

BERKSHIRE HATHAWAY 2015 ANNUAL MEETING NOTES

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We attended the Golden Anniversary Berkshire Hathaway annual meeting held on May 2, 2015, in Omaha, along with a record crowd of more than 40,000 other folks from around the globe who gathered once again for the Woodstock for Capitalists. Warren Buffett, Chairman of Berkshire Hathaway, and Charlie Munger, Vice-Chairman, answered questions from shareholders, analysts and the media. The meeting opened once again with an entertaining movie produced by John Landis of Trading Places that included humorous clips with Buffett and Munger acting with celebrities in skits featuring their brands, and ended with Warren Buffett, as the Berkshire Bomber, in the ring with Floyd Mayweather, welterweight boxing champion, in a parody of Mayweather's fight which was scheduled later that evening with Manny Pacquiao.

Here are my notes from the annual meeting.

FIRST QUARTER RESULTS

Warren Buffett began the meeting with a brief recap of Berkshire Hathaway's first quarter financial results (see our detailed first quarter analysis for Berkshire Hathaway on our website). Book value increased .5% from year end to \$146,963 per A share. Insurance float as of 3/31/15 was approximately \$83.5 billion. Operating earnings increased 20% to \$4.2 billion during the first quarter. Burlington Northern Santa Fe (BNSF) did dramatically better in many measures as Berkshire spent more money on the railroad. BNSF gained market share during the quarter. The trains are running again the way they should with huge improvement over last year.

BUSINESS PRACTICES OF CLAYTON HOMES AND 3G CAPITAL

Warren Buffett responded to the long-term shareholder with heartburn over "predatory lending practices" described in *The Seattle Times* article on Clayton Homes and the moral practices of 3G Capital, which gutted jobs at Tim Horton and Heinz when they took over the companies in partnership with Berkshire. The shareholder wondered what happened to capitalism with compassion historically practiced by Berkshire.

Buffett noted there were important mistakes in the Clayton Homes article. Clayton follows an exemplary pattern and is extraordinary in home building and the mortgage business. The greatest cause of the housing bubble of 2008 occurred when the mortgage holder became totally divorced from the mortgage originator. The mortgage originator sold mortgages around the world and suffered no loss if loans went bad. At Clayton, unlike other builders, mortgages are offered to all buyers of their homes. Berkshire retains roughly \$12 billion of mortgages on 300,000 homes. When a mortgage goes bad, the person who bought it loses and the person that owns the mortgage loses. Since Berkshire retains 100% of the mortgages, they have the same interest as the buyer. Berkshire has no interest in selling anyone a house where the mortgage will default. There has been much talk in terms of possible changes in mortgage rules - not making mortgage loans to people who will get in trouble on the loans. Most Clayton home buyers are lower income buyers who would not be able to have a home without Clayton

financing. At Clayton, they lend intelligently to people who can make payments and keep the house. Clayton is exemplary in doing that. However, about 3% default, which may be due to death, divorce or the loss of a job. In those cases, Clayton loses money, and the person who bought the home loses money. However, 97% of Clayton homebuyers don't default. Buffett advised folks to take a look at the 1200 square foot Clayton house on display at the meeting. For \$69,500, the house, complete with appliances, will be transported and ready to go. The home buyer only needs land, which may cost another \$25,000. This represents a decent value with Clayton putting their own money at risk to help the homeowner finance the home.

Buffett read *The Seattle Times* article, which said Berkshire was making a 20% profit on the homes which he knew was "nonsense." The statement in the affidavit mentioned in the article discussed a gross profit of 20%. The report confused the difference between gross profit and net profit. Net profit includes operating expenses and taxes. Clayton's gross margin is 20%, however, the pre-tax margin is 3% and the net profit margin is just 2%. Clayton always provides buyers the lending terms available from a variety of lenders. Buffett displayed a copy of the one-page document with no small print on it with a list of four or five lenders. Buffett exclaimed that he makes no apologies about Clayton's lending terms, noting that he has not received one call from any party in connection with a Clayton home complaint in the last three years.

Buffett noted that Clayton Homes is regulated in almost every state. During the last three years, they have had 91 examinations by various states to make sure they conform to state laws. The largest fine from all the exams has been \$5,500 with \$110,000 issued in refunds. Most borrowers have FICO scores below 620, with the average principal and interest payment approximating \$600 a month. Buffett concluded that he is proud that Clayton Homes' management has put 30,000 people into homes at a low cost. A high percentage of those folks will have their homes paid off probably in 20 years or less. Clayton Homes have been a real bargain.

