



“Innovation and Addiction”

September 9th, 2018

To Focused Compounding members:

One of Warren Buffett’s most famous uses of the word “moat” was at a 1999 talk he gave in Sun Valley, Idaho:

*“The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the **durability** of that advantage. The products or services that have wide, **sustainable** moats around them are the ones that deliver rewards to investors.”*

The emphasis on the words “durability” and “sustainable” is mine. But, that idea of investors profiting from the longest lasting stream of profits rather than the industry that was the most innovative was the key idea Buffett wanted to get across to the dot com billionaires in that audience back in 1999 (Jeff Bezos was one of them). In that same Sun Valley talk, Buffett recapped the business history of cars and planes in the U.S. Here’s what he said about car makers: *“...there appear to have been at least 2,000 car makers, in an industry that had an incredible impact on people’s lives. If you had foreseen in the early days of cars how this industry would develop, you would have said, ‘Here is the road to riches.’ So what did we progress to by the 1990s? After corporate carnage that never let up, we came down to three U.S. car companies--themselves no lollapaloozas for investors.”*

Buffett followed up his discussion of car makers with a discussion of airplane makers: *“I went back to check out aircraft manufacturers and found that in the 1919-39 period, there were about 300 companies, only a handful still breathing today.”* And, then there’s Buffett’s most famous example of a “moat-less” industry, airlines: *“Here’s a list of 129 airlines that in the past 20 years filed for bankruptcy...As of 1992, in fact--though the picture would have improved since then--the money that had been made since the dawn of aviation by all of this country’s airline companies was zero. Absolutely zero.”*

Since 1900, the best performing industry for investors has been one of the least glamorous, innovative, or beneficial to society. It’s the tobacco industry. Tobacco stocks have compounded at just under 15% a year for just over 115 years. Buffett is reported to have summed up the amazing economics of cigarettes by saying: *“It costs a penny to make. Sell it for a dollar. It’s addictive. And there’s fantastic brand loyalty.”* You may not want to invest in tobacco stocks. You don’t have to. But, the question to ask about Facebook, Apple, Amazon, Netflix, and Google isn’t whether they’re changing the world – it’s whether millions of people will be addicted to those products and services in 10, 20, or 30 years. Of course, there is one other question you can ask...

Are there less well known, less glamorous companies out there with equally addictive products? And can you invest in them?

To learn about our managed accounts, email Andrew at info@focusedcompounding.com or call or text him at 469-207-5844.