"It's good to learn from your mistakes. It's better to learn from other people's mistakes." - Warren Buffett

THE INTELLIGENT INVESTOR'S MISTAKES: WARREN BUFFETT

38 Buffett's Investment Stories, Gain Wisdom, Master Risk, and Maximize Profits to Build Enduring Wealth

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Table of Content

Preface

This book was written to learn from the mistakes made by the greatest investor, Warren Buffett. Let me declare at the beginning that he is one of the great heroes to me. Many books describe Buffett's success formulas, investment style, and life journey. The best concept in investing is to learn from other's mistakes rather than doing them ourselves!

I first came across Buffett in 2005. I was on a start-up team after completing my post-graduation from IIT Bombay, a premier Technical Institute in India. Since then, I started reading about and understanding him and Berkshire Hathaway Inc. (Berkshire). I read all his letters to the partners in his Buffett Partnership and later to Berkshire shareholders.

He inspired me to do an executive post-graduation program from the National Stock Exchange (NSE) and other certifications from the Bombay Stock Exchange (BSE) to learn about businesses and market ecosystems. And, of course, accounting, the language of business. In the same way, Charlie Munger inspired me not to pursue a full-time MBA, - 'invert', although I don't have an opinion against them.

I have been revisiting these letters recently. In a 1985 letter to Berkshire shareholders, Buffett acknowledged Charlie Munger, who advocated studying mistakes, rather than success, both in the business and other aspects of life. This inspired him to derive, *"All I want to know is where I'm going to die, so I'll never go there."*

In the same Chairman's letter, Buffett announced the *Shutdown of Textile Business*, saying he had generated *ample material to study his mistakes and errors*.

This inspired me to write this book!

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The major research for the book is from Buffett's letters, Berkshire's annual reports and Annual General Meetings, and his media interactions. I also studied the books and articles written about him. I apologize if you find any "errors". If so, kindly bring them to my notice with factual references to modify them, accordingly. *My Gratitude to you!*

These company stories run over years… and some cases over decades. Accounting practices have changed over this period. The data presented in Berkshire's annual report has changed too. I tried to be conscious while capturing them; I present them to you to make sense of them so the right message can be received. *As you know, facts matter in investments and businesses to make effective decisions. So in Life!*

In 2010, Todd Combs joined Berkshire as an investment manager, and a year later came Ted Weschler. They make independent investment decisions for Berkshire. So, if I did not get a correct reference for a transaction executed by Buffett himself, I skipped them in this book.

Please remember that the book was written in hindsight. Specific years are mentioned only for reference to put the story in perspective. Of course, a lot of events took place before and after. As you know, for an "investor" or a "businessman", these events occur on an ongoing basis.

I tried to avoid stock price movement discussions wherever possible. For me, the key messages are to learn about investment opportunities, business economics, and how to value them. The prices may deviate on either side to any extent for any given point of time. Benjamin Graham correctly pointed out, *"In the short run, the market is a voting machine but in the long run, it is a weighing machine."*

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The sequence of stories starts in 1965 when Buffett first acquired Berkshire Hathaway Inc., the event that transformed him. I believe what you are about to learn here will help you excel in the investment game.

The core focus of this book is to learn from an intelligent investor. Apart from the brief coverage of Buffett's investments, you will learn lessons to improve your toolkit. You should get an edge in finding opportunities and executing decisions while taking a perspective that makes the most sense to you.

I kept the book structure simple and crisp so you can learn quickly. I love short books with powerful ideas. Each chapter offers a brief story about the company or a business “group”, where Buffett made a “mistake”. It is followed by the quote(s) from Buffett, and bonus quote(s) from Munger associated with the company. The lessons and insights are mine as a key takeaway for you. There might be a possibility some lesson seems to repeat based on the story. However, *I believe that repetition and consistency help to develop a habit!*

Thank you.

