BERKSHIRE HATHAWAY 2016 ANNUAL MEETING NOTES

BY INGRID R. HENDERSHOT, CFA

We tuned into the first webcast of Berkshire Hathaway's annual meeting held on April 30, 2016, in Omaha. For the first time in about 20 years, we skipped the crowd of more than 40,000 folks from around the globe who gathered for the Woodstock for Capitalists and listened from our comfy chair to Warren Buffett, Chairman of Berkshire Hathaway, and Charlie Munger, Vice-Chairman, answer questions from shareholders, analysts and the media.

Here are our notes from the six hour Q & A session.

INTRODUCTION

Warren Buffett: Good morning. I'm Warren Buffett. This is Charlie Munger. I'm the young one. You may have noticed in the movie, incidentally, that Charlie is always the one that gets the girl. He has one explanation for that, but I think mine is more accurate. As you know, every mother in this country tells her daughter at an early age, if you're choosing between two very old and very rich guys, pick the one that's older.

We are webcasting this for the first time. I'd like to welcome our visitors from all over the world. We are having this meeting simultaneously translated into Mandarin. That poses certain problems for me and Charlie because I'm not sure how sensible all our comments will come out once translated into Mandarin, but I'm not so sure how sensibly they come out initially sometimes. We are delighted to have people around the world joining us.

Kerry Soba puts this whole meeting together. There she is - Wonder Woman. Kerry joined us as a receptionist about six years ago. She put together the 50th anniversary book which we actually expanded further this year. We have a revised edition. Charlie and I autographed 100 of them. Kerry also had a young baby girl, her second baby, late in January. She has gone ahead to put on this whole annual meeting. I really want to thank her. It has been terrific.

We have one surprise guest. I think my youngest great-grandchild, who is about 7 months old, is also here today. If he happens to break out crying a lot, don't let it bother you. It's just his mother explaining to him my views on inherited wealth.

We also have our directors with us. Warren Buffett introduced the Board of Directors.

FIRST QUARTER RESULTS

I have two slides to show you now. The first one is preliminary summary figures for the 1st quarter.

Berkshire Hathaway Inc.
Preliminary First Quarter After-Tax Earnings
(in millions)

	2016	**2015**
Insurance – underwriting	$ 213	$ 480
Insurance – investment income	919	875
Total insurance	1,132	1,355
Railroad, utilities and energy	1,225	1,466
Manufacturing, service & retailing	1,266	1,123
Finance	311	289
Other	(197)	11
Operating earnings	3,737	4,244
Investment and derivative gains/losses	1,852	920
Net earnings	$ 5,589	$ 5,164

You will notice that insurance underwriting- these are after-tax figures by category – are down somewhat. The basic underwriting at Geico is actually improving. We had some important hailstorms in Texas toward the end of the quarter, and we have had some since the end of the quarter, too. There were more catastrophic losses in the first quarter than there were last year. Railroad earnings are down significantly. All of the major railroads were down significantly in the 1st quarter, probably will continue to be down - almost certainly going to continue to be down the balance of the year.

We had two companies which we added to the manufacturing, service and retailing segment – Precision Castparts and Duracell, but they were added during the quarter. Full earnings aren't showing in the figures.

In the other category, and I don't like to get too technical here – you should read the 10-Q when it comes out next weekend – but when we borrowed money in other currencies, and the only currency we've done that with is the Euro, but we have a fair amount of money that we borrowed in Euros. The nature of accounting is that the foreign exchange value each quarter is actually shown in interest expense. If the Euro goes up, we have a lot of extra interest expense. It's not a realized factor. It moves from quarter to quarter. If the Euro goes down, it offsets interest expense. It's a technicality to some extent because we have lots of assets in Europe, and they are expressed in Euros. When they go up, it does not go through the income account. It goes directly to other comprehensive income. That figure which looks a little unusual – that's the reason for it.

We always urge you to pay no attention to the figures below operating earnings. They will bounce around from quarter to quarter. We make no attempt to manage earnings in any way. We could do that very easily, but that would be ridiculous. We make investment decisions solely on the basis of what we think the best investment decision is, not on the basis of how it affects earnings in any quarter or in any year.

In the 1st quarter, we completed a transaction that was begun over a year ago whereby we exchanged our Procter & Gamble stock for cash and for Duracell. That largely accounts for the large capital gain in the quarter. Those are the figures for the 1st quarter.

I put up a second slide. I started the slide in 1999. The reason being at the end of 1998, we effected a large merger with Gen Re. At that point, we sort of entered a different era. We had a little over 1.5 million A equivalent shares outstanding. Since that time, we have only increased the number of shares outstanding over the next 17 years by 8.2%. These figures represent a fairly unchanged share account since that point. In terms of operations, I told you our goal at Berkshire is to increase the normalized operating earnings every year. Sometimes it will turn out to be only a little bit, and sometimes we can get some fairly decent jumps. Earnings will not increase every year because there's such a thing as a business cycle. In times of a recession, we will earn less money obviously than in times when things are much better overall. On top of that, we are heavily into the insurance business. Earnings there can be quite volatile because of catastrophes. This chart shows you what happened to the operating earnings since that time – again, pointing out that shares outstanding have gone up very little during that period. In 2001, when we suffered significant insurance losses through 9-11, we actually were in the red in terms of operating earnings. The figures are very irregular, but over time–- by adding new subsidiaries, by further developing the businesses we have, by bolt-on acquisitions, by reinvestment of retained earnings,– the earnings have moved up in a very irregular fashion quite substantially. I put in also the capital gains we've achieved through investments and derivatives, and they total some $32 billion after tax. Those numbers can go all over the place. The main advantage from my standpoint in the $32 billion is it gives us money to buy other businesses. We hope the bigger operations will grow 5, 10 or 20 years from now substantially. We don't manage to try to get any given number from quarter to quarter. We never make a forecast on earnings. We don't give out earnings guidance. We think it's silly. We do not have budgets at the parent company level. Most of our subsidiaries have budgets, but they are not required to submit them to headquarters. We just focus day after day, year after year, decade after decade on trying to add earning power – sustainable and growing earning power to Berkshire.

I ask the audience that you limit your question to one question. Multiple questions have a way of sneaking in occasionally. Let's keep them to a single question.

CAPITAL INTENSIVE BUSINESSES

Q: You commented on the kinds of companies that Berkshire Hathaway liked to buy, those that required a small amount of capital. Today, the company invests in companies that need tons of capital expenditures, are overregulated and earn lower returns on equity capital. Why did this happen?

Warren Buffett: – It's one of the problems of prosperity. The ideal business is one that takes no capital, but yet grows. There are a few businesses like that. We own some, but we'd love to find one we could buy for $10, $20, or $30 billion that is not capital intensive in any way. We may, but it's harder, and that does hurt us in terms of compounding earnings growth. Obviously, if you have a business that grows and gives you a lot of money every year and doesn't take it, it isn't required in its growth, you get a double-barrel effect. See's Candy was a good example of that. Back when the newspaper business was good, Buffalo Newspaper was making $40 million a year and had no capital requirements. We could take that whole $40 million and go buy something else with it. Increasing capital acts as an anchor on returns in many ways. One is it drives us into businesses that are much more capital intensive. We have a $3.6 billion investment coming up in wind generation. We pledged, overall, to have $30 billion in renewables. Anything that Berkshire Hathaway Energy does, anything that BNSF does takes lots of money. We get decent returns on capital, but we don't get the extraordinary returns on capital that we've been able to get in the businesses that are not capital intensive. We have a few businesses that earn actually 100% a year on true invested capital. Clearly that's a different sort of operation. Berkshire Hathaway Energy may earn 11% or 12% on capital, and that's a very decent return, but it's a different animal than the businesses that are very low capital intensity. Charlie?

Charlie Munger: – When our circumstances changed, we changed our minds.

Warren Buffett: – Slowly and reluctantly.

Charlie Munger: – In the early days, quite a few times we bought a business that was soon producing 100% per annum. If we could have continued to do that, we would have loved to do it. When we couldn't, we went to plan B. Plan B is working pretty well, and in many ways I've gotten so I sort of prefer it. How about you, Warren?

Warren Buffett: – That's true. When something is forced on you, you might as well prefer it. We knew that was going to happen. The question is, does it lead you from what was a sensational result to a satisfactory result? We are quite happy with a satisfactory result. The alternative would be to going back to working with very tiny sums of money. That really hasn't gotten a lot of serious discussion between Charlie and me.

PRECISION CASTPARTS ACQUISITION

Q – Precision Castparts, besides confidence in CEO Mark Donegan, what do you like about their business that made you pay an extraordinarily high multiple?

Warren Buffett: – We completed the acquisition of Precision Castparts at the end of January this year. We made the deal last August. You covered the most important asset in your question, Mark Donegan, who runs Precision Castparts is an extraordinary manager. We've seen a lot of managers over the years. I would almost rank Mark as one of a kind. He is doing extremely important work in primarily making aircraft parts. I would say there are certainly no disadvantages to him to be working for the company, being a subsidiary of Berkshire, and not being a public company. I think he would say over time there could be some significant advantages. For one thing, he can spend 100% of his time now on figuring out better things to do with aircraft engines. It was always his first love to be thinking about that, and he did spend some time thinking about that, but he also had to explain quarterly earnings to analysts and perhaps negotiating bank lines. His time can be spent exactly on what makes the most sense to him. Mark doesn't have to come ever to Omaha to put on some show for me in terms of justifying a billion dollar acquisition. He doesn't have to waste his time on anything that isn't productive. Running a public company, you do waste your time on quite a bit of stuff that isn't productive. We've taken the main asset of Precision Castparts and made him in this case even more valuable to the company. Precision Castparts has always made a number of acquisitions, but being part of Berkshire, there's really no limitation on what can be done. His canvas has been broadened with the acquisition by Berkshire. I see no downside whatsoever. I have an 800 number if he needs capital. He wasn't paying much of a dividend before, but he doesn't have to pay any dividend now. Precision Castparts will do better under Berkshire than it would have independently although it would have done very, very well independently.

Charlie Munger: – In the early days, we used to make wise-ass remarks. Warren used to say we buy a business that an idiot can manage, because sooner or later an idiot will. We did buy some businesses like that in the early days. They were widely available. Of course, we'd prefer to do that, but the world has gotten harder, and we had to learn new and more powerful ways of operating. A business like Precision Castparts requires a very superior management that's going to stay superior for a long time. We gradually have done more and more of that. It's simply amazing how well it works. I think to some extent we've gotten almost as good at picking superior managers as we were in the old days of picking the no- brainer businesses.

Warren Buffett: – We would love to be able to find, but we won't be able to find them because they are very rare birds – we'd love to find another 3 or 4 of a similar type business as Precision Castparts where forever they are going to be producing something where quality is enormously important, where the customer depends very heavily on them and where the contract extends over many years. People don't simply accept the low bid in order to get the gadget of one sort or another. It's very important that you have somebody there with enormous skill running this business, and their reputation among aircraft and engine manufacturers is absolutely unparalleled.

HAPPINESS

Question from London – Looking backwards, what would you have done differently in life in your search for happiness?

Warren Buffett: – Well, I'm 85, and I can't imagine anybody any happier than I am. By accident or whatever, I'm sitting here eating exactly what I like to eat, doing in life exactly what I love to do with people I love. It really doesn't get any better than that. I did decide fairly early in my life that my favorite employer was myself. I think that presented – I managed to avoid really aggravation of almost any sort. If you or those around you that you love have health problems, then that is a real tragedy. There's not much you can do about it but accept it. Charlie and I have really been blessed. Charlie is 92; he's doing every day something that he finds fascinating. He probably finds what he is doing at 92 as interesting, as fascinating, as rewarding, and socially productive, as any period you can pick in his life. We've been extraordinarily lucky. We are lucky it's a partnership; it's more fun doing things as a partnership. I don't have any complaints. I would say if you're talking about business life, I wouldn't have started with a textile company.

Charlie Munger: Looking back, I don't regret that I didn't make more money or become better known or any of those things. I do regret that I didn't wise up as fast as I could have. There's a blessing in that, too. Now that I'm 92, I still have a lot of ignorance left to work on.

REINSURANCE

Question from Germany: – Why did Berkshire sell down its holdings in Munich Re while sticking with reinsurance operations within Berkshire?

