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## ORACLE OF OMAHA COULD HAVE BEEN TALKING TO LENDERS

Warren Buffett's shareholder letter is required reading for credit officers.

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- Two weeks ago, Warren Buffett, the "Oracle of Omaha," commented on the successful year that his company, Berkshire Hathaway, enjoyed in 2009. In his letter to stockholders, he shared his beliefs with new investors. The advice hasn't changed much over the years, so it's well that we bankers take a look, too, and find if there are principles that we can use in our line of work.

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- Seven points from Buffet

- Here's the list. Note how simple and clear the advice is.

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- &bull; Stay liquid.

- "We will never become dependent on the kindness of strangers."

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- &bull; Buy when everyone else is selling.

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- &bull; Don't buy when everyone else is buying.

- "Those who only buy when commentators are upbeat end up paying a heavy price for meaningless reassurance."

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- &bull; Value, value, value.

- "What counts is . . . what that business earns in the succeeding decade or two."

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- &bull; Don't get suckered in by big growth stories.

- ". . . [A]void businesses whose futures we can't evaluate no matter how exciting their products may be."

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- &bull; Understand what you own.

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- &bull; Defense beats offense.

- "Though we have lagged the S&P in some years that were positive for the market, we have consistently done better than the S&P in the eleven years during which it delivered negative results. In other words, our defense has been better than our offense."

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- This speaks to a mindset and not a specific strategy. We could use more of that sort of mindset in banking.
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- What can Buffett teach a lender?
- These seven points contain good advice for investors and Berkshire's owners, who, along with Mr. Buffett, have profited handsomely over the years. But this list is also good advice for bankers, especially his advice on liquidity, value, knowing what you own, and being conservative. Some thoughts:
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- 1. Liquidity. The examiners have been telling us with increasing urgency to pay particular attention to liquidity. The harshest criticism has come over excessive reliance on non-core funding. Today, it's impossible for a bank-especially a community bank-to fund itself without some degree of reliance on non-core sources of funds, so the issue is one of degree, or perhaps better described by the term "concentration." Buffett's comments speak directly to the core vs. non-core distinction that is so important to examiners.
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- Core funding should be thought of doing business in a "face to face" way with people whom you know and with whom you likely have multiple business relationships and contacts. Non-core funding is loyal to a rate, not to a person.
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- How much business do any of us want to do with people we don't know? You could lift that quote about not being dependent on strangers verbatim and put it into your ALCO policy-and everyone would know exactly what you mean.
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- 2. Avoiding the unlikely growth story. Mr. Buffett's aversion to the big growth story is particularly relevant to bankers.
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- I recall a prospect in Orlando who was trying to raise money for an ambitious project to grow tomatoes hydroponically. (This means rooting the plants in water rather than soil.) It was proven farming technology at the time. But what concerned me were his lofty sales projections.
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- I finally said, "I'm having trouble believing your projections."
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- He shot back, "What do you want them to say?"
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- We espouse Mr. Buffett's value principles when we follow lending policies that speak to "productive, non-speculative" loan purposes. Value and quality mean different things. But they become synonyms when we are speaking of loans that are well structured and extended to borrowers who have demonstrated the Cs of credit.
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- There's nothing wrong with strong growth and we wish such fortune for all our customers.
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- The problem is that strong growth seldom comes without some increased level of risk compared to more moderately growing enterprises. Modest growth is a characteristic of an established business rather than a start up or relatively new one. Thus, experience says that the risk profile of rapidly growing businesses is higher. Beware.

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- Where two key disciplines intersect
- I used to think that investment analysis and credit analysis were very different disciplines. In some ways they are. But really only in the way the information is ultimately used.
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- Bankers are using borrowed money-your mother's savings account for example-to fund loan deals. We are (and we should be) risk-averse, owing primarily to our funding sources. But there are conservative investors too and Warren Buffett is in the vanguard of those who are. You can't argue against his success or the principles that produced it.
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- You can download Buffet's shareholder letter, and many from the past, at Berkshire Hathaway's site.

- About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear interviews with Ed about workouts here. You can e-mail him at [etoleary@att.net](mailto:etoleary@att.net). O'Leary's website can be found at [www.etoleary.com](http://www.etoleary.com).

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