Disclosure: *I do not hold any shares of Berkshire Hathaway Inc.*

Introduction

> *"I like to study failure. We want to see what has caused businesses to go bad, and the biggest thing that kills them is complacency. You want a restlessness, a feeling that somebody's always after you, but you're going to stay ahead of them. That restlessness — that tomorrow is more exciting than today — you have to have it permeate the organization."*
>
> - Warren Buffett, 2013 at The Coca-Cola Company's AGM

Warren Buffett has a terrific record as an investor and businessman. Charlie Munger and he built Berkshire Hathaway Inc (Berkshire) from a textile company in 1965. Today, it is a holding company for businesses that they either fully or partially own. The market value of Berkshire nears $900 billion as of March 2024. It was the world's 8th most valuable company also in 2024. Berkshire has become a vehicle to ride for many people for their financial success.

Buffett started his investment journey at an early age when he was just eleven years old. Since childhood, he entertained many interesting projects, all entrepreneurial. He played many roles as a salesman, speculator, and trader. I believe these experiences shaped him. They helped him to build a strong foundation as a great investor, businessman, and legend.

Buffett ***evolved*** from a trader, investor, and businessman into an empire builder. The success he achieved is remarkable and unique in many ways. It is amazing to achieve this kind of success in one's lifetime. It puzzles me more, knowing the kind of mistakes made on the way. There are many mistakes, and a few are major. The big ones are omissions, not commissions. It means he did NOT buy the investments he liked and understood. I dedicated a complete section of the book to them.

Buffett openly confesses his mistakes and embraces them. *Mistakes are* inevitable *in investments*. Further, he acknowledges that he will be making more mistakes in the future. However, he mastered learning from his mistakes and moving forward. It is the key to success. These mistakes didn't hold him back. He understands the edges of his circle of competence.

There is another angle to embrace the mistakes is his *leadership style*. He encourages Berkshire business managers to report their issues and mistakes, promptly so the corrective actions may be expedited. This practice helps maintain Berkshire's reputation. *It is a corporate culture trait!*

In 1989, Buffett published, "Mistakes of the First Twenty-five Years", in Berkshire's annual shareholder letter. He reviewed his mistakes in that letter. I believe these confessions helped him to feel relieved. Also, in another 25 years, in 2015, he predicted there more pages to cover his mistakes.(not published). Buffett expects more mistakes at Berkshire in the future. They will be of omission and not commission.

If you look at Buffett's investment journey, he kept evolving. He experimented with many things. H succeeded as shown in the records, and he also failed few times. He started as a cigar-butt investor; later, he became a successful businessman. He enjoyed the journey, and it kept him active. In fact, he has the longest record of successful investments. *This reflects his character trait to keep learning and evolve!*

This is quite different from his teacher's belief. Benjamin Graham (Ben), retired from active investing at the age of 62, in 1956. Ben thought there were no challenges to solve in the investment world. He was more of a professor, challenge seeker, and problem solver.

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As noted, on his long journey, Buffett made many mistakes. They were of different types at different stages. They were in business acquisition, common stock investment, and in the trade. It is easier for an investor to correct a mistake in a marketable security. Just sell the stock either immediately, or in the near future, based on the assessment.

In the case of an owned business, fixing the mistake might be an ongoing activity… and it is hard. In some cases, let them run it on their own but with no more capital allocation. In most cases, the businesses need to be either liquidated or sold.

Buffett also made mistakes in accessing the economic characteristics of a business, like in the airline business. Sometimes, he traded in the commodity business when the cycle was at its peak. Like ConocoPhillips, an oil & gas exploration and production company. This is because humans are easily carried away in a booming market, as in 2007. A few mistakes involve not acting quickly enough, the effect of over-caution or procrastination. This caused him to miss out on a few wonderful opportunities. For example, Google.

Buffett and Munger together built a strong filtering mechanism in 'decision-making'. They were quick to say "no" most of the time. This behavior offended many people. Even then, they made many mistakes. These mistakes were due to Buffett's own biases and emotions. They include too much optimism and pessimism. In a few cases, he failed to do a holistic business analysis and recognize the economic outcome. The mistakes are both of omission as well as in commission categories.