Warren Buffett: – I said in the annual report that I thought it was very likely that the reinsurance business would not be as good in the next 10 years as it has been in the last 10 years. I may be wrong on that. That's a judgment based on seeing the competitive dynamics of the reinsurance business now versus ten years ago. We sold our entire holdings, which were substantial, of Munich RE and Swiss RE. They are fine companies, well managed companies. We like the people that run them. The business of reinsurance companies generally is less attractive for the next 10 years than it has been for the last 10 years in part because of what happened to interest rates. A significant portion of what you earn in insurance comes from investment of the float. Almost all of the reinsurance industry is somewhat more restricted in what they can do with their float because they don't have the huge capital cushion that Berkshire has. They also don't have the great earning power that Berkshire has. So it was not a negative judgment in any way on those two companies or their management, but it was at least a mildly negative judgment on the reinsurance business. We have the ability at Berkshire to arrange to a degree, we have more flexibility to modify business models and we have operated that way over the years in insurance generally and reinsurance. Munich Re, Swiss Re, and all the major reinsurance companies, except for us, are pretty much tied to a given type of business model. They don't really have as many options in terms of how capital gets deployed. I think they will do fine but not as fine in the next ten years as they have in the last ten years. I think if we played the same game as we were playing the last ten, we wouldn't do as well. But we're more flexible in how we conduct our insurance operations. We have an extra string to our bow that the rest of the industry doesn't have. The amount of capital that has come into the reinsurance business, it's no fun running a traditional reinsurance company and have money coming in, particularly in Europe, and look around for investment choices and find out many of the things you were investing in years ago now have negative yields. It looks like it will be unattractive, if not terrible, for a considerable period.

Charlie Munger: – There's a lot of new capacity in reinsurance and a lot of very heavy competition. A lot of people from finance have come over into reinsurance and all the old competitors remain, too. That's different from Precision Castparts because most of the customers would be totally crazy to hire some other supplier because Precision Castparts is so much more reliable and so much better. We like the place with more competitive advantage. We are learning.

Warren Buffett: – To put it into terms of Economics 101, basically reinsurance supply has gone up but demand has not gone up. Some of the supply is driven by Investment managers who would like to establish something offshore where they don't have to pay taxes. Reinsurance is sort of what you might call the beard behind which to actually engage in money management in a friendly tax jurisdiction, and you can set up a reinsurance operation with very few people by taking large chunks of what brokers may offer. It's a very easy way to have a disguised investment operation in a friendly tax jurisdiction, but that becomes supply in the reinsurance field. Couple that with poor returns on float, it's not as good of a business as it was.

PROGRESSIVE VS GEICO

Q –Geico got whooped by Progressive Direct last year. Why is Geico suddenly losing to Progressive Direct?

Warren Buffett: – I forget what year it was we passed Allstate and Progressive, but Geico's growth rate in the 1st quarter was not as high as it was in the past couple of quarters, but it was quite satisfactory. Last year, both frequencies, how often people had accidents, and severity, which is the cost per accident, both those went up quite suddenly and substantially. Progressive's figures show they were hit by that less than Allstate and Geico. I don't think you necessarily will see the same trends this year. Last year for the first time in I don't know how many years, the number of deaths and auto accidents per hundred million miles went up. If you go back to the mid 1930s, there were almost 15 people killed per hundred million miles driven. It got down to just slightly over 1 – from 15 to 1. Cars have gotten far, far, far safer. It's a good thing. If we had the same rate of deaths from auto accidents as we had in the 1930s, we would have had a half million people die instead of 40,000. Last year there was more driving, more distracted driving, you really had this uptick in frequency and more important in severity. Geico adjusted its rates. My own prediction would be that the underwriting margins at Geico will be better this year than last year. March and April had a lot of activity. I made a bet a long time ago, a mental one, on the Geico model versus the Progressive model. They were significantly ahead of us in volume a few years back. We passed them and Allstate. I hope on my 100th birthday that the Geico people announce to me that they passed State Farm. I have to do my share on that by getting to 100.

Charlie Munger: – I don't think that it's a tragedy that some competitor got a little better ratio for one period. Geico quadrupled its market share since we bought it.

Warren Buffett: – Quintupled.

Charlie Munger: – I don't think we should worry about the fact that someone else had a good quarter.

Warren Buffett: – I'm far surer that Geico will pass State Farm some day than I will make it to 100.

AMAZON'S COMPETITIVE THREAT

Q – Warren, you have always demonstrated a heart for direct selling. In the midst of a tornado in a barbershop, you immediately offered to write an insurance policy for us.

Warren Buffett: – They were all huddled down there in the barbershop. There wasn't going to be any tornado so I told them if they gave me a dollar, they could go upstairs, and if anything happened to them – I think it was a million dollars I'd give them.

Q – With the rise of Amazon.com, we see a shift from push marketing to pull marketing. How will this affect Berkshire Hathaway?

Warren Buffett: – The development you refer to is huge. It's not just Amazon. Amazon is a huge part of it. What they have accomplished is remarkable. We don't make any decision, involving even the manufacturing of goods or retailing, before thinking long and hard about what the world will look like in 5, 10, 20 years–looking at the powerful trend you just described. We will not try to beat them at their own game. They are better than we are at that. Charlie and I are not going to outbezo Bezos by a long shot. We are going to think about that. It does not worry us with Precision Castparts. It does not worry us in terms of the overwhelming majority of our businesses, but it's a huge economic trend that 20 years ago was not on anybody's radar screen and lately has been on everybody's radar screen. Many of them, and including us in a few areas, have not figured a way to participate in it or counter it. Geico is a good example of a company in an industry that had to adjust to change. We were slow on the Internet. The phone had worked so well for us in traditional advertising that there's always a resistance to think about new possibilities. When we saw what was happening on the Internet, we jumped in with both feet. The nature of capitalism is if you've got a good business, somebody is always trying to figure out a way to take it away from you and improve on it. The full effect on the industry is far from having been seen. It is a big, big force, and it already has disrupted plenty of people. I think Berkshire is quite well situated. One big advantage is we didn't see ourselves starting as one industry. We didn't think of ourselves as department store guys or tire guys or steel guys. We thought of ourselves as having capital to allocate. If you start with a given industry focus and spend your whole time working on how to make a better tire, whatever it may be, I think it's hard to have the flexibility of mind that you have if you just have hopefully a large and growing pile of capital and figure out what is the next best move you can make with that capital. I think Amazon has a real advantage, too, this intense focus on having hundreds of millions of generally very happy customers getting very quick delivery on something they want promptly and shop the way they want to shop. If I owned a bunch of shopping malls, I'd be thinking very hard on what they might look like 10 or 20 years from now.

Charlie Munger: – We failed so thoroughly in retailing when we were young that we pretty well avoided the worst troubles when we were old. Our biggest retailers are so strong they will be among the last people that have troubles from Amazon.

COKE AND HEALTH

Q – With the health problems it causes, why should shareholders be proud to own Coke?

Warren Buffett: – I happen to like to consume about 700 calories a day from Coca Cola so I'm about one-quarter Coca Cola. But I think if you decide that sugar generally is something that the human race should not have… I elect to get my calories from things that make me feel good when I eat them. That is my sole test. It wasn't a test that my mother necessarily thought was great or my grandfather, but there are over 1.9 billion 8 ounce servings of some Coca Cola drinks consumed daily. They have an enormous range of products, 1.9 billion daily servings – 693 billion 500 million of 8 ounce servings a year, except it's a leap year–that's almost 100 8 ounce servings per capita for 7 billion people in the world every year, and it's been going on since 1886. I would find quite spurious the fact that you eat 3500 calories a day or you're consuming 2700 or 2800 and some of it is Coca Cola, and blame the obesity-related illness on the Coke you drink. You have the choice of consuming more than you use, and I make a choice to get 700 calories from this. I like fudge a lot, peanut brittle. I think if you were happy every day, it may be hard to measure, but I think you're going to live longer as well. I'm a very, very happy guy, and I'm serious. If you were happy every day, you'd live longer as well. So it may be a compensating factor. I wish I had a twin and that twin had eaten broccoli his entire life, and we both consumed the same calories. I know I would have been happier and probably would have lived longer. I think Coke is a marvelous product. Something is going to go wrong with your body at some point. Balance out the calories so that you don't become obese. I'm not seeing evidence that convinces me that I'd reach 100 if I suddenly switched to broccoli and water. A friend of mine, RJ Miller, a remarkable man, the president of Ford Motor Co., had his 100th birthday on March 4 of this year. I saw him for his birthday, and RJ told me that there were 10,000 men in the US that live to be 100 or better and 45,000 women. I checked the Internet, the census figures, and sure enough, that is the ratio. If you really want to improve your longevity prospects, have a sex change. You are four and a half more times more likely to get to be 100. It's just a matter of fact, folks. I think I'll have Charlie go first on that one.

Charlie Munger: – I like the peanut brittle better than the Coke. I drink a lot of Diet Coke. I think people that ask questions like that one always make one ghastly error that's inexcusable. They measure the detriment without considering the advantage. That's really stupid. 100 people die a year in air crashes. The benefit is worth the risk. If every person has to have 8, 10 glasses a day of water to stay alive and it's pretty cheap and sensible and adds to life to add a little extra sugar, add a little stimulation and calories, there are huge benefits to humanity. We ought to have almost a law, now I'm sounding like Donald Trump, these people shouldn't be allowed to cite the defects without citing the advantages. It's immature and stupid.

BERKSHIRE ENERGY

Q – Does Berkshire Energy have the capacity to produce 100% renewable energy from solar and wind production?

Warren Buffett: – Any decision we make, including the one we just showed during the movie, any decision about changes in generation has to go through what is usually called the Public

Utility Commission. We cannot make changes that are not approved by the PUC. We've had more problems in bringing in renewables in PacifiCorp because it's regulated by six states. They don't necessarily agree on how costs and benefits should be divided. We have to follow their instructions. Iowa has been marvelous about encouraging it at every level. Consumer groups and the governor have seen benefits. We have one major competitor called Alliant. They have not pursued renewables the way we have. Our rates are considerably lower than theirs. They may well need a rate increase within a year. We will not need a rate increase for 13 years. It is a determination that is made at the state level. We would not have the renewable generation that we have if it wasn't for the building of those projects being subsidized by the federal government with tax credits. Benefits of reducing carbon emissions are worldwide, and therefore, it's deemed proper the citizenry as whole should participate in the cost. That is allowed in Iowa as well, but the degree to which the renewables replace primarily coal, but there are plenty of emissions connected with natural gas, will depend on Governmental policy and so far I think it's been quite sensible in having the cost borne by society as a whole in terms of reduced tax revenues through subsidies. Less emissions into the atmosphere is not limited to the people of Iowa when we build wind generation. You will see a benefit that accrues to the world. You will see continued change. It will vary by jurisdiction. We have the capital. We've got lots of taxes, federal taxes paid, in our consolidated return to take advantage of the tax credits. We are in a position to be a very big player.

Charlie Munger: – I think we are doing way more than our share of shifting to renewable energy. We are charging lower prices to our utility customers. When the whole rest of the world is behaving as we are, it will be a much better world. I think the people that worry about climate changes don't have my view. I like all of the shifting to renewables, but I have a different reason – I want to conserve the hydrocarbons for chemical feedstocks. I'm in their camp, but I have a different reason.

Warren Buffett: – Nebraska has not done much with wind power. Maybe two miles from where we are sitting, people are buying their electricity cheaper than in Omaha. Wind blowing does not start at the Missouri River. It blows across Nebraska, too. Nebraska is entirely a public power state. The bonds are issued on a tax-exempt basis yet electricity is cheaper across the river. The real irony is because our electricity is so much cheaper in Iowa, it's become a tech haven for these operations that gobble up electricity. Iowa has gotten plant after plant, job after job, and gotten more property tax revenues. The massive Google server farm is located in Iowa because we have cheap wind-generated electricity, and it's creating jobs. Nebraska has prided itself on public power, originated back in the '30s. It has been a source of pride, but lately it has been a source of cost, too.

DERIVATIVES

Q – How do you analyze and value companies like Bank of America and Merrill Lynch and other commercial banks that Berkshire has investments in relative to their derivative exposures.

Warren Buffett: – Derivatives do complicate the problem very dramatically. They are moving away to being collateralized which helps. The great danger in derivatives is if there is discontinuity. If the system stops for awhile – it stopped after 9-11 for three or four days – it stopped during World War I for many months. They debated closing the stock exchange very seriously the day after October 19, 1997. There were a lot of people that wanted to close it, but it continued. If you have a major cyber, nuclear, chemical or biological attack on the country, which will certainly happen at some point, you will have a lot of problems. When things reopen, you will find there can be enormous gaps in things you thought were totally protected by collateral or netting arrangements and that type of thing. I regard large derivative positions as dangerous. Berkshire lost $400 million in unwinding General Re derivative positions in benign conditions.

