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“What could go wrong?” Micron answers Samsung’s question.

“This is a piece of cake! What could possibly go wrong?”

By the time most of us have been around the block a few times, collecting dents and bruises along the way, we begin to feel a certain way about that remark. We sheepishly recall saying such things with reckless abandon in the years before the dents and bruises; but now we treat it like the Curse of the Mummy’s Tomb—never to be spoken out loud, and we’d rather not even *think* it if we can help it. In the same league as “What could go wrong?” is something else we often find ourselves saying: “They’re all the same, pretty much.” We slap those words on all kinds of things we actually don’t know enough about. When we find out how much we didn’t know, we realize the truth is more like, “Nothing whatsoever is the same:” not people, not leaders, not armies, not companies and not coaches, among a galaxy of other categories.

“They’re all the same, pretty much” might be the most widely-assumed wrong belief in the investment world when it comes to companies which make things in factories. That’s most of Outlook’s core companies. We’ve been pondering that wrong notion lately, as a story about Micron Technology (the memory king) has been developing over the last 6 months or so.

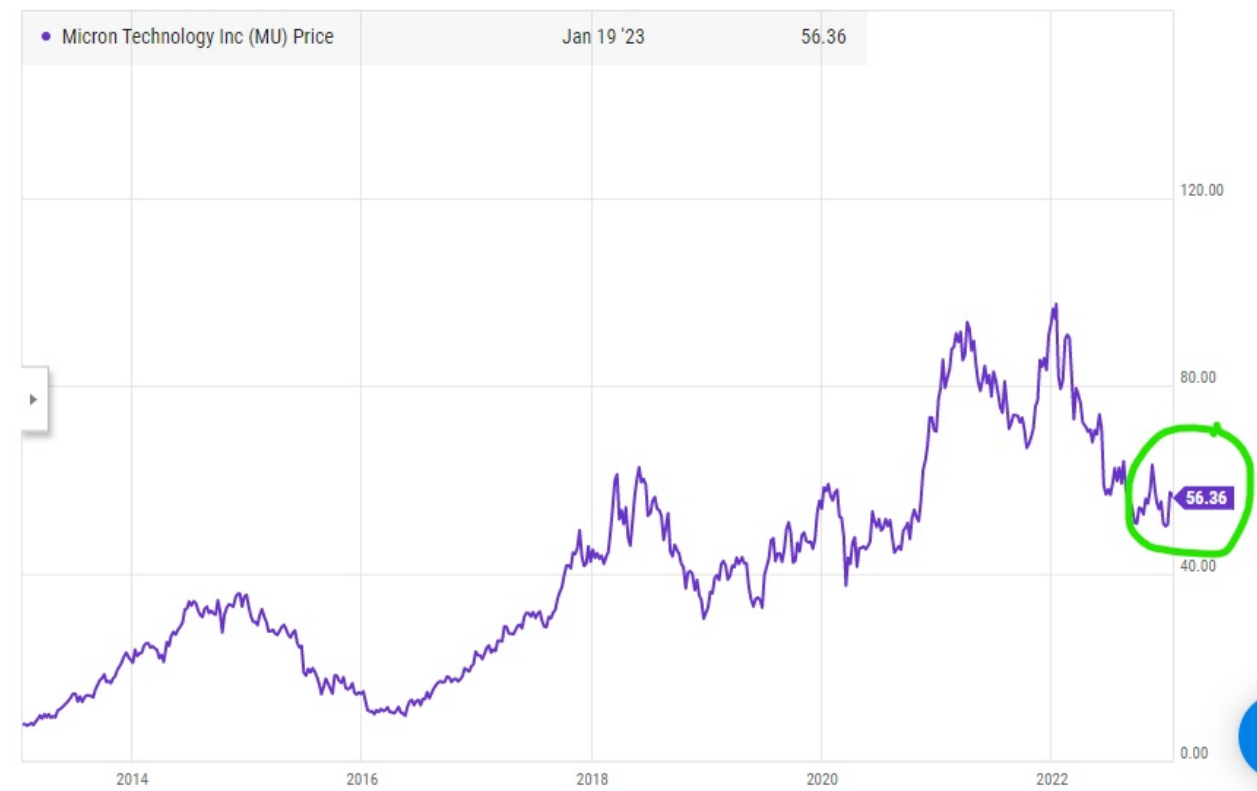
If we were journalists the title of the story might be, “Are Samsung’s factories imploding?” (That would catch our eyeballs.) Samsung has been the world’s first-place memory chip maker for a long time. Micron has been in 3rd place for a while . . . and slowly gaining. Now, for memory chip companies (or anybody making anything in factories) the Holy Grail is to make your product superior, and at lower cost to you, than the competition. If a company pulls that off, it’s got a better product which it can sell, if it chooses, at a lower price . . . and it can expect the world to beat a path to its door. If the product’s price is governed by a cycle, the company makes more money than its competitors whether the price is rising or falling. That’s the memory chip market in spades.

But factories are a world away from “all the same.” It takes intense and constant management; the nerve to spend money to improve the process; and the judgment to cut costs which won’t really hurt the process during downcycles. Micron, over the past several years, has changed its factory processes from “OK” to “world class”: passing Samsung for the world lead in memory technology and the world lead in low-cost production. And here’s that “story.” Samsung didn’t let that happen because it was asleep at the switch. It happened because Samsung gambled a good chunk of its future on a new chip production method . . . and it’s looking a lot like that gamble blew up in the company’s face. In essence, a couple of years ago both Samsung and Micron looked hard at the chance to leap ahead by converting production to “the chip process of the future”: EUV lithography. Samsung said, “We’re doing it.” Micron said, “Nope. Too difficult; too risky; and too clear a path toward keeping our cost-and-product-superiority lead by sticking with the old technique for another 2 to 4 years.”

It looks very much like Samsung’s judgment was wrong, and Micron’s right. Samsung has been having serious enough troubles making “new technique chips”, for the last 12 – 18 months, that the company itself has begun whispering “Houston, we have a problem.” It can’t produce good enough chips in the volumes customers want; and those chips are costing Samsung far more than is good for it. So even in a memory downcycle, Micron has been gaining market share and Samsung has been losing it.

We've noted, once or twice, that Rio Tinto (the world's biggest mining company) stumbled very badly over the past several years in Mongolia, where it aimed to do what our Freeport pulled off in Indonesia: convert a big mine from open-pit to underground. That extended the life of the mine by decades, and opened up fairly vast profit potential by producing copper at something like the world's lowest cost. But Rio and its partner ran into problem after problem, and spent a Mississippi River of cash trying to fix the problems, rather than the Des Plaines river they'd planned to spend. It was really the same story as Samsung and Micron. Attention to detail, experience and good judgment applied over many years won the day for Micron and Freeport. Samsung and Rio did nothing incompetent . . . they just weren't quite up to an extraordinarily difficult job.

Here's Micron's last 10 years. Yes, cyclical! But at today's \$56 price, the market is valuing Micron between 5 and 7 times the earnings it's already shown it can make at the top of the cycle. We usually call such valuations "doubtful," "anxious," "skeptical," or downright "fearful." Most of all, we call them "dead wrong" and, if we were journalists, no doubt we'd call them "Screaming Buy!" Micron has made its golden future the hard way, over the years. We will be along for the whole ride.



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