Despite these mistakes, Buffett and Munger built a business empire from scratch. They were open and honest about their mistakes. They were learning machines. They used these experiences to improve their investment approach over time.

As an investor, mistakes are eminent on the journey. The trick is to recognize them promptly and do something about them; that is what matters, and the sooner is better. With this, you can turn, *lemons into lemonade*. Unfortunately, in the investment world, the rearview mirror is always clearer than the windshield.

My major intent is to capture learnings from Buffett's mistakes to help you become a successful investor. Of course, they could be helpful for a trader, as well. On my own journey, I made a lot of mistakes as part of a reasonable record in life. But recognizing them and correcting them promptly matters the most… no matter what it takes. It needs not only humility and a strong gut, but *character!* Amazon founder, Jeffrey Bezos, says he is not defensive and wants to learn from his failures. *Grow through adversity*.

Mistakes impart wisdom on what not to do. Of course. I prefer to learn from others than my own experiences. This book is my attempt to study mistakes and present them as learnings to you. I believe they will help you to become a successful investor and live a fulfilled life.

Have a Joyful Journey!

PART-A: Mistakes of Commission

"The man who does things makes mistakes, but he doesn't make the biggest mistake of all-doing nothing." -Benjamin Franklin

Chapter 1: Berkshire Hathaway Inc.

[Year- 1965]

"Emotions are more spontaneous than thoughts." - Shri Ramakrishna Paramahansa

Berkshire and Hathaway were two age-old textile companies that merged in 1955. It was the only surviving textile company in New England. The company had fifteen operating plants with over $120 million in revenue. By 1962, Berkshire Hathaway Inc.'s (Berkshire's) scale of operation had shrunk to only seven operating plants. The company was making losses. The stock market valued the company at only $7.50 per share, while the working capital was $10.25, and the book value was $20.20.

Buffett was aware of the company while working at Graham-Newman Corp. The company was co-founded by Benjamin Graham. During this time in 1962, Buffett was managing funds for a group of people he knew. The Buffett Partnership Ltd. (BPL) was making returns well above the Dow Jones Industrial Average, as well as many leading investment firms at that time.

Considering the market price, Buffett found it a typical cigar-butt value investment opportunity. Buffett started buying Berkshire at $7.50 per share in December of 1962. He did this under the "Private Owner" category of the BPL. Under this category, Buffett generally purchased undervalued stocks.

In Berkshire's purchase, the main qualification for Buffett was its bargain price. It is a typical Benjamin Graham value teaching. It was selling well below working capital, although it showed a significant net loss over the last ten years. There were expectations in the market that the company could buy back the share in the future. Buffett felt he could tender the shares in the company's buy-back process at a higher price and make a good gain on the deal. So, the investment thesis was clear: buy-in, as cigar-butt value investing, and sell out or tender the shares whenever the opportunity arises.

Seabury Stanton was the president of Berkshire, in charge of the overall operations of Berkshire operations. In 1964, as expected, promoters planned to buy back the shares. As Buffett Partnership was holding a big chunk of stock, Stanton enquired Buffett for a price at which he could tender them. As per Buffett's calculations, the fair price was $11.50 per share. Mr Stanton agreed to the same price.

However, when the offer letter was received on 6th May 1964, the tender ask price was $11.375 per share, $1/8 less. Buffett was furious and felt cheated. He was carried away emotionally; instead of selling the shares, he started buying Berkshire shares.

One reason for Buffett's unusual behaviour was Howard Buffett, Warren's father. He died six days before the tender offer on April 30, 1964. Buffett regarded his father as a hero and was very close to him. Buffett might have been going through a depression. He might not had the right frame of mind essential for a rational decision.

By April 1965, Buffett and BPL, the partnership firm, became major shareholders of Berkshire. BPL partners' holding was more than 38% stake, which accounted for more than 25% of the partnership's total capital. Till then Buffett maintained secrecy by showing holdings under the broker's account.