Charlie found one position when he was on the audit committee at Solomon that was mismarked by $20 million. By happenstance, I do know of one incredibly mismarked position. It almost staggers the mind how it was marked. Some trader got influenced or did it himself. Some of the things get so complicated they are very hard to evaluate. They can be extraordinarily hard to mark. Auditors are not capable of holding that behavior in check. Now there are four really big auditing firms. They are auditing Company A that's on one side of the transaction and auditing Company B that's on the other side, the same auditor. There are plenty of times that the marks that they are attesting to are significantly different which would be an interesting exercise to pursue in terms of checking the numbers out. Derivatives are still dangerous in large quantities. We would not do them on a collateralized basis because if there was discontinuity, I don't know where we would end up. I would never get us in a position where we would have money demanded of us and not be able to fill it. We have some derivatives in runoff. It's been very attractive for us. It's still a potential time bomb in the system. Kuwait went into a delayed system on settlement of stock purchases. It caused all kinds of problems. You have an IOU from someone for six months. If you have a zillion of those, a lot of trouble can ensue. I'm not in the least troubled by Bank of America or Wells Fargo as investments. There are a great number of banks in the world. Take the 50 largest banks in the world, we wouldn't even think of touching 45 of them.

Charlie Munger: – We are in the awkward position where we will make about $20 billion out of derivatives in just those few contracts that we did years ago. We would prefer it if those derivatives would have been illegal for us to buy. It would have been better for our country.

FLOAT AND NEGATIVE INTEREST RATES

Q – What happens to float investment income if the U.S. has negative interest rates?

Warren Buffett: – Some of our float actually exists in Europe where we have the problem of negative interest rates on high grade and even medium term bonds. Anything that reduces that value of money will affect Berkshire because we will always have a lot of money. Because we have so much capital and so many sources of earning power, we have the ability to use our float to a certain degree in ways that most insurance companies can't think about. We can find things to do. We've got $50 odd billion of short term government securities now and another $8.3 billion in all likelihood coming in June from Kraft Heinz preferred stock. We will be back over $60 billion again very soon. The difference between a ¼ percent and minus ¼ a percent is not that great, so it will not be that painful if interest rates become negative. Float is not worth as much to insurance companies with lower interest rates as it was 10, 15 years ago. It's worth considerably more to us than it is to typical insurance companies. Having lots of money around now is not just a problem for insurance companies. It's a problem for retirees. It's a problem for anyone stuck with fixed-dollar investments and finds their income now is a pittance or in Europe possibly a negative rate. We love the idea of increasing our float. That money has been very useful to us over time. It's likely to be very useful to us in the future. It's shown as a liability on our balance sheet, but it's actually a huge asset.

Charlie Munger: – I've got nothing to add.

Warren Buffett: – He's now in full swing.

RAILROAD INDUSTRY AND BNSF

Q – The railroad industry seems to be suffering with volume down. How much of the weakness is cyclical versus secular and how does it impact the value of BNSF?

Warren Buffett: – Certainly the decline in coal, 20% of revenue, is secular. Other factors cause volume trends to jiggle around. We had a mild winter with utilities carrying unusual amounts of coal. Part of the reason for that is service got bad, and we got low on coal. The utilities compensated by bringing in more than they needed just to catch up. Weather was mild and the electricity use was poor in the wintertime. Utilities continue at this point to have more coal on hand than they would like. They are trying to under order what they will be using. The decline in coal is secular. It's true that the market generally got very enthused about railroad stocks a year ago. Equity valuations have come down in the railroad industry with market capitalizations down 30%. We love the fact that we own BNSF. We think we bought it at an attractive valuation. We don't mark up and down our wholly-owned businesses based on stock market valuations. Obviously, stock market valuations are some factor in our thinking. We regard BNSF as a good business, and we will hold them forever. But BNSF will lose coal volume, and they will lose in some other areas and gain in other areas. BNSF will earn a lot of money this year but not as much as last year.

Charlie Munger: – I've got nothing to add.

HOGWARTS AND VALUE INVESTING

Q – A long-winded question began by comparing Berkshire with Hogwarts in Harry Potter, noting that the rest of the world does not believe in value investing. How should children look at companies when every day they see in the media IPOs and the business cycle getting shorter and shorter?

Warren Buffett joked: – Would you mind repeating the whole thing? Buffett gave credit to Andy Haywood, the creator of "The Secret Millionaires Club," a children's program on money. I know it's helped thousands of children. It grows in strength. Having young children learn good lessons in terms of handling money and making friendships and behaving as better citizens, it's a great objective.

You don't really have to worry about what's going on in IPOs. People win lotteries every day. You don't have to be jealous. If they want to do mathematical unsound things, that's nothing to worry about. They put the one winner on television, and the other million that contributed to it – with the big slice taken out for the state – don't get on. All you have to do is figure out what makes sense. When you buy a stock, get yourself in a mental frame of mind that you're buying a business. Don't get a quote on it for five years. You don't get a quote every day on your farm or apartment house or McDonald's franchise. You want to look at stocks as businesses and think about performance as a business. Think about what you pay as if buying a business. Let the rest of the world go its own way. Don't get into a stupid game just because it's available.

Charlie Munger: – I think that your children are right to look for people they can trust in dealing with stocks and bonds. Unfortunately more than half of the time they will fail.

Warren Buffett: – They really have an easy problem. American businesses as a whole will do fine over time.

Charlie Munger: – But not clients of stockbrokers.

Warren Buffett: – As Charlie would say, a lot of problems are caused by envy. You have to figure out what makes sense and follow your own course.

SOLAR ENERGY

Q – Solar energy in Nevada. Why are there new rules in Nevada on solar energy?

Warren Buffett: – The public utility and pricing policy is everything in Nevada as well as other places. There are three commissioners that decide what's proper. The situation in Nevada in terms of rooftop power was that for the last few years, if you had a solar project on your roof, you could sell back excess power you generated to the grid at a price that was far, far above what we, as a utility, could buy it for elsewhere. They were being subsidized by the federal government. The people who had the 17,000 rooftop installations were selling back to the grid at roughly 10 cents a kilowatt hour energy that we could purchase elsewhere for 3.5 cents or thereabouts. Ninety-nine percent of our consumers were being asked to subsidize the 1% that had solar units by paying triple the market price at what we could otherwise buy electricity and sell it to the other 99%. It's a question if you wish to have the 99% subsidize the 1%. The PUC in Nevada originally let this small group experiment by giving them this 10 cent rebate. They then decided the 99% should not be subsidizing the 1%. For solar to be competitive, it needs subsidization. Who pays for the subsidy gets to be a real question. I personally think if society is the one benefitting, then society should pick up the tab. I don't think someone sitting in a house in Nevada should be picking up the subsidy for their neighbor. It is not right for 1 million customers in Nevada to subsidize 17,000 customers. The PUC agrees with that. Greg?

Greg Abel, president of NV Energy – One, as you've touched on earlier, we absolutely support renewables. We are for solar. We want to purchase renewable energy at the market rate – not where 1% of the customers will benefit and the other 99% will not. A working family in Nevada who cannot afford the rooftop unit, and you ask them if they want to subsidize their neighbor, the answer is no. By 2019, we will be replacing 76% of our coal units and replacing it with solar energy.

Warren Buffett: – Put up Slide 7, it will give you a view of what the situation is. This accounts for all of our Berkshire Hathaway energy operations. In a 20 year period, we will have a 57% reduction in our coal usage. It's moving at a fast pace. You want to be sure that you treat fairly the people involved in this. Someone pays the cost of electric generation. If you are doing something to benefit the planet, and it's important that it be done, you should not have the costs assessed for that on a specific person who's having trouble making ends meet in their job. They are not the ones to subsidize the person who can afford to put the solar unit in.

OIL PRICES

Q – Berkshire is more influenced by oil markets than many thought. Is Berkshire making a long term statement about the price of oil with recent oil investments?

Warren Buffett: – We haven't the faintest idea of what the long term price of oil is. There's always a better system available. You can buy oil for delivery a year from now or two years from now. We actually did that once. We made money, but we don't think we can predict commodity prices. We do some forward buying. Basically, we are not two fellows who think that we can predict the price of corn or soybeans or anything else. Some of the securities you mentioned were bought by Todd or Ted and one by me, but neither they nor I bought those, or if we sell them, based on commodity price predictions. We are thinking about other things when we make those decisions.

Charlie Munger: – I'm even more ignorant than you are [about predicting commodity prices] and that might be hard to be.

Warren Buffett: – I think that's the first time I heard him say that. It has a nice ring to it.

STUDENT LOANS AND RISING EDUCATION COSTS

Q – Rising college education costs.

Charlie Munger: – I think if you expect a lot of financial efficiency in American higher education, you are howling at the wind.

Warren Buffett: – He's also saying that more philanthropy ought to be devoted to financing college costs.

Charlie Munger: – I do a lot more than Warren does in this field. Monopoly and bureaucracy are everywhere and universities are not exempt from it. If people want to give more to it, I'm all for it.

Warren Buffett: – You have the option of very good state schools. We spend a lot of money on education in this country. We spend $600 billion educating 50 million kids from kindergarten to 12th grade. People talk about entitlements for Social Security. We have entitlements for the young. Nobody ever seems to bring that up. The people in their working ages, generally speaking, have an obligation to both the young and the old. Based on the amount we spend, if we have problems with our school system, it's not because we are cheap. There are other problems that contribute to it. I was a trustee at a college that saw the endowment go from $8 million to over $1 billion. I did not see the tuition come down or the number of students go up.

Charlie Munger: – Nothing went up except the president's salary.

Warren Buffett: – When you read the figures on the endowments at the big schools, some have gotten up to the big numbers. The main objective is to have the endowment grow larger.

Charlie Munger: – No further comment. I've created all the enemies I can afford at the moment.

Warren Buffett: – That's never slowed him down in the past.

DONALD TRUMP

Q – What specific risks are there for Berkshire if Donald Trump becomes the President of the United States?

Warren Buffett: – That won't be the main problem. The government is a very big factor in our business and all businesses. I will predict that if either Donald Trump or Hillary Clinton becomes President, and one of them is very likely to be, I think Berkshire will continue to do fine.

Charlie Munger: – I'm afraid to get into this area.

Warren Buffett: – We've operated under price controls. We've had 52% federal taxes applied to our earnings for many years and higher at other times. We've had regulations come along. In the end, business in this country has done extraordinarily well for a couple hundred years. It has adapted to society, and society has adapted to business. This is a remarkable place to operate a business. Owners of businesses, look at returns on tangible equity, they have not suffered even as people that own fixed-investment instruments have suffered. Farmer's income has fallen off in the last few years. Business manages to take care of itself. In my lifetime, the GDP per capita has gone up six for one. Overall, people have six times the real output they had at the beginning. It will keep working. Twenty years from now there will be far more output per capita in the United States. The quality will get better. No presidential candidate or President is going to end that. They can shape it in ways that are good or bad, but they can't end it. Now Charlie, give us something pessimistic.

Charlie Munger: – I want to say something optimistic. I think the GDP figures greatly understate the real advantage that our system has given our citizens. The real achievements over the last century are way higher than indicated by the GDP figures, and the GDP figures are good. I don't think it's necessarily going to be quite as good as the past, but it doesn't have to be.

Warren Buffett: – There's no one that says with my same talents, I wished I was born 50 years earlier. The majority of the American public thinks it's a bad time to be born today compared to when they were born. They are wrong. The pace of innovation has never been better – just think how differently you are living. But you're making free choices that were not available to you 20 years ago. I'm still staying with the landline, but you people are way ahead of me.

RAIL MERGERS

Q – Mergers among railroads?

Warren Buffett: – Directed the question to Matt Rose, president of BNSF.

Matt: – Back in 1999, we had a failed merger with Canadian National Railway which was blocked due to new regulations. The public litmus test for the next merger would have to be different. Didn't think a large merger would be possible currently, when we think of our four constituencies – those four are customers, labor groups, communities in which we serve and the shareholders. We didn't see any interest outside of the shareholders. We believe if a final round of mergers occurs, there will be great efficiencies made between shippers and communities. Right now we don't see the dynamics in place. When the population grows from 315 million people in the U.S. to 350 million and transportation becomes scarcer, then mergers may occur.

INVESTMENT BANKS AND WELLS FARGO

Q – How do you feel about investment banking given higher regulation?

Warren Buffett: – The public policy since 2008 and 2009 has been to toughen up capital requirements in a variety of ways for banks, but specifically it's the design to make very large banks less profitable relative to smaller banks. You can change the math of banking totally by capital requirements. If you said every bank had to have a 100% capital ratio, that would be terrible, and you wouldn't make any money. If you let people operate with 1% capital ratios, they can make a lot of money, and they will cause the system all kind of trouble. The rules are tilted against the larger banks with returns on equity going down. It's a less attractive business than earlier. Some of the investment banks operate as bank holding companies.

