you wouldn't have capitalization structures designed for appearance's sake.

BUFFETT: Some companies use 12% assumptions on pension plans, when others use 6%. Should we be looking at the firms the same? The latter might be more realistic.

In the end, we're not going to hold too much debt at Berkshire.

QUESTION: Regarding new standards for goodwill accounting.

BUFFETT: In a 2000 or earlier annual report, we said how we'd like to see it -- not amortized. That's pretty much what we have now.

You might argue that it's against our interest, because some were averse to buying companies due to goodwill [under the old rules and might now compete with us to buy certain companies]. But I regard the present goodwill rules as making sense.

MUNGER: I agree.

QUESTION: Regarding whether compensation plans at Berkshire have anything to do with mispriced insurance policies.

BUFFETT: [He verifies who the questioner is and mentions that he dated the guy's aunt long ago and didn't get a second date. He picked her up in a hearse.]

I don't think our problems at General Re had to do with compensation. I think it had some problems that were drifting away -- but the whole industry in a sense was drifting away. It's difficult in the investment insurance world -- when people are being successful doing sillier and sillier things, it's tempting to follow. It's tough to walk away. It can even sometimes be a mistake to walk away. There was a cultural drift.

I've seen many compensation systems that have been abominations.

MUNGER: Stock option plans -- whether they do more good than harm... I don't know. You have a CEO who's been loyal for decades... and the board of directors grants him options to keep him loyal. I think it's demented. And immoral.

I don't think it makes sense to give people in their 60s options.

BUFFETT: More money has been made in options at Berkshire by accident than at our other entities. It can lead to extremely capricious compensation results that have no reflection on a job performance. Anyone at Berkshire in the top job has to allocate capital. A logical plan would have a cost of capital factored in. There can be cases where that makes sense.

Options shouldn't be priced below the current price, though. When a CEO says his company's stock is undervalued and then gets below-price options, what's that saying?



MUNGER: We're so different than the rest of corporate America. A lot is horribly wrong -- lots of gross excess, which isn't good for the country. They're unfair.

BUFFETT: It will be hard to change. CEOs have their hands on the switch. I've been on corporate boards for 19 years and it's hard to affect any change. CEOs want more each year because everyone else is getting more, and consultants support them.

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