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## Why the Rich Get Richer

by Robert Kiyosaki

### Investing: Why Value Matters More Than Price

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Warren Buffett is famous for talking about the "intrinsic value" of stocks. But while many people parrot this phrase, few know what it really means.

The good news is that once you understand intrinsic value, you may better understand why some investors make more money than others. You might also realize that you can find intrinsic value in investments other than stocks, such as real estate.

#### Follow the Bouncing Ball

When the average investor thinks about making money, he or she usually thinks about buying low and selling high. For example, an investor buys a stock for \$10 and sells it when (and if) it reaches \$20.

This leads many investors to check their stock prices immediately first thing every morning; their day gets off to a good start if the price has gone up, and a bad start if the price has gone down. Many of these investors become addicted to watching their stocks rise and fall throughout the day.

Warren Buffett doesn't do this, and neither do I. While the price of an asset is important, it's not something we watch on a daily basis. Buffett owns businesses rather than stocks, and pays close attention to price only when he buys one. After that, he isn't really concerned if the share price goes up or down, nor does he care if the stock market is open or closed.

In very simple terms, Buffett looks for well-managed businesses that grow more valuable over time; consequently, he often refers to a business's value "compounding," or accelerating in value. This is its intrinsic value, and being aware of it is one of the differences between an amateur investor and a professional one.

#### A Real Estate Example

Intrinsic value may be easier to understand from a real estate perspective.

When I buy a piece of property, I, like Buffett, am only concerned about price at the time of the purchase, because price determines returns. For the long term, I focus more on the following:

- **Income (cash flow):** This is often called positive cash flow after all expenses are paid, including my mortgage payment and taxes.
- **Depreciation (phantom cash flow):** This appears as an expense when it's really income that comes from a tax break. This confuses many people who are new to investing in real estate; it's essentially income you don't see.
- **Amortization:** This is income because your tenant is paying down your loan. Paying the mortgage on your personal residence is an expense, but when your tenant pays your loan down, it's cash flow.
- **Appreciation:** This is really inflation that appears as appreciation. If your rental income goes up, you as an investor can refinance and borrow your appreciation out as tax-free cash, and have your tenant pay for the amortization of the new loan amount. In other words, it can be tax-free cash flow.

Together, these components amount to the intrinsic value of a sound real estate investment, purchased at the right price

and well managed. They provide me with what I invest for -- increased value and cash flow.

### Investing vs. Speculating

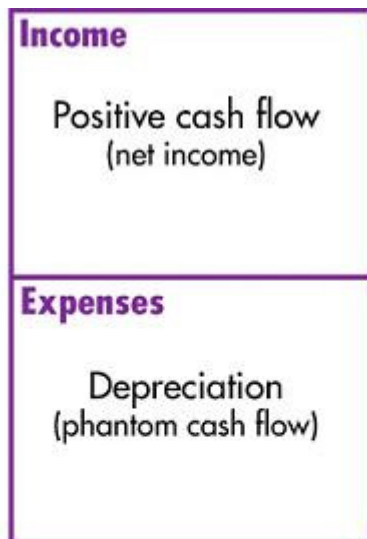
Investors who buy a property to sell, often known as flippers, invest primarily for capital gains. This is often taxed at higher rates if they spend their gains instead of reinvesting their money; to me, these people are speculators, not investors.

True investors aim for cash flow and increased value. Warren Buffett doesn't like to sell because selling shares triggers a tax, and a tax reduces his wealth. Those who know Buffett's formula know that he wants to compound his returns, not share them with the government.

### Keeping an Eye on Intrinsic Value

You become a better investor by training your brain to "see" what your eyes can't -- the real value (or lack of value) in any investment, regardless of whether it's a stock, bond, mutual fund, business, or real estate. This is its intrinsic value.

This highly simplified diagram of a financial statement better illustrates what I mean:



These components amount to the intrinsic value a professional real estate investor looks for in a property -- and most amateur investors miss.

When Warren Buffett mentions the intrinsic value of a company, he is referring to many of the same things. The

### **Amateur Investing Yields Average Returns**

The average stock investor refers to P/E ratios the same way that the average real estate investor refers to cap rates. While these are important indicators, they're hardly a measure of intrinsic value -- and, as I mentioned, professional investors are looking for value, not price.

To sum up, the average investor only knows one way to make money: buying low and selling high. A professional investor would rather buy low, realize gains from other arenas, and let the asset grow forever.

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