Warren Buffett: – Wells Fargo has an investment banking aspect that primarily came in through Wachovia. It's our largest marketable security – not counting Kraft Heinz. In that situation we are in the control situation. I like Wells Fargo extremely well compared to other securities. It does not have the most upside of our other securities except on a weighted basis.

Charlie Munger: – It's not the investment banking. It's the general banking of Wells Fargo.

Warren Buffett: – We think Wells Fargo is a very well run bank. We didn't make any decision to buy a single share because of the investment banking business. They have a huge base of very cheap money. We think it's a very well run bank. Charlie and I are probably a little affected by the experience we have. We made a major investment in preferred shares of Goldman Sachs. We continue to hold some shares from when we made the investment in 2008. I can't recall us making an investment banking purchase – a marketable security involving an investment bank.

Charlie Munger: – Generally, we fear investment banks more than we love them.

BREAKING UP BERKSHIRE HATHAWAY

Q – What corporate defenses are in place to prevent activist from trying to break up Berkshire Hathaway in the future?

Warren Buffett: – I used to worry more about that than I do now. Size is one factor now. Berkshire will always be in a position to repurchase very significant amounts of stock. As long as it's willing to buy back the stock close to intrinsic value, there should not be a large discount to intrinsic value, so there would be no advantage to breaking up Berkshire. There would be money lost by breaking it up. Mid-American Energy could not have done what it has in terms of renewables without Berkshire being the parent. I don't think there will be a spread that will be enticing to anyone. The numbers involved would be staggering. I think it's very unlikely, but there have been periods in business history where stocks sold at dramatic discounts from what you may call intrinsic value. In '73-'74, there were really good companies, one of which was Cap Cities that was selling at a huge discount. People did not come along to take advantage of the discount, because when discounts are huge, money is usually scarce. It's not a huge worry with me. In my own case, because the way my stock will be distributed after I die; it's very likely that my estate for some years would be by far the largest shareholder of Berkshire in terms of votes. It's not something I worry about now.

Charlie Munger: – I think we have almost no worries at all on this subject. Other people have justifiable worry, and I think that helps us. I look forward to this subject with optimism.

Warren Buffett: – Do you want to explain how it helps us?

Charlie Munger: – If you're being attacked by people you regard as evil [activists], you want a strong ally. How many people would you pick in preference to Berkshire?

Warren Buffett: – My name is Warren Buffett, and I approve that message.

LEASING BUSINESS

Q – Talk about Berkshire Hathaway's competitive advantages of its leasing business.

Warren Buffett: – We've got a very good truck leasing business. We've got a good tank car leasing business. We expanded it by a billion dollars when we bought the GE fleet recently. Leasing generally isn't something – we have to bring something to the party – there are important service advantages. Leasing of new cars, which is a huge business, the math is not that attractive for us. Banks have an advantage because their costs are lower. Wells Fargo's cost is around 10 basis points. When someone has a trillion dollars or so, that they are paying ten basis points for it, I don't feel very competitive. Pure money type leasing is not an attractive business for us. They've got the edge. We've got rail car leasing which is more attractive and involves a lot more than a financial transaction. Those cars require servicing. Aircraft leasing doesn't interest me in the least. That is a scary business. Some people have done well in it. That isn't for us.

.

SILVER BULLET

Q – If you had a silver bullet, which competitor would you take out and why?

Charlie Munger: – I don't think we have to answer this one, which competitor would you kill if you could?

Warren Buffett: – Charlie is a lawyer. We have lots of tough competitors. In many areas we are a pretty tough competitor ourselves. We want our managers to think every day about how to achieve a stronger competitive position; we call it widening the moat. We want better products, cost to a minimum, and know what our customers want from us a month or year or ten years from now. If you take care of the customer, the customer will take care of you. There are cases where a force comes along and you may not have the answers for it, and you need to get out of the business. We had the department store in Baltimore. If we kept it, we would have gone out of business. Recognizing the reality is also important. Don't try to fix something that is unfixable.

We really hope to be the ones that the other guy wants to use the silver bullet on.

SEQUOIA FUND AND VALEANT

Q – Mr. Munger has said the Valeant business model is highly immoral. Has your view changed of Sequoia, which had a highly concentrated position in Valeant of more than 30% of the fund's portfolio?

Warren Buffett: – In a sense, I'm the father of the Sequoia Fund. I was closing up my partnership in 1969. I was giving back a lot of money back to partners. They wanted to know what they should do with their money. We helped out those who wanted to put their investments in municipal bonds. Most were equity-oriented type investors. There were two people we admired in the investment business enormously. Those two were, Sandy Gottesman, our director, and Bill Ruane. They were friends themselves. Sandy took on a number of people. Some are still clients to this day. A lot of them went with both of them. We had a lot of people whose total funds were not of a size that made them economic individual clients. Bill said, "I will set up a fund." They had an office in Omaha. John Harding became the employer here. A number of my ex-partners joined Sequoia Fund as a way to find an outstanding investment manger both for ability and integrity and could deploy small sums with him. Bill ran Sequoia roughly until 2005 when he died, and he did a fantastic job.

I don't know if there's a mutual fund that has a better record – there probably is one or two – but it's far better than the S&P. Bill did a great job for people. Bill died in 2005. The record continued to be good until a year or so ago. At that time, the manager took an unusually large position in Valeant, despite the objection of some people on the board. He not only maintained that position, but then increased it. The record to date still is significantly better than average even with the recent problems. The manager who made the decision on Valeant is no longer running the fund. It was a very unfortunate period as that manager got overly entrenched with the Valeant business model. They are very smart, decent people who are probably way better than average analysts in terms of Wall Street.

I watched the Senate hearings a couple of days ago when three people were interrogated from Valeant. It was not a pretty picture. It was enormously flawed – the business model. It illustrated a principle: that if you're looking for a manager, find someone that is intelligent, energetic and has integrity. If they don't have the last attribute, make sure they don't have the first two. If they don't have integrity, you want them to be dumb and lazy. You can get into a lot of trouble with management that lacks integrity.

Charlie and I have seen – we are not remotely perfect. We've seen patterns – we have pattern recognition – it gets very important in evaluating humans and businesses. None of the patterns exactly repeat themselves. There are certain things in business that we've seen over and over and frequently come to a bad end but frequently look extremely good in the short run. One which I talked about last year was the chain letter scheme. No one calls them that because that has a connotation that will scare you off, but they are disguised chain letters. There were patterns at Valeant certainly if you go and watch the Senate hearings, you will see there are patterns that should have been picked up on. It was very painful to the people of Sequoia. Sequoia has good people now.

Charlie Munger: – I totally agree with you that Sequoia has reconstituted – it's a reputable investment fund. The manager is a reputable investment advisor. I have quite a few friends and clients that I've advised them to stay with the place as they have reconstituted.

Valeant, of course, was a sewer. Those that created it deserve all the opprobrium that they got.

HEDGE FUND BET

Warren Buffett: – Put slide 3 up, which showed that over the last eight years, the Vanguard S&P 500 Index fund was up 65.7% versus five hedge funds that were up 21.9% over the same period. Some years ago I made a wager. I promised to report before lunch how the wager was coming out. I've been doing that regularly. It seems appropriate since it has developed this far to point out a rather obvious lesson which is what I hoped to drive home to some degree by offering to make the wager originally. Incidentally, when I offered to make the wager, namely, someone could pick out five hedge funds, and I would take the unmanaged S&P Index used by the Vanguard Fund. I would bet that over a ten year period, the unmanaged index would beat these five funds that were all being managed by people charging incredible sums to people because of their supposed knowledge. Put in Longbets.org – it's a terribly interesting website – people take the opposite side of various propositions that have a long tail to them and make bets as to the outcome. Each side gives their reasons. You can go to that website, and you can find bets about all kinds of things. Our bet became quite famous. A fellow I like bet that he could pick out five hedge funds – funds of funds. In other words, there was one hedge fund at the top, and then that manager picked out who he felt was the best managers underneath. Five funds of funds represent maybe 100 or 200 hedge funds underneath. The fellow making the bet was picking out funds where the manager on top was getting paid perhaps .5% a year, plus a cut of the profits, for merely picking out who he felt were the best managers underneath who were in turn getting paid perhaps 1.5% to 2%. The guy at the top was incentivized to pick great funds. The result after eight years, and several hundred hedge fund managers being involved, the totally unmanaged fund by Vanguard with very minimal cost is now 40 some points ahead of the group of hedge funds. It might be a terrible result for the hedge fund investor, but it's not a terrible result for these hedge fund managers. You have a top manager charging perhaps .5% and down below you have managers charging 1.5 to 2%, a couple percentage points sliced off every year, that's a lot of money.

We have two managers at Berkshire. They manage $9 billion for us. If they had a 2 and 20 arrangement with Berkshire, which is not uncommon, they would be getting $180 million each merely for breathing annually. It's a compensation scheme that's unbelievable to me. That's one reason I made this bet. What I'd like you to do – imagine in this room, you people own all of America. You are the 18,000 that somehow managed to accumulate all the wealth in the country. Let's assume we divide the room down the middle. On this side, we put half of all the investment capital in the world. That capital is what a certain presidential candidate might call low energy. In fact, they have no energy at all. They buy 50% of everything that exists in the investment world. Half of it is owned by these no energy people. They don't look at stock prices; they don't turn on the business channel or read the Wall Street Journal. They are a slovenly group that just sits, year after year, owning half of America's business. What is the result going to be? The result will be average. No expenses, nothing.

What's going to happen to the other half? The other half is hyperactive investors. Their gross result is also going to be half. The whole has to be the sum of the parts here. This group can't change from its half. The half will have the same gross results as the low energy. This half will have huge expenses hiring consultants and paying commissions. That hyperactive half, as a group, has to do worse than this low energy half.

I hoped through making this bet to create a little example of it. I felt it was very probable that index funds would outperform the hedge funds over any 10-year period. I would make the same offer now. The ten years to collect gets a little problematic. It seemed so elementary. I will guarantee you no endowment fund, no public pension fund, no extremely rich person wants to sit in that low energy part of the auditorium. They can't believe because they have billions of dollars to invest that they can't go out and hire somebody who will do better than average. This group – sophisticated people, generally richer people – hires consultants. No consultant in the world is going to tell you to buy an S&P fund and sit still for the next 50 years. You don't get to be a consultant that way. You certainly don't get an annual fee that way. The consultant will talk for hours. You pay them a large fee, and they will tell you anything, but they always suggest something other than sitting on your rear-end. They will tell you to go to this person that charges fees. It demonstrates so dramatically – I've talked to huge pension funds and taken them through the math – when I leave, they go out and hire a bunch of consultants and pay them a lot of money. The consultants tweak the funds from year to year. They have lots of charts and PowerPoint presentations. The flow of money from the hyperactive to the helpers is dramatic. I hope you realize, for the population as a whole, American business has done wonderfully. You should just sit back and enjoy American business. The net result of hiring professional management is a huge minus. All the commercial push is to think about doing something different today than you did yesterday.

Charlie Munger: – You're talking to a bunch of people that solved their problem by buying Berkshire Hathaway and have done better than the S&P index. There are a few managers that are really good. It's a tiny group of people. It's like finding a needle in a haystack.

Warren Buffett – The people that went with Sequoia fund have been well served if they stayed for the whole period. There's been far, far more money made by people in Wall Street through salesmanship abilities than investment abilities. There are a few people out there who are going to have an outstanding investment record. The people you pay to identify them don't know how to identify them. They do know how to sell to you. That's my message.

COMMERCIAL INSURANCE

Q – Berkshire Hathaway has an online portal for commercial insurance business – coveryourbusiness.com. Is there an opportunity to go direct?

Warren Buffett: – We will find out. We have actually two online arrangements. I'm not sure whether they are both up yet. One is called – I believe it's called BIG – I believe we got that domain name – and that will be run by Applied Underwriters which is a subsidiary of ours that writes workers' comp. We do commercial auto through GEICO as well. We have been a little bit and will be exploring more with various insurance lines. When you look at what has happened with Amazon, you want to try a lot of things. It amazed me how fast the inquiries on personal auto migrated from phone to the Internet, and I would have thought that the younger people would do it, but the people like myself would be slow to do it. The adaptation by the American people has been incredible and shows no sign of slowing down. The answer is we will try various things, make some mistakes and my guess is 10, 20, 30 years from now it will be a lot different.

SUCCESSION

Q – What is the plan for how Berkshire will maintain its culture when Howard Buffett no longer fills the role and what should shareholders watch for to make sure the culture is being maintained decades from now?