In early May 1965, during the board meeting, BPL formally took control of Berkshire. Stanton resigned from the board. Buffett was appointed as Chairman and since then has been running the Berkshire business. When BPL took control, Berkshire operations had already been scaled down to only two mills and 2,300 employees.

Buffett knew that the textile business could not be profitable. However, he felt comfortable owning the mills. He was betting on the newly appointed President, Kenneth Chace, and other salespeople in Berkshire. Also, one of the reasons Buffett gave to BPL partners in his letter was that there were no labor unions in southern textile plants. Hence, he believed it could be an important competitive advantage.

Chace was in charge of all the operations at Berkshire, while Buffett took charge of capital allocation. Buffett asked Chace to run the operations with no or minimal new capital. He asked him to send monthly financial statements to him at Omaha. Over the next two years, textile operations turned profitable. In 1967, Buffett declared only the maiden dividend of 10 cents per share in the history of Berkshire, since he took the charge.

However, soon after, the textile business started struggling to survive. Working capital and the labor-intensive businesses demanded more capital from Buffett. Further, the high electricity expenses added more challenges. A commodity textile business was competing in a global marketplace. During the next twenty years, textile operations were doing either losses or barely able to generate mediocre returns. It was always one step forward, and two steps back scenario.

Meanwhile, in 1969, Buffett dissolved his partnership. He became the full-time Chairman of Berkshire Hathaway Inc.. Later in the 1983 annual report, Buffett confessed, *"The book value consists of textile assets that could not earn, on average, anything close to an appropriate rate of return. In terms of our analogy, the investment in textile assets resembled investment in a largely wasted education."*

Buffett cites one reason for keeping the textile division for twenty years: it was the labor at the operations. He tried to sell it off to other companies, but that didn't work out. Finally, after twenty years post-acquisition of Berkshire Hathaway, Buffett decided to close down the textile division in July 1985.

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The good part of this whole episode was that Buffett maintained tight control over the capital allocation to the textile business. It helped to limit the capital drain, and the surplus capital was utilized in acquiring other businesses. So, the impact of textile business operations was shrinking over this period for Berkshire.

Buffett started "diversification: as early as in 1966. He and his friends, Charlie Munger and David Gottesman, bought a company called, Hochschild Kohn, in Baltimore, Maryland. It was a department store. However, the company disappeared over time. We will talk about it later in the book.

In 1967, when Berkshire made a profit and generated cash, Buffett purchased National Indemnity Insurance Company. This was a '"colossal" mistake, to be discussed later. However, it gave Berkshire an entry into insurance. Later, the insurance division's cash (float) became the core engine to buy other wonderful businesses for Berkshire.

During this period, Buffett and Munger were managing three businesses separately. They were the majority shareholders and decided to merge them together: Diversified Retailing, Blue Chip Stamps, and Berkshire. This gave Berkshire Hathaway Inc. today's avatar. Based on Munger's guidance, Buffett started focusing more on purchasing wonderful businesses to grow Berkshire: insurance businesses, marketable securities, and controlling companies.

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In Buffett's own words [1985 AR]:
"When a management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact... Should you find yourself in a chronically

leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks."

Lessons:

1. An investor needs to be close to the matter to be rational. The facts matter rather than being carried away by emotions. The market doesn't know about either your feelings or emotions.

2. The key to investing is to understand why something is "cheaply" available. Is It really an opportunity for long term journey or just a cigar butt.

3. The cigar-butt investment style has a classic challenge. It looks only at the gap between market price and intrinsic value and misses the big picture. It's a short-sighted approach that might work in trading marketable securities; however, not as a long-term investor or as a business owner. To gain long term, you need to know the business's economic traits.

4. Investors need to remain agile and recognize their circle of competence. They need to book losses or bad investments as quickly as possible. It not

only frees up capital but also the mental capital to focus on other better investment opportunities. In the span of twenty years, Buffett recognized that the textile business would not generate high returns on investments. However, he delayed and hoped for a reasonable return.

5. If the investor's thesis has broken, she or he should reevaluate the scenarios and plan to sell sooner rather than later to free-up the resources.

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