Charlie added that he did not know much about the lending practices of Clayton Homes. He did acknowledge that they sold an enormous amount of homes and had 50% market share among manufactured homes, which is a very efficient way to create houses. He also noted that Clayton is a very productive part of the economy. He stated, "You can't make lending to poor people buying houses 100% successful."

Buffett agreed as death, divorce, and loss of a job impacts the financial ability to make mortgage payments –noting it happens with high-priced houses, too. It happens to people living on the edge. During the 2008/2009 recession, the default rate on regular homes in all kinds of securitized deals was many times more than what happened at Clayton Homes.

Turning to 3G management practices, Buffett said 3G people are successful in building marvelous businesses. They entered into purchases where there were more people running the business than needed. After a reduction of people needed, the companies did well. Burger King outgrew its competitors by a significant margin. Buffett stated, "I don't know any company that has a policy that says we will have a lot more people than we need. I hope our Berkshire Hathaway companies are not being run with more people than we need."

Charlie agreed that businesses need to be right-sized. He explained what happened in Russia. Some workers said, "They pretend to pay us, and we pretend to work." With that approach, an economy does not work. Charlie concluded, "Of course, we want the right number of people in the right number of jobs."

Buffett recounted that in the past, 1.6 million people worked in the railroad business which was a lousy business. Today, less than 200,000 folks work in the railroad business, which is now carrying more freight, covering more distance and doing it in dramatically safer conditions. Buffett concluded, "Efficiency is required over time in capitalism. I tip my hat to the 3G people."

In another question on whether 3G management methods were congruent with Berkshire's methods, and whether 3G management would cut jobs at Berkshire if they managed Berkshire's business, Buffett commented that GEICO, with 33,000 employees, is run just as efficiently as 3G. They don't believe in having extra people around. Buffett noted that Berkshire newspapers had to cut back employees, and that Berkshire cut back employees in the textile business in the early days of the company. Buffett acknowledged that some Berkshire businesses may have more people than needed, but they do not believe in running fat operations. Berkshire's owner manual never endorses running a business at a loss to have excess people around. Buffett boasted, "Our corporate office has 25 people!"

Charlie grumbled, "We've almost exhausted this topic. Waves of layoffs frighten people. What would our country do if we kept everyone on the farm?" Businesses need to be right-sized.

VAN TUYL ACQUISITION

Buffett was asked whether Van Tuyl will need to adapt to a new mode of selling cars versus the traditional dealership model of selling cars.

Buffett responded, "If change is required, it will be made." The one-price selling method has been experimented with before with no negotiating and no haggling. When you implement that system for some reason it breaks down. Negotiation is going on in a lot of businesses. Van Tuyl will adapt to what the customer wants. There is no problem at all if the world goes in that direction. However, Buffett noted he wouldn't be surprised if the system remains the same for the next 5-10 years. He thinks Berkshire Hathaway Automotive, the new name for Van Tuyl, will be quite profitable and important to Berkshire Hathaway. Buffett noted that people want to negotiate when dealing with a big ticket item, whether it is cars, jewelry or real estate. He concluded, "We will do fine, whatever direction it goes."

Answering another question on the synergies of acquiring more dealerships, Buffett said there are not huge advantages in owning lots of dealerships. Running dealerships well is a good business. Dealerships are local businesses with 17,000 dealers in the country. Berkshire will be buying more dealerships but on a local basis. You don't widen profit margins by having 1,000 dealers vs. having 100 dealers or having just one. While Berkshire is able to borrow money at a low price, they do not plan to be in the auto finance business. Wells Fargo has a huge advantage as the largest provider of auto loans. Berkshire can't come up with money as cheaply as the banks. They just hope that they run the local auto dealer operations very well.

Charlie added that Van Tuyl has a system of meritocracy--getting the right people into power and ownership. He said Van Tuyl and Omaha-based Kiewit are "kissing cousins" in terms of culture. They both have a very good thing going for them with the right people prospering.

In a related question on whether there may be national synergies between Van Tuyl and GEICO, Buffett said he didn't think so. Most of the time synergies do not work especially with auto dealers and insurance. If Berkshire were to try and create synergies, they would probably have to compensate people that made the insurance sales. GEICO is a wonderful low-cost business model with its success dependent on delivering low costs and first-class service. The two companies will do better operating independently.

Charlie said. "I agree it's a dumb idea and we are not going to do it."