Warren Buffett: – Although I hope that Howard is made chairman just for the reason that if a mistake is made in selecting a successor, it's easier to correct it if you have a non-executive chairman. It's maybe a 1 in 100 or 1 in 500 probability. It's not a key factor. The main, by far, factor in keeping Berkshire culture is you will have a board, successor board members, managers and successor managers, and you have shareholders that clearly recognize the special nature of the culture, have embraced the culture. When managers sold the business to us, they wanted to join the culture. It embraces those who enjoy and appreciate it. I think to some extent we don't have a lot of competition on it. It works. I think the chances of us going off the rails in terms of culture are very slight regardless if there's a non-executive chairman or not. I think the main problem Berkshire will have will be size. I thought that when I first started managing money. Size is the enemy to performance to a significant degree. I do think that the culture of Berkshire adds significantly to the value of the individual components viewed. I don't see any evidence of any board member or managers that will move away from what we have now for many, many decades.

Charlie Munger: – I'm even more optimistic than you are.

Warren Buffett: – I never noticed it.

Charlie Munger: – I really think the culture will surprise everyone in how it lasts. They never made any fuss over us in the first place. It is going to work very well.

Warren Buffett: – We have so many good ingredients in place in terms of the businesses and the people that are already here.

Charlie Munger: – There's so much power in place.

Warren Buffett: – Another thing that's interesting is how little turnover we get. The number of managers we've had to replace in the last ten years is very few. Without a retirement age – and I tend to bring that up at every meeting to kind of reinforce the idea – people are working because they love their jobs. They like the money as well, but their primary motive is they like accomplishing what they do in their jobs. The turnover is low. The directors are not here for the money. We have great tenure among the directors. I would argue that's a huge plus. It's going to go on a very long time.

DIVERSITY

Q – Two dozen men and women work with you at headquarters. There's a lack of diversity among staff and board members. Does that need to change? Do you consider diversity in a company?

Warren Buffett: – It's a multiple part question. We will select board members. We lay it out and have done so for years. We've been much more explicit than most companies. We are looking for people who are business savvy, shareholder oriented and have a special interest in Berkshire. We found people like that. As a result, I think we've got the best board that we can have. They are clearly not in it for the money. I get called by consulting firms who've been told to get candidates for directors for other companies. By the questions they ask, it's clear they've got something other than the three questions we ask in terms of directors in mind. They want somebody whose name will reflect credit on the institution, which means a big name like at one organization, Theranos, – the one that did blood samples with small pricks – they have some very big names on their board. The names are great. We are not interested in people that want to be on the board because they want to make $200,000 or $300,000 a year for ten percent of their time, and we are not interested in the ones who it is a prestige item or ones that want to go and check boxes or that sort of thing. We will continue to apply that test: business savvy, shareholder oriented and with a strong personal interest in Berkshire. Every share of Berkshire that our directors own, they bought them like everyone else in the room. Our directors walk in the shoes of shareholders. I've been on boards where they have given me stock – I get it for breathing basically – there's maybe three or four that I've been on the board of. We want our board to be smart enough that they know what they should and should not get involved in.

The people on our corporate staff – I'm hoping when we take the Christmas picture this year, they are exactly the same 25 that we had last year. It's a remarkable group of people. Just take this meeting, virtually every one of the 25, they've been doing job after job connected with making this meeting a success and a pleasant outing for our shareholders. It's a cooperative effort. The idea you would have some annual meeting department, you would have a person in charge of it, and he or she would have assistants and they would go to various conferences and then they'd hire consultants to help them. We just don't operate that way. It's a place where everybody helps each other. My job is extraordinarily easy, but the people around me really make my job easy. Part of the reason is we don't have any committees, but maybe we have some that I don't know about, but I've never been invited to any committees at Berkshire. We may have a PowerPoint some place. I haven't seen it, and I wouldn't know how to use it anyway. We just don't make work activities. We might go to a baseball game together or something like that. I've seen the other kind of operations, and I like ours better.

Charlie Munger: – Years ago I did some work for the Roman Catholic Archbishop of Los Angeles, and my senior partner pompously said, "You don't need to hire us to do this. There are plenty of good Catholic tax lawyers." The Archbishop looked at him like he was an idiot and said, "Mr. Pieler, last year I had some very serious surgery, and I did not look around for the leading Catholic surgeon." That's the way I feel about board members.

SHARE REPURCHASES

Q – Intrinsic value continues to exceed book value, yet Berkshire has done very little share repurchases in the last four year even in January and February when the stock price dipped below 1.2 times book value (the valuation Berkshire has set for repurchasing shares). Are we at a point to consider buying back shares?

Warren Buffett: – Berkshire's stock price has come fairly close to 1.2 times book value, but I can almost guarantee you that it hasn't hit 1.2 times book value, or we would have done it [repurchased shares]. I will be happy to send you figures on it any day that you might feel that it did hit the 1.2 times book value mark. Clearly in my view and Charlie's view and the board, the stock is worth significantly more than 1.2 times book value. It should be worth significantly more or we wouldn't have it at that level. We did move it up from 1.1 to 1.2 because we had acquired more businesses over time where the differential between our carrying value and the intrinsic value really had widened from when we set the 1.1 times book value threshold.

I have mixed emotions on the whole thing. From strictly a financial standpoint, and from the standpoint of the continuing shareholders, I love the idea of buying it at 1.2 times book value, which means I would probably love the idea of buying it a little higher than 1.2 times book value. It's the surest way of making money per share there is. If you can buy dollar bills for anything less than a dollar, there's no more certain way of making money. On the other hand, I don't enjoy the actual act of buying out people who are my partners at a price that is well below what I think the stock is worth. The odds are extremely high that we would buy a lot of stock at 1.2

times book value or less, but we would do it in the manner where we were not propping the stock at any given level. If it happens, it will be very good for the continuing stockholders. If it's true that we will and are eager even from a financial standpoint to buy it at that price, it's really like having a savings account. If you take your money out as a dividend or interest payment, you get a dollar, but if you leave it in, you are almost guaranteed that we will pay you $1.20. Why would anyone want to take money out of a savings account if they could cash it in at 120%? It acts as a backstop for insuring that a no-dividend policy results in greater returns than if we paid out a dollar and people got a dollar. If they leave it in, they will get at least $1.20. It's not a total guarantee, but it's a pretty strong probability. Would we increase that number? Perhaps. If we run out of ideas, and it really becomes apparent that we can't use capital effectively within the company in quantities in which it is being generated, then at some point the threshold might be moved up a little. You don't want to keep accumulating so much money that it burns a hole in your pocket. It's been said actually that a full wallet is like a full bladder. You may get an urge very quickly to pee it away. We don't want that to happen. If we have $100-$120 billion in cash, we may consider increasing the multiple we pay for share repurchases. Anytime you can buy stock for less than it's worth, it's advantageous to the continuing shareholders. Intrinsic value can't be that finely calculated that you can figure it out to four decimal places.

Charlie Munger: – You will notice elsewhere in corporate America these buyback plans get a life of their own. It's gotten very common to buy back stock at very high prices. It doesn't really do the shareholders any good at all. I don't know why people are exactly doing it. I think it gets to be fashionable.

Warren Buffett: – It's fashionable, and they get sold on it by advisors. Can you imagine somebody going out and saying we are going to buy a business, and we don't care what the price is? That's what companies do when they don't attach some kind of metric on their buybacks. They should say we are going to buy back $5 billion of stock if it's advantageous to buy it back. We should buy it at this price, but we won't buy it at 120% of the price. I've sat on board of directors, one after the other, where they voted buybacks, and basically they are saying that we are doing it to prevent dilution. Dilution by itself is a negative. Buying back stock at too high of a price is another negative. It has to be related to valuation. You will not find a lot of press releases that say a word about valuation. Jamie Dimon is one of the few CEO's who says he will only do a buyback if it is advantageous to J.P. Morgan to do so.

Charlie Munger: – We are always behaving a lot like what some might call the Episcopal prayer. We prayerfully thank the Lord that we are not like these other religions that are inferior.

NEBRASKA FURNITURE MART

Q – Nebraska Furniture Mart has been opened a year in Dallas. How have the sales been?

Warren Buffett: – It's our largest store in volume, but we had a problem there like we had in Kansas City. We generated so much initial volume that we had a delivery problem. It was worse in Kansas City. That was the first one we opened. We had to take our foot off the gas pedal. The last thing we want to do is make first impressions accompanied by delivery problems. So it's our largest store in volume. The deliveries have gotten far better – they are actually meeting our company's standards that we have in Omaha. We opened up the largest home furniture store in the US. We thought we trained the drivers as well as we could. Delivery problems occurred with 100 plus units out there in the new operation, taking in carpet, people getting lost and routing being bad. There was plenty of work to be done, and it has been done. I think it will be a billion dollar annual store before very long – it's a terrific area. We have 20 plus auto dealerships there in the Dallas/Fort Worth area. We probably have three or four of them in the area where our furniture mart is. They can't build fast enough down there. It already is a great store, but it will be something far beyond that. They are doing terrific volume. I'm staring to sound like Donald Trump—"Tremendous, terrific, fantastic, I've never seen anything like it!" Wait until next year. It'll come back, and it will really be in shape them. It's doing well. We have over 400 acres. We were very fortunate in corralling a whole bunch of land. We are bringing prices and variety like nobody has seen. Now we just have to bring delivery like nobody has ever seen.

CNBC-CYBER, NUCLEAR, BIOLOGICAL, and CHEMICAL THREATS

Q – You have expressed concern about cyber, biological, nuclear and chemical attacks. Preventing catastrophe is not getting enough attention. The bill got bottled up in the Senate. Is it a good idea to fund a campaign and counteract industry lobbyists?

Warren Buffett: – In my view, there is no problem remotely like the problem of what I call CNBC – cyber, nuclear, biological, and chemical attacks – that either by rogue organizations, even possibly individuals or rogue states. You can think about a lot of things, and it will happen. I think we have been both lucky, and frankly, the people have done a very good job in the Government because Government is the real protection on this in not having anything since 1945. We came very close during the Cuban missile crisis. I can think of many people if they were in place of either Kennedy or Khrushchev, we would have had a very different result. It's the only real threat to Berkshire – external threat to Berkshire's economic well being over time. I hope when it happens, that it is minimized. The desire of psychotics, and megalomaniacs and religious fanatics and whatever to do harm on others is a lot more when you have seven billion people on earth than when you had three billion or so which is the case when I was born, less than three billion. Unfortunately, their means of doing it – if you were a psychotic back far enough; you threw a stone at the guy in the next cave. There was sort of a linear relationship of damage to psychosis. That went along through bows and arrows and spears and cannons and various things. In 1945, we unleashed the nuclear threat, something like the world had never seen. That's a popgun compared to what can be done now. There are plenty of people that would like to cause us huge damage. I came to that view when I was in my 20s in terms of my philanthropic efforts. I decided that was one of two issues that should be the main issue. I got involved with all kinds of things.

Charlie Munger: – You supported the Pugwash conference year after year after year all by yourself.

Warren Buffett: – I've given some money to the nuclear threat initiative that was created – sort of a Federal Reserve System that will take away some of the excuse for countries to develop their own highly enriched uranium. It's overwhelmingly a governmental problem, and I think it actually has been the top priority for president after president. They don't want to scare the hell out of everybody or tip people's hands as to what they are doing, but being in the insurance business – you don't have to be in the insurance business to know someday, somebody will pull off something on a very, very big scale that will be harmful. The United States is probably the most likely place it will happen. It could happen in a lot of other places. That's one huge disadvantage to innovation.

Charlie Munger: – I think he also asked why we don't spend more time telling the Government what they should be doing.

Warren Buffett: – It seems sort of hopeless. They don't know what to do beyond what they are doing. Incidentally, they've done a lot of things. It all doesn't get publicized. Khrushchev shouldn't have been sending it over to Cuba. At least he had enough sense when he knew Kennedy meant business to turn the ships around. You can't count on there being Kennedys and Krushchevs all the time in charge of things. I see the mistakes being made in business with human behavior where people act so contrary to their own long range self-interests. There are a lot of frailties. You can argue if Hitler hadn't been so anti-Semitic, he could have gotten to the Atomic bomb before we did, but he drove out the best of the scientific minds.

Charlie Munger: – Imagine a guy stupid enough to think the way to improve science is to kick out all of the Jews.

Warren Buffett: – The hero of the 20th Century may have been Leo Szilard. Leo is the guy that got Einstein to co-sign a letter to Roosevelt – one side or the other is going to get it, and we got it first. Post 9-11, people started getting a few envelopes with Anthrax. When you have a mind that is going to send Anthrax to people, how that decision is made is just totally beyond comprehension. The capability for damage is absolutely incredible. If I knew how to reduce the probabilities of the CNBC type mass attack by 5%, all of my money would go to that. No question about that.

Charlie Munger: – Hasn't it been true that we haven't been very good at getting the Government to follow our advice?

