The Fortnighter

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If you read the financial press last week, you probably saw the news that Warren Buffett's Berkshire Hathaway, along with a partner, was paying $28 billion for H.J. Heinz Company, makers of the world's most loved condiment.

According to Buffett, this was "his type of deal". Great brand, great company, great cash flow etc. etc. I thought it interesting that Heinz wasn't on our "top pick" list. Good company for sure, but the stock was a bit expensive. Yet here was the "world's greatest investor" not only buying Heinz but paying a **20% premium** for it. What gives?

Like many of Buffett's moves, I think the individual investor can learn a number of things from this deal. The first is time frame. Despite being 80, Buffett invests like he's 30. He literally intends Berkshire Hathaway to own companies like Heinz forever. Individuals consistently put too much emphasis on the short term. Even a 65 year old investor will, in general, have a 20 year investment time frame. That's long-term in the financial world.

The second is cash flow. If a company kicks out a consistent stream of cash (that exceeds what they need to re-invest in the business) they can return some of that to shareholders in the form of a dividend. Ultimately, that's what investing is all about – getting income. And if that income is in the form of a dividend, it's a more reliable source of cash flow than that from capital appreciation. Heinz certainly fit that bill with a pre-Buffett yield of a bit over 3% - and a great track record of increasing that cash payout over time.

That leads to our final issue – the intelligent use of leverage (debt). While I'm not advocating that individuals borrow to invest, it's a foundation of Warren Buffett's success.

Most of us will think nothing of borrowing to buy a depreciating asset (like a car) or a passive asset (like our homes), but Buffett only uses debt to buy appreciating assets – especially a "cash cow" like H.J. Heinz (or Geico, Coca Cola or Gillette for that matter). Berkshire can borrow long-term at less than 4%. If an acquisition kicks out 10% in free cash flow, why not use someone else's money to fund the purchase? Add in the fact that debt costs are fixed while those cash-flows may grow over time – and you can see one of the reasons the "Oracle of Omaha" has been so successful.