CHARACTERISTICS OF A GOOD COMPANY

A shareholder asked if there were five characteristics of a company that gives one confidence to predict its earnings 10 years out in the future?

Charlie responded, "We don't have a one-size fits all. Every industry is different. We keep learning. What we did 10 years ago, we hope we are doing better now. We can't give you a formula."

Buffett added that many items are considered before making a purchase. Most of their filters stop them from buying a business. Very different filters apply to different business, but they try to get a reasonable fix on what the business will look like in 5-10 years. It's not the same five questions. However, one question is, "Do we really want to be in a partnership with the management of this business?" If not, that will stop any further consideration. Buffett laughed, "We don't have a list of five. If we do, Charlie has kept it from me."

In response to a similar question, Buffett said he looked for companies where he thought he could understand what their future was like. He added, "We had to know our limitations. We stayed away from a lot of things." At the time, prices were different. It was a much easier decision than it is now. During the early years, Buffett said, "We kept reading and thinking, looking at things that came along, and in those days we were capital constrained. We usually had to sell something if we were to buy something else. We probably leaned toward things that we were certain to get a decent result than hopeful of getting a billion dollar result."

With regard to the GEICO acquisition, Charlie added, "We had some good fortune. Not every 20-year old was going to buildings in Washington. We made some of our luck." "Getting your own nose whacked hard also helps," he chuckled.

Buffett agreed noting that they thought they knew more than they did about the Baltimore department store business that did not work out well for them. He stated, "We've had a lot of

experience with bad businesses which sharpens your ability to make a distinction between good and bad ones. If you enjoy what you're doing, you're likely to get better results.”

Charlie concluded, “We owe a considerable amount to the families we were raised in.”

CONVINCING EARLY INVESTORS

A similar question asked, “How were you able to persuade your early investors besides family and friends to overcome doubts and fears and believe in what you're doing?”

Buffett joked, “We didn't do very well prior to getting a winning record. I started selling stocks when I was 20. I looked like I was 16 and behaved like I was 12.” People joining Buffett early on as investors were family and friends. They had faith in him. His father-in-law was a dean at the University of Omaha and gave Buffett everything he had to manage. They knew he had done reasonably well by 1956. He had about \$175,000 at a young age so they figured he was doing something right, and they gave him their money. Ben Graham was winding up his partnership and recommended Buffett to his investors. A year or two later, a doctor family friend called and introduced Buffett to Charlie. At the time, Charlie was practicing law. Buffett told him law was all right for a hobby, but a lousy business.

Charlie stated matter-of-factly, “Of course, that's the way you start [with family and friends]!” The people that avoided being “perfect idiots” and followed the Graham & Dodd investment path have all done well.

IBM

Charlie was asked if he tried to talk Buffett out of buying IBM.

Charlie emphatically said, “No!” He added that Berkshire has owned lots of companies with temporary reversals, and that IBM is a very interesting company. It's very rare when technology changes comes along that people adapt as well as IBM. Personal computers have been a mixed bag. However, IBM is an enormous enterprise and admirable.

Buffett said, “When we bought IBM, it was a 2-0 vote.” Buffett noted that they get asked questions about investments we own. However, they have no interest in encouraging other people to buy what they buy. He asked, “Why would we want the stock to go up if we're going to be buying more in a year or so?” He joked, “If we were talking our book, we would say pessimistic things about our Big Four investments as they all are buying back their shares.”

In classic Charlie fashion, Charlie chimed in with this zinger, “If people weren't often wrong, we wouldn't be so rich. “

INSURANCE SUCCESS AT BERKSHIRE

Buffett noted he had three pieces of extraordinary luck in establishing a successful insurance business at Berkshire:

- 1) When he was 20 years old, he traveled to Washington DC on a Saturday morning and banged on GEICO's door until a janitor opened the door. The only fellow working there was Lorimer Davidson, the CEO, who was willing to spend four hours with a 20-year old kid, explaining the insurance business to him. Buffett said he couldn't have gotten better lessons than that in business school.
- 2) In 1967, Jack Ringwald got mad about something and wanted to sell his company. That is how Buffett bought National Indemnity. He said he couldn't have done it an hour later as Ringwald would have likely changed his mind as he had done in the past.
- 3) In the mid-1980s, on a Saturday, a guy came in the Berkshire office looking for a job, who had never worked in the insurance business. Buffett hired Ajit Jain and asked how lucky can you get?

Buffett asked what are the odds of pulling off a trifecta like that? The insurance business was in a sweet spot of a business Buffett could understand. He said it is important to keep yourself open to good business ideas as they come along.