Warren Buffett: – But this one is important. Nobody argues with you about it. Some people work for a while on it and just get discouraged and quit. I was involved for a while – I forget the name of it – a bunch of nuclear scientists, their idea was to affect elections in small states, government was the main instrument and you would have the maximum impact. People got discouraged. I think our leaders are good on this. I do not worry about the fact that either Clinton or Trump would regard that as the paramount problem of their presidency. I just don't know if the offense can be ahead of the defense. You can win the game 99.99% of the time. Eventually, anything that has any probability of happening will happen. I wish I could give you a better answer.

Charlie Munger: – I have no hope of giving a better answer.

Warren Buffett: – That's what they all say to me.

LUBRIZOL

Q – Lubrizol, how has the core business done? Talk about the performance of one or two of their acquisitions,

Warren Buffett: – The additive business, there's four companies in it basically. It's a no growth but very good business. We are the leader. It has performed almost exactly as you would anticipate. Lubrizol made one large acquisition which was a big mistake. That was in the oil field specialty business. It was made right at the peak of oil prices. Afterwards, oil took a nosedive. The biggest acquisition should not have been made. We still have the fundamental earning power of the additives business. That has not disappointed us in any way. It's not a growth operation.

MICROECONOMICS AND MACROECONOMICS

Q – Berkshire Hathaway does not make investment decisions based on macroeconomic factors, but do you have good microeconomic indicators from Berkshire's many businesses?

Warren Buffett: – Charlie and I read a lot. We are interested in economic matters and political matters. We are familiar a lot with almost all the macroeconomic factors. We don't know where zero interest rates are going to lead. We do know what's going on.

Charlie Munger: – There's confusion here. It says microeconomic factors. We pay a lot of attention to those.

Warren Buffett: – In terms of the businesses we buy and when we buy stocks, we look at it as buying businesses, so they are very similar decisions. We try to know as many as we can know of the microeconomic factors. I like looking at the details of a business whether we buy it or not. I find it interesting to study the species. I don't think there's any lack of interest in those factors or denying the importance of them.

Charlie Munger: – There could hardly be anything more important than the microeconomic factors. That is business. Business and microeconomics is sort of the same term. Microeconomics is what we do and macroeconomics is what we put up with.

ANCHORING BIAS

Q – The anchoring effect, how do you deal with that?

Warren Buffett: – We are not anchored, we are ignoring. Charlie and I find it interesting in every business. We like to look at micro factors. When we buy a See's Candy in 1972, there may have been 140 shops. We look at the numbers on each one and watch them over time. We really like understanding businesses. It is interesting to us. Some of the information is useful. Some of it may look like it's not helpful. Who knows when some little fact does pop up and makes a difference? We love doing this. It is like watching baseball games. Every pitch is interesting, whatever it may be. That's what our activity is.

Charlie Munger: – We try to avoid the worst anchoring effect which is always your previous conclusion. We really try to destroy our previous ideas.

Warren Buffett: – Charlie says if you disagree with somebody, you ought to be able to state their case better than they can. At that point, you've earned the right to disagree with them.

Charlie Munger: – Otherwise, you should just keep quiet. It would do wonders for our politics if everybody followed my system.

PERSONAL INVESTMENTS VS BERKSHIRE INVESMENTS

Q – How do you determine which investments you will make personally like Seritage Growth Properties and Phillips 66 as disclosed on Form 13-G's versus the investments you make for Berkshire?

Warren Buffett: – I have never owned a share of Phillips 66. Maybe there's some way when the form is filled out that because I'm CEO of Berkshire, on some line, it imputes ownership to me. I've never owned a share of Phillips. Seritage is a real estate investment trust that had a total market value of under $2 billion when I bought it. I have about 1% of my net worth outside of Berkshire and 99% in it. I can't be doing things that Berkshire does. Seritage is not something of Berkshire size, and we've never owned a real estate investment trust in Berkshire at all. I could buy that and not worry about a conflict. My best ideas are off limits for me because they go to Berkshire if they are sizable enough. We will not be making investments, unless it's something very odd, in companies with a total capital market value of a couple of billion. So, every now and then, I see something that is sub-sized for Berkshire that I will put that 1% of my own net worth in. I own some wells that I bought a long, long time ago. I try to stay away from anything that could conflict with Berkshire.

Charlie Munger: – Part of being in a position like that is you really don't want a conflict of interest or even the appearance of it. Both of us practically have nothing of significance in the total picture outside of Berkshire. I have some Costco stock because I'm a director. Berkshire has some Costco stock. There are two or three little overlaps like that, but basically Berkshire stockholders have more to worry about than some conflict Warren and I are going to give it. We are not going to do it.

Warren Buffett: – It may sound a little crazy, and it's only because I can afford to say this, but I would much rather make money for Berkshire than for myself. It's not going to make any difference to me anyway. I have all the money I can possibly need and way more. Everything is more wound up in how Berkshire does because I'm going to give it all away. I know my end result is going to be zero, and I don't want Berkshire's end result to be zero. I'm on Berkshire's side.

FREE CASH FLOW

Q – Berkshire is generating about $10-$12 billion in free cash flow or $20 billion with changes in deferred taxes. What is the outlook for free cash flow? Expect similar dynamics going forward?

Warren Buffett: – There's a lot of deferred tax that is attributable to unrealized appreciation of securities. I don't have the figure, but let's just assume its $60 billion of unrealized appreciation of securities and $21 billion of deferred tax. Some arises through bonus depreciation. The railroad will have depreciation for tax purposes that's a fair amount higher than for book purposes. Deferred taxes do not provide cash available for use but avoided to have to pay out. Overall, I think primarily of the cash flow of Berkshire relating to our net income plus our increase in float, assuming we have an increase. Over the years, float has added $80 billion plus to make available for investment beyond what our earnings allowed for. We are going to spend more than our depreciation in our businesses – the railroad and Berkshire Energy – for a long, long time. The other businesses, unless we get into inflationary conditions, it won't be a huge swing. Our earnings, not counting capital gains, of around $17 billion, plus our change in float is the net new available cash for Berkshire to invest. But, of course, we can always sell securities and create additional cash or we can borrow money. People didn't appreciate the value of float. What Charlie and I think about, we want to add every year something to the normalized earning power per share of the company. We have retained earnings to work with every year. Sometimes it doesn't look like we have accomplished much and in other years something big happens. It will be lumpy.

Charlie Munger: – There are very few companies who have ever been similarly advantaged. In the whole history of Berkshire Hathaway, we lived with a torrent of money and constantly deployed it. We were rising up as we went along. That's a pretty good system. We are not going to change it.

Warren Buffett: – It's allowed for a lot of mistakes. American business has been good enough that you don't have to really be smart to have a decent result. If you can bring a little bit of intellect, you should get a pretty good result.

Charlie Munger: – You have to be adverse to the standards of stupidity. Just keep those out. You don't have to be smart.

THINKING AHEAD OF THE CROWD

Q –. What elusive truth has allowed you to think ahead of the crowd?

Warren Buffett: – I think I got the question. I owe a great deal to Ben Graham in terms of investing, and I owe a great deal to Charlie in terms of learning a lot about business. I spent a lifetime looking at businesses and why some work and why some don't work…pattern recognition. As Yogi Berra said,"You can see a lot just by observing." That's pretty much what Charlie and I have been doing for a long time. It is important to recognize what you can't do. We've generally tried only to swing at things in our particular strike zone. It's really not much more complicated than that. You don't need the IQ in the investment business that you need at certain activities in life. You do have to have emotional control. We've seen very smart people do very stupid things with unnecessary risks. People do it time after time, self-destructive behavior of one sort or another. It doesn't take a genius to do it, but I think we sort of avoided the self-destructive behavior.

Charlie Munger: – There are a few simple tricks that work well. Temperament that has a combination of patience and opportunism in it is one. I think it's largely inherited, but it can be learned to some extent. Another factor that Berkshire has done so well is we really try to behave well. I had a great-grandfather that when he died, the preacher gave the talk and said, "None envy the man's success won fairly and used wisely." It's exactly what Berkshire is trying to do. There are a lot of people that made a lot of money, and everybody hates them. They don't admire the way they earned the money. I don't believe in the gambling business. We've turned down businesses, including a big tobacco business. I don't think Berkshire Hathaway would work so well if it were just terribly shrewd. We want to have people think of us as having won fairly and used wisely. It works.

Warren Buffett: – We were very lucky to be born when we were and where we were.

Charlie Munger: – Think of how lucky you were to have your Uncle Fred. Warren had one of the finest uncles. I used to work with him, too. A lot of people have terrible relatives.

Warren Buffett: – Just yesterday we had a meeting of all my cousins. There were probably 40 or 50 of us there. They were pointing out some old pictures. I had four great aunts in these pictures. You were so lucky to have one like that, and I had four. In every way, they reinforced a lot of things that needed some reinforcement in my case.

Charlie Munger: – I wish you had a couple more. We'd be doing even better. Warren is a Democrat. I worked for his grandfather, Ernest, and he was earnest. When they passed Social Security which he disapproved of, he thought it would reduce self-reliance. He paid me $2 for ten hours work. There was no minimum wage in those days. At the end of the ten hours, and it was a hard ten hours, he made me give him 2 pennies which was my contribution to Social Security and then gave me a long lecture on social policies and told me about the evils of Democrats and the lack of self-reliance and on and on.

Warren Buffett: The people that we were around when we were young, we were very lucky.

DUE DILIGENCE ON DEALS

Q – Does your due diligence process, which is speedy and usually done within days, an advantage or risk on deals?

Warren Buffett: – I get that question often from lawyers. We would have paid them by the hour for it. We've made plenty of mistakes in acquisitions and making mistakes in not making acquisitions. Mistakes are always about making a proper assessment of economic conditions or the future of the company. They are not the things on the checklist for every acquisition for every major corporation. What counts is whether you really have a fix on the basic economics or how the industry is going to develop or whether Amazon is likely to kill them in a few years.

We've not found a due diligence list that gets at what we think are the real risks when we buy a business. We have made at least half dozen mistakes and maybe more when you talk about mistakes of omission. None of those would have been cured by a lot more due diligence, but may have been cured by us being a little smarter. Assessing whether a manager who I'm going to hand a billion dollars to for his business and he will hand me a stock certificate, assessing whether he's going to behave differently in running that business than he has in the past when he owned it, that's incredibly important. So, if we thought there were items of due diligence, there are a few that get covered, but if we thought there were things that were missing that were important in assessing the future economic prospects of the business, we would by all means drill down on those. When we bought See's, we probably had 150 leases. When we bought Precision Castparts, there are 170 plants. There will be pollution problems at some place. However, the individual plants were not important, but the business prospects 10-20 years from now. I do think it probably facilitates things with at least certain people that our method of operation does cut down the due diligence. You get into squabbles on small things – I've seen deals fall apart because people start arguing about some unimportant point. Their egos get involved. They draw lines in the sand. When we start to make a deal, it usually gets done.

Charlie Munger: – Business quality usually counts for something more than whether you crossed the T on some old lease. The human quality of the management that are going to stay are very important, how will you check that by due diligence? I don't know anyone who has had a better record than Berkshire in judging business quality and the human quality of people. I don't think it would have improved at all by using some different method. We are doing it the way we should.

Warren Buffett: – Negotiations that drag out tend to blow up. People can get obstinate about small points. It's silly to get obstinate, but people get silly sometimes. I like to keep things moving, and I like to show a certain amount of trust because usually trust comes back to you. The truth is there are some bad apples out there. Spotting them will not come from looking at documents. You really have to size up whether that person who is getting a lot of cash from you, how they are going to behave in the future because we are counting on them. That assessment is as important as anything involved. We know all the figures going in and what we will pay. We don't want things to get gummed up in negotiation. If I have the deal in the right terms, I don't believe in winning every point. Tom Murphy taught me not to try to win every point in deal making. Make a decent deal. If you think its bad faith, it gives an indication of the character you're dealing with, then you have another problem. You're lucky if you find that out early.

Charlie Munger: – How many people in this room that are happily married carefully checked their spouse's birth certificate? My guess is our methods are not as uncommon as they appear.

Warren Buffett: – I'll think about that.

SUCCESSION PLANNING

Q – Has there been a change in succession planning with Ajit Jain taking over reinsurance from Ted Montross?

Warren Buffett: – Ted has done a sensational job for Berkshire. Gen Re was a problem child for a while as you know. I tried to get him to stay on longer. As you say, it makes sense to have the reinsurance operation under Ajit. Ajit oversees a company called Guard. We bought it a few years ago. It is based in Wilkes-Barre, PA. It's doing a great job with small business policies. It's flourished under Ajit. He started the specialty operation a couple years ago. That's going gangbusters. I have found with really abled people, they can handle so much. If you have some preconceived notion, at an annual meeting with 40,000 people, that you need to spend millions of dollars with meetings and meetings, but really abled people can do anything. There's no limit to what talented people can accomplish. Anything on insurance, Ajit can handle.