Charlie added that Berkshire created its reinsurance business in Omaha, and it has turned into a huge business.

BERKSHIRE CULTURE

When a German investor asked how Berkshire's culture will be maintained, Buffett simply stated, "You will be pleased with Berkshire's culture after we are gone." Berkshire's culture runs as deep as could be in any large company. Buffett explained how Berkshire recently closed on a German transaction in which the family lovingly built a business over 35 years that owned retail shops, dealing with motorcycle owners. After the husband died a couple years ago, the wife wanted to sell to Berkshire Hathaway because of its culture. That wouldn't have been the case 30-40 years ago because Europeans would have been unaware of Berkshire's culture.

It is a vital part of Berkshire Hathaway to have a deeply embedded culture. It is even reflected in Berkshire shareholders, where 97% of them voted against a dividend. Berkshire directors also reflect the culture as they see their role as a great opportunity for stewardship, rather than serving as directors for the money. People who join Berkshire believe in the culture. People that shun Berkshire don't believe in it. Buffett is "virtually certain" that Berkshire's culture will continue and become stronger as it has become self-reinforcing over the years. It's institutionalized. No one will doubt that it will last for decades.

Charlie added that Berkshire has had a hard time buying companies in Europe. Traditions are different in Europe than in the U.S. and some other countries. Germany has a long tradition of being good at technology and capitalism. Charlie stated, "We admire the way Germans have performed. They work fewer hours and produce a lot more. Of course, Warren and I are pretty good at that. We admire the Germans, particularly the engineers."

Buffett agreed but said that he thinks Berkshire is now more on the European radar screen as a potential acquirer than they were a few years ago. He said he'd be surprised if Berkshire doesn't make more deals in Germany within the next five years. He said Berkshire needs a

business they understand. Berkshire has the money, and European prices may be a little more attractive. There's a reasonable chance something might get Buffett's attention in Europe given comparatively more attractive valuations than in the U.S.

Charlie added, "Berkshire will do fine after we are gone. In fact, it will do better in dollar terms. We will never gain as much in percentage terms as we did in the beginning years. There is a worse tragedy than having Berkshire's growth slow a little."

Buffett laughed, "Name one!"

Buffett responded to another question on culture, by saying culture is everything at Berkshire. He added, "Berkshire isn't a monastery, but I can guarantee that Charlie and I and the other managers are more concerned about getting a good job done for Berkshire than what they get out of it themselves." Culture has to come from the top. It has to be rewarded when followed and punished when not. It has to be reinforced over the years. It takes a long time to become solid. It is like a grain of sand over time, just like a child following a parent's behavior. It's much easier to do it if you inherit a culture you like. It is also easier to establish a culture in smaller companies.

Buffett noted that they have over 340,000 people working for Berkshire. There's some 12, 15, maybe 100 folks that are doing something they shouldn't be doing. As soon as a manager finds out about it, they have to do something about it. He recounted how when Berkshire bought Kirby vacuum cleaners, there were sales practices they didn't like, particularly with older people. They changed the policies so that if you were over 65 and you bought a Kirby, and for any reason you didn't like it, you'd get all of your money back.

GEICO will settle millions of claims. When two people are in an auto accident, they don't agree 100% of the time on whose faults it is. Buffett noted that Berkshire is far from perfect, but in all activities they try to behave as if their roles were reversed.

Charlie added that they always are dissatisfied with what they do. The ability to keep learning is what makes the culture work. He concluded, "If we stayed frozen in time, particularly Warren, it would have been a terrible place."

SUGAR CONSUMPTION

With society attuned to greater sugar consumption in rising health costs, Buffett was asked whether this was narrowing the moat around Coke, Heinz and Kraft.

Buffett answered that Coke has an enormously wide moat, despite current trends. Buffett said 1.98 billion 8 oz. servings of Coke products were consumed in the world today. All food and beverage companies will adjust to expressed preferences of consumers as they go along. No company does well ignoring consumers. Twenty years from now, there will be more Coke cases consumed than there are now. In the 1940's, folks also said Coke's growth was over. In 1988, when Berkshire bought its Coke shares, people again were not enthused over the company's

profitability. Buffett noted that a quarter of the calories he consumes each day come from Coke. He joked, "If I'd been eating broccoli and Brussels sprouts, I wouldn't have lived as long. It would be like going to jail when I approached meals."