In terms of my succession, we will have a board meeting on Monday. We will talk about it as we always do. Our thoughts are as one on that, and everybody knows why it makes the most sense. Five years from now, something else could make sense. Who knows what happens in terms of the time when it happens? Maybe the person involved their situation changes. There are no tea leaves to read in the fact that Ajit is supervising Gen Re from this point forward.

Charlie Munger: – Not only can the abled people usually do a lot more, but the unabled people by and large you can't fix. You are forced to use our system if you have your wits about you.

Warren Buffett: – We don't feel the need to follow any kind of organizational common view. We try to make the most logical decision. We don't have a grand design in mind, like an Army organization chart, and we never will.

Charlie Munger: – Warren and I once reached a decision that we wouldn't pay more than X dollars for something. A man who was subordinate to both of us said, "You're out of your minds. This is really stupid. This is a quality operation. You ought to pay up for it." We looked at one another and did it his way. We don't pay any attention to titles.

Warren Buffett: – He was right.

Charlie Munger: – We did it his way. He was right.

Warren Buffett: – One time the woman that does clean my office came in. She was kind of wondering what I did. Her name was Ruby. One day she decided to get to the heart of the matter. She said, "Mr. Buffett, do you ever get any good horses?" That's apparently where she thought I was getting my money, at the track.

BERKSHIRE'S CREDIT RATING

Q – Why doesn't Berkshire have the highest credit bond rating?

Charlie Munger: – The rating agencies are wrong and set in their ways.

Warren Buffett: – We don't fit their model very well. We don't look like anything they see otherwise. When they come in the door, I always say let's talk AAAA. I never get any place.

3G AND COST CUTTING

Q – Berkshire formed a partnership with 3G in the Kraft Heinz deal. Why is 3G's cost cutting leading to reduced volume and revenues at Kraft Heinz?

Warren Buffett: – Sometimes you can cut costs that are a mistake to cut and sometimes you can keep costs that are a mistake to keep. Tom Murphy had the best approach. He never hired a person he didn't need, and therefore, he didn't have layoffs. At Berkshire headquarters, we have a similar approach. If you don't need them now, you didn't need them in the first place. At cyclical businesses like the railroads, you may have to cut back on people when volume goes down.

There are all kind of American companies that are loaded with people that aren't doing anything or are dong the wrong thing. My impression from everything I've seen is that 3G in terms of the cost cuts that they have made have been extremely intelligent about it and have not done things that will cut volume. In the packaged good industry, it's true that the volume trends are not good right now. The test will be over time. Are the operations which have had their costs cut, do they do poor in terms of volume that in my judgment look very fat? I see no evidence of that whatsoever. I do think at Kraft Heinz there are certain lines that will decline in volume and other lines will increase in volume. Overall, the packaged goods industry will not go anyplace in terms of physical volume. It may decline a bit. I have never seen anyone run something more sensibly than 3G in terms of taking over operations and getting the costs under control in a hurry. I look at everybody else's figures every month. I'm always looking for any signs of underperformance. I've seen none.

Charlie Munger: – Sometimes when you reduce volume, it's very intelligent because you are losing money on the volume you're discarding. It's quite common for a company to have more employees than it needs, but sometimes is has two or three customers that you would be better off without. It's hard to tell from the outside whether things are going good or bad just because volume is going down a little. I think the leaner-staffed companies do better at everything than the ones that are overstaffed. It's not a plus.

Warren Buffett: – Sloppy thinking in one area probably indicates there may well be sloppy thinking in other areas. As a director of 19 companies over time, I've seen operations that are outstanding and some sloppy ones. There is a vast difference between the two. If you have a wonderful business, you can get away with being sloppy. We could be wasting a billion dollars a year at Berkshire, $650 million after tax, four percent of earnings, and maybe you wouldn't notice it.

Charlie Munger: – I would.

Warren Buffett: – Charlie would notice it. It's the really prosperous companies – a classic case is the tobacco companies many years ago– they went off into this thing and that thing, and it was practically play money because it was so easy to make. It didn't require good management, and they took advantage of that fact.

VAN TUYL ACQUISITION

Q – Are the economics of the $4 billion Van Tuyl deal better than it looks?

Warren Buffett: – You are right. It's better than it looks. We have a billion dollars worth of securities that came with the $4.1 billon deal. Those billion dollars are available to us. There's some very significant acquisition accounting charges that will continue for a couple years. The economics of Van Tuyl have worked out almost exactly the way we anticipated. Van Tuyl has a first class CEO. Take a billion dollars off the purchase price for openers; there are some amortization charges of items that are allowable that make you correctly see a fairly low income figure against what it appears the acquisition price was. So far, the acquisition is exactly on schedule and producing perfectly satisfactory results. We haven't had much luck in acquiring other auto dealerships. People think we paid X. Therefore, they think they are entitled to X. We didn't pay X. We bought very little so far in terms of other auto dealerships. We are not going to change our metrics as far as how we value auto dealerships.

ZERO AND NEGATIVE INTEREST RATES

Q – When interest rates go from zero to negative in a country, how does that affect valuation?

Warren Buffett: – Going from, which we haven't done yet in this country yet, going from 0% to -½%, it's really no different than going from 4% to 3 ½%. It has a different feel to it if you have to pay a half a point to somebody. If you have your base rate reduced by a ½ point, it's of some significance, but it's not dramatic. What's dramatic is the low interest environment generally. We have been with a low interest rate situation for a long time and longer than I would have anticipated. You will pay more for a business when interest rates are zero than when they are 15% when Volcker was around. Very cheap money makes me pay a little more for businesses than when money was what we thought previously were very normal interest rates, and very tight money would cause me to pay somewhat less. We had a rule for 2600 years – Aesop – and it was that a bird in the hand is worth two in the bush. A bird in the hand now is worth about 9/10th of a bird in the bush in Europe. These are very unusual times. If you asked me if I paid a little more for Precision Castparts because interest rates are around zero than if they had been 6%, then the answer is yes. I try not to pay too much more, but it has an effect. If interest rates continue at this rate for a long time, that will have an enormous effect on asset value.

Charlie Munger: – I don't think anyone knows much about negative interest rates. We never had them before. We never had periods of stasis, except for the Great Depression. We didn't have things like what happened in Japan, great modern nation playing monetary tricks, stimulus tricks, mired in stasis for 25 years. None of the great economists that studied this and taught it to our children understand it either. We just do the best that we can.

Warren Buffett: – They still don't understand it.

Charlie Munger: – Our advantage is that we know we don't understand it.

Warren Buffett: – It makes for an interesting movie. It does modestly affect what we pay for businesses – I don't think anyone expected it to last this long.

Charlie Munger: – If you are not confused by negative interest rates, you did not think about it correctly.

IBM AND GEICO RELATIONSHIP

Q – GEICO is working with IBM's Watson. Can you comment on whether they will sell data from their relationship to other insurance companies?

Warren Buffett: – Both parties thought about that matter, very intensively and extensively. Neither would be in a position to talk about it. I don't like to not answer any questions, but there are some things it doesn't pay to answer. Am I right, Charlie?

Charlie Munger: – Of course you're right.

Warren Buffett: – I like that.

AMERICAN EXPRESS

Q – American Express will need to reinvent itself overtime. Shouldn't Berkshire reassess its investment position in American Express?

Warren Buffett: – We reassess reasons for owning all investments on an almost continuing basis. Usually we are in a general sense of agreement, but sometimes we are a fair distance apart. Payments are an area of intense interest to a lot of smart people with a lot of resources.

Charlie Munger: – And rapid change.

Warren Buffett: – I still feel good about owning American Express. Their position and it has been under attack for decades, more intensively lately, and will continue to be under attack. It's too big a business and too interesting and too attractive of a business for people to ignore it. It plays to the talents of some very smart people.

Charlie Munger: – A lot of great businesses are not quite as great as they used to be. The packaged good business, the Procter & Gamble and the General Mills, they are all weaker than they used to be at their peak.

Warren Buffett: – Auto companies.

Charlie Munger: – When I think of the power of General Motors when I was young. They loomed over the economy like a colossus. It looked totally invincible with torrents of cash, and then it went bankrupt. So the world changes? We can't make the portfolio change every time something is a little less advantaged than it used to be.

Warren Buffett: – You have to be thinking all the time to see if something has changed the game in a big way. That's not only true for American Express. It's not that we are not cognizant of price, but assessing the probability of those threats being a minor or major problem, or a life threatening problem, it's a tough game, but it's interesting.

Charlie Munger: – Anyone in payments is facing threats today.

CATTLE INVESTING

Q – A cattle rancher asked about thoughts as it relates to an expanding global population and an investment in cattle. Do you think it's wise?

Charlie Munger: – I think it's one of the worst businesses that I can imagine for somebody like us. Not only is it a bad business, but we have no aptitude for it. It has one good year every 20 years.

Warren Buffett: – There's nothing personal. Some people have done well in it.

Charlie Munger: – One out of every twenty.

Q – I know you guys like steak.

Warren Buffett: – Actually I know a few people that have done reasonably well in cattle. They usually own banks on the side. I wish you the best in it. I'm in Kiewit Plaza if you want to send anything along.

Charlie Munger: – Somebody has to occupy the tough niches in the economy.

Warren Buffett: – We need you.

COMPENSATION INCENTIVES

Q – The power of incentives – how will you compensate the next Berkshire CEO?

Charlie Munger: – I wouldn't worry about the next CEO. Our incentive systems are different. They try to adapt to the reality of each situation. Basic rule is you get what you're rewarded for. If you have a dumb incentive system, you get dumb outcomes. One of our really interesting incentive systems is at GEICO. We don't have a normal profit type of incentive for the people at GEICO.

Warren Buffett: – At GEICO, we have two variables. They apply to well over 20,000 people. You have to be there a year. Anyone that's been there a year knows these two variables will determine bonus compensation. As you go up the ladder, it has a multiplier effect. It gets to be larger and larger in terms of bonus compensation as a percentage of your base. It's always significant.

I care about growing the business and I care about growing it into a profitable business. We have a grid which consists of growth in policies in force, on one axis, and then on the other gird, the profitability of the seasoned business. It costs a lot of money to put the business on the books. We spend a lot of money on advertising. The first year we put any business on the books, it's going to reduce profits. I don't want people to worry about profit that might be impaired by growing the business fast. We've used it since 1995. We put a tiny new tweak in for new business. Everybody understands it. It totally aligns the goals of the organization in terms of compensation with the goals of the owner.

Charlie Munger: – Other people might reward something like just profits. They don't take on new business because it hurts profits. You need to think things through, and Warren is good at designing incentive compensation plans.

Warren Buffett: – Do you reward profits? It would be the dumbest thing you could do. You quit advertising and start shrinking the business a little. People know the very top person is getting paid based on the same two variables. They don't think the guys at the top have a cushy deal compared to them. Interesting thing is if we brought in a compensation consultant, they would come up with plans designed for all of Berkshire. The idea of having sort of a coordinated arrangement for incentive compensation across 70 or 80 businesses is totally nuts. If we brought in somebody, they would be thinking in terms of some master plan and subplans. We try to figure out what makes sense in each business we are in. There are some businesses where the top person is enormously important and some where the business itself dominates. We try to design plans that make sense. One fellow, he wanted to sell his business, but he also wanted to keep running it. I made a deal. I said, "Tell me what the compensation plan should be." He said, "I thought you told me." I said, "No. I don't want a guy working for me that has a plan that he doesn't think makes sense." He told me what made sense, and we've been using it ever since. We never changed a word. Some are very tough businesses, some are very easy, some are capital intensive and some aren't. To think you will have a simple formula that can be stamped out for the whole place, you would be wasting a lot of money, and you would be misdirecting incentives. In terms of the person that succeeds me, I sent two memos to the board with thoughts on that. Maybe I will send a third one. I don't think it would be wise to disclose what exactly is in those letters.

Charlie Munger: – A lot of bad examples of incentives come from banking and investment banking. If you reward someone with some share of the profits, and the profits are being reported using accounting practices that cause profits to exist on paper that are not really happening, then people are doing the wrong thing, and it's endangering the bank and hurting the country. That was a major part of the cause of the financial crisis. The banks were reporting a lot of income they weren't making. The accounting allowed a lender to use his previous historical loss rate – an idiot could make money on giving loans with high interest, accruing interest and saying, "I won't lose money on these since I didn't lose it in the past." It's insane for the accountants to allow that. Nobody is ashamed of it.

Warren Buffett: – You get the very greedy cheap executive who wants an enormous payoff for himself. He designs a pyramid so others get paid, and it doesn't look like he's all by himself in terms of the fantastic payoff he arranged for himself. There's a lot of misbehavior. You saw it in pricing of stock options. I'd hear conversations in a board room. They were issuing options at a terribly low price. You get enough people interested; they may occasionally do something that might cause it. What could be dumber than a company looking to issue shares at a low price? If you were a consultant, you would want to make people think that compensation is very complicated.

Charlie Munger: – We want it simple and right. Those of you with children, if you constantly rewarded every child for bad behavior, the house would be ungovernable in short order.

BNSF CAPITAL EXPENDITURES

Q – BNSF capital expenditures are about 20% of revenues. What are maintenance expenditures?

Warren Buffett: – All railroads merely spending their depreciation expense will not keep them in the same place. We spent a lot of money in 2015 to correct problems. That was when we spent the $5.7 billion. I'd say that the true maintenance is higher than 60% of that number. There is an additional expense at BNSF that is not reflected in the figures. We also have a lot of intangible expenses that aren't real expenses. Overall, I think Berkshire figures are on the conservative side. That's not true at any railroad. We also had something called positive train control investments. I think we may be further along than most of them in paying for that, which will be $2 billion in aggregate for the industry. It is a very capital intensive business. I'd say it's very likely that we will spend more than depreciation – quite a bit more to stay in the same place for a long, long time as will other railroads. That's a negative. We will always be looking for ways for capital expenditure money to develop additional business. We did a lot of that in the Bakken region, and we got benefits from it when oil prices rose – but not as much as we thought we would. I hope we get the opportunity to do more.

Coal volume declining doesn't really have anything to do with our overall capital budget. We would be open to investing more in intermodal, but you have to see a fair amount of revenue coming. We had a proposition we worked on for many years. We would have spent a whole lot more money, if it had been approved. The court came out with a decision that was negative on it.

Charlie Munger: – Our competitors pretend to be environmentalists. It's a common practice now. We were trying to do the right thing, and so far we've lost to the courts.

LOW CRUDE OIL PRICES

Q – A lot of people are losing their jobs due to sharp decline in crude oil. Will this influence monetary policy decisions?

Charlie Munger: – Not much.

Warren Buffett: – It's an important industry. The decline in the price of oil has had a lot of effects. It's very good for the consumer but very bad for some businesses like the one we bought in Lubrizol and some others. It should be good for the United States overall. We are an importer. It's good for the US to have low prices for bananas so it is good to have low prices for oil. Oil extends into so many areas that it also hurts plenty when the price of oil falls. It particularly hurts capital investments. The consumer gets the benefit when they go to the filling station every 2 or 3 weeks. The capital investment contraction is huge if you project out lower price oil for a while. An oil field that was worth X may be worth ½ X or no X overnight. There are certain big factors in terms of our chemical operation, people stopped ordering immediately. The U.S. is better off and Saudi Arabia is worse off. Our economy has continued to make progress despite the oil price decline. Different regions suffer disproportionately.

Charlie Munger: –That will do for this subject.

EXCESS CASH

Q – Why does Berkshire Hathaway have so much excess cash in its Manufacturing, Service and Retailing section of the balance sheet?

Warren Buffett: – We have excess cash at every place at Berkshire. At present, it doesn't really make any difference if it's at certain subsidiaries or other subsidiaries. We have excess cash. We will never go below $20 billion in cash and actually stay comfortably above it. We will have more than $60 billion in cash when the Kraft Heinz preferred matures. We don't really worry much about what pocket it's in. It's not making anything at these levels now. If rates move higher, we've actually got the mechanics in process to do sweep accounts. I'd pay no attention to the particular cash that is being held in that category there. The cash in Berkshire Hathaway Energy and the railroad, we have independent levels that we don't guarantee their debt. They run with ample cash, and we would not look at sweeping that down to a minimum. If we take about 40 or 50 of our miscellaneous subsidiaries, we will go to a sweep account when rates make any difference to do it. When you're getting zero, it doesn't make much difference where you get zero.

Charlie Munger: – One of his ideas is why don't we imitate some of these other people and pay our suppliers more slowly so we have more working capital?

Warren Buffett: – That's a big thing in business now. Last year Wal-Mart went to all of their suppliers, certainly the companies that we supply. They had a list of a half dozen things that they wanted the present suppliers to agree to. One of those things was more extended terms. Each of our companies made their own decisions. My guess is they got more extended terms from most of their suppliers. I don't remember the exact request, whether they went from 30 days to 60 days, but they got a meaningful extension. In a couple of years, you will see higher payables relative to sales at Wal-Mart than you saw a year or two ago. They are under a lot of pressure competing with Amazon and others. It's conceivable that one of our subsidiaries might deem it wise to do it, but I don't think they will. I think the pressure for cash at Berkshire is not that high. I think the desire for great relations with suppliers would probably overcome most of our managers' minds in the desire to start extending terms.

Charlie Munger: – I think it's hard to do that brutally when you're rich, and your supplier isn't and think your supplier is going to love you. There's something to be said for leaning over backward to have a win – win relationship with both suppliers and customers always.

Warren Buffett: – You can argue we have a pretty good thing going in float.

Charlie Munger: – We don't need it. Let someone else set the record on that one.

LACK OF RESTRUCTURING CHARGES

Q – Does Berkshire not incur much in restructuring costs because most of your acquisitions are stand alone?

Charlie Munger: – That's a question like asking, "Why don't you kill your mother to get the insurance money?" We don't do it. We are not interested in manipulating those numbers. We haven't had a restructuring charge ever and we are not about to start.

Warren Buffett: – The numbers would not be huge. They are more conservatively stated than most companies. I think our depreciation expense at our railroad is inadequate as a measure of true operating earnings.

Charlie Munger: – We like to advertise our defects.

Warren Buffett: – Not all of them. I think we will have more amortization and certain intangibles which reduce earnings and reported earnings which in reality are not expenses. I pointed that out. We will have more of that than some companies. We do not report adjusted earnings. Things are good enough at Berkshire that we don't need to inflate the figures.

CREDIT DEFAULT SWAPS

Q – Fixed-income manager asked about premium on Berkshire's credit default swaps (CDS).

Warren Buffett: – We have one position left over from six or seven years ago that involves us selling protection on zero coupon municipal bonds with a nominal maturity value. I think $7.7 billion or something like that. We are sitting with the position because we like the position. Our CDS – that's an insurance premium against our debt that people buy. There is a fair amount of activity in it from time to time. That's partially caused by the fact that we neither collateralized that municipal contract he refers to. I think the counterparties have to buy protection on Berkshire credit through CDS. It's probably an internal rule at some of the firms on the other side of the contract. Back in 2008 and 2009, our CDS prices went up to a crazy level. I even commented at the annual meeting I'd love to be selling them myself except I wasn't allowed to. What goes on in the CDS market isn't really of any particular interest to us. It's too bad for the other guys that they didn't get collateral from us. We wouldn't have given it to them. They have to buy these things. From our standpoint, they are wasting their money.

Charlie Munger: – The truth of the matter is we don't pay much attention by trying to get an extra two basis points by being gamey on our short term things. Credit default position is a weird historical accident, and we don't pay much attention to it either. It will go away in due course.

Warren Buffett: – All of our contracts are just going to expire. There are a couple of places they do certain things. It is peanuts. The positions I instituted six or seven years ago are basically all in a big runoff position.

Charlie Munger: – We don't fool around with our own credit default swaps.

Warren Buffett: – People were paying 5% in terms of betting that Berkshire would go broke. I couldn't take advantage of it. I wanted to.

AJIT JAIN

Q –Please comment on whether there's another Ajit in the house.

Warren Buffett: – There's not another Ajit in the house. It would be very significant if we lost him…Tony Nicely, too, and many other managers who have made billions for Berkshire. It's quite dramatic with Ajit's operations. There were a few years where we had 30 people, where its earning potential under Ajit was fantastic. It probably won't happen to that degree again. Wish it would. He has done a tremendous amount for Berkshire. There have been a lot of managers that created billions and billions of value for Berkshire, and maybe you can get to the tens of billions. Having a fantastic manager that has a large potential business available to them and who makes the most of it, it is huge over time. When you're building capital value, think of the value of Jeff Bezo to Amazon. It wouldn't have happened without him. You are looking at huge values. The value of Dan Burke and Tom Murphy – they didn't invent television. They just managed it so well. Really outstanding managers are invaluable. We want to align ourselves with them. We want them to feel the way about Berkshire Hathaway that we do.

Charlie Munger: – Ajit has a longer shelf life than we do. He would be particularly missed.

Warren Buffett: – Let's not give up here, Charlie. I reject such defeatism.

FLOAT

Q – With your retrocessional insurance business that is booked at a loss, you get to use the float for a long time. Is that the underlying value?

Warren Buffett: – We take the loss with the probability that we will get to use the money for a very long period of time. With today's low interest rates, we couldn't do much with that. For the duration of the kind of contracts we have, we don't expect these low rates to last indefinitely. We do think occasionally, we will get chances, even with low interest rates, to do things that will produce very reasonable returns. We are measuring the potential utility with the unusual flexibility we have for the deployment of the funds at favorable rates. Over a long period, we will have the opportunity perhaps to come up with one or two things where we can deploy the funds at higher rates of returns than today's low interest rates.

Charlie Munger: – We are willing to pay a little money now to have the certainty of having a lot of money available in case something really attractive comes up – it's an option cost.

Warren Buffett: – The option came in handy in 2008-2009.

REAL ESTATE

Q – How do you feel about the real estate market today?

Warren Buffett: – It is not as attractive as it was in 2012. There are certainly – and it's driven by these low interest rates – and there are properties that being sold at very low cap rates that strike me as having more potential for loss than gain. If you can buy for very little, 100 basis points or 150 basis points, there's a great temptation is to do it. I think it's a mistake to do it, but I could be wrong. I don't see a nationwide bubble in residential real estate now. In a place like Omaha, or most of the country, you are not paying bubble prices for residential real estate. It's quite different than it was in 2012. I don't think the next time around the problem is going to be a real estate bubble.

INVESTMENTS BY TODD AND TED

Q – What have been Todd and Ted's biggest investment hits and failures?

Warren Buffett: – I'm trying to think of very big deals that we can do something in, whether is in investments or acquiring a business. Their primary job is working on investments – each has a $9 billion portfolio. One of them has 7 or 8 positions. The other has 13 or 14. They have a very similar approach to investing. They've both been enormously helpful in doing several things for which they don't get paid a dime. They're perfect cultural fits for Berkshire. They are smart at what they do. They are a big addition to Berkshire.

I would say they have a bigger universe to work with. They can look at ideas in which they can put $500 million to work. I'm trying to think of ways to invest sums in the billions. They certainly have more extensive knowledge of activities in certain business and industry that have developed in the last 10-15 years. Their approach to investing is similar. They are looking for businesses that they understand, where they can buy the stocks at a sensible price, and where they think the business will be earning significantly more money five or ten years from now.

Charlie Munger: – We don't want to talk about specific hits and failures.

Warren Buffett: – We file reports every 90 days to show what Berkshire does in marketable securities. We don't get into identifying what they do individually.

CASH IN THE FINANCE SEGMENT

Q – Where did the additional $3.5 billion in cash come from in the finance segment of the business?

Warren Buffett: – I can't tell you where it came from. $3.5 billion, you think I would. We were funneling money into the parent company and the finance company. That money was basically dedicated to making the $22 billion portion of the Precision Castparts purchase. We actually borrowed $12 billion. We pushed money from various sources into those two entities and eventually into the parent company to take care of the $22 billion that was coming due. There's really no significance other than that.

IBM MOAT

Q – How would you explain IBM's moat?

Warren Buffett: – I'm not sure it's a simple question. IBM has certain strengths and certain weaknesses. We don't want to get into giving an investment analysis of any of the portfolio companies we own.

Charlie Munger: – Coping with considerable change in the computer world. It's attempting something that's big and interesting. God knows whether it will work modestly or very well. I don't think Warren knows either.

Warren Buffett: – We will find out if it has the strengths.

Charlie Munger: – It's a field that a lot of intelligent people are trying to get big in.

SENSE OF HUMOR

Q – In your annual shareholders letters and during interviews, your sense of humor always shines through. Where does your sense of humor come from?

Warren Buffett: – It's the way I see the world. It's a very interesting and very humorous place. I think Charlie has a better sense of humor than I do, and I will let him answer where he got his.

Charlie Munger: – I think if you see the world accurately, it's bound to be humorous because it's ridiculous.

Warren Buffett: – Well, I think that's a good note to close on.