Charlie said sugar is an enormously helpful substance that prevents premature softening of the arteries. He dryly added, "If it shortens my life, I've avoided a few months dribbling at a nursing home."

Buffett remarked, "I have enjoyed every meal I had except at my grandfather's when he made me eat those damn green vegetables." Buffett noted while there have been shifts in preferences for food; it is remarkable how durable some foods are. Berkshire Hathaway was the largest shareholder of General Foods 30-plus years ago. Those same terrific brands are at Kraft today. Heinz brands go back to 1869. Ketchup came out in the 1870s. Coke brands go back to 1886. It's a pretty good bet a lot of people will like the same things decades from now. Buffett joked, "When I compare drinking Coke to something that someone would sell me from Whole Foods, I don't see smiles on the people at Whole Foods." Buffett concluded, "I like the brands we are buying."

STOCK MARKET VALUATION

A shareholder noted that several valuation metrics Buffett has mentioned before such as market capitalization as a percentage of GDP and corporate profits as a percentage of GDP are at high levels. He asked if Buffett thought overall stock market valuations were too high?

While profits/GDP might be a concern for segments of society, Buffett remarked that American business has done well in recent years, despite the "terrible" disadvantage of U.S. tax rates claimed by many companies. The fact is American business has prospered incredibly. The stock market capitalization/GDP is very much affected by the fact we live in an interest rate environment that many would have thought was impossible with extremely low interest rates in the U.S. and negative interest rates in Europe. Profits are worth a whole lot more if the Government bond yield is 1% than if the yield were 5%. The opportunity cost is owning bonds earning practically nothing or stocks. Investors need to look at stock values in the context of a world with incredibly low interest rates and determine how long low interest rates will likely prevail. If interest rates remain low for decades like they did in Japan, stocks will look cheap. If interest rates revert to normal levels, stock valuations would appear high.

Charlie asked, "Since we failed to predict what did happen, why would anyone ask us what our prediction is for the future?"

Buffett said they don't make deals based on macro factors. He can't recall a time ever where Berkshire turned down an acquisition due to macro factors. He said, "We know we don't know what the next 12 or 24 months will look like." It really doesn't make a difference if Berkshire is holding a good business. The important consideration in making acquisitions is determining how strong the competitive moat of the business is and what will be the profitability over time. He joked, "We think any company that has an economist has one employee too many."

RAILWAY SAFETY

Buffett was asked about new government regulations on transporting crude oil by train and improving the safety of tank cars.

Buffett responded that the rules came out two days ago, and he had not read the 300 pages yet. He said Berkshire has an interest in developing safer cars. As a common carrier, BNSF is required to carry things they may not like to carry as these products have to be transported. The most dangerous kinds of things BNSF carries include chlorine and ammonia, which are more dangerous products to carry than oil. Buffett said that probably everyone will be somewhat unhappy with the new rules, but it is up to the government to develop rules for transportation. Transporting by pipeline has problems and transporting by rail has problems. BNSF's safety figures get better year after year and lead the industry. Derailments will still occur as nothing will be perfect.

Charlie added that Burlington Northern, Exxon and Chevron have a lot of engineers that know how to make things safer. Safety will be improved consistently and should be. Buffett added that Berkshire Energy has an extraordinary safety record.

Charlie recounted how after Berkshire bought the Omaha pipeline, they watched Berkshire employees work day and night improving safety. Buffett exclaimed, "We went from last to first or second!"

INSURANCE COVERAGE FOR RAILROADS

Given concerns over rail accidents in urban areas, Buffett was asked if Berkshire offers insurance coverage to the railroads.

Buffett said Berkshire's reinsurance unit went to four major railroads offering high limits, something like \$5-\$6 billion, in excess insurance coverage. There's no question, if you have the exact wrong circumstances, the possibility exists that a worst-case scenario can happen. To minimize risks, regulations require that trains run slower in urban areas with speed limits brought down to 35 miles an hour. While the industry is always working to be safer, it will never be perfectly safe. While BNSF has some insurance, Berkshire has the capability to handle any loss that comes along. Berkshire is more likely to offer insurance to other railroads. However, the other railroads did not like the rates Berkshire offered and have not bought it.

Buffett said Berkshire will not be buying 5,000 rail cars. The Marmon operation has taken on new facilities. They will be working three shifts on retrofitting rail cars and manufacturing new cars. The industry has been waiting to see what the new regulations will require. During the first quarter of 2015, practically no tank cars were ordered. Historically, the railroads have never owned tank cars, but instead leased them. This will likely continue.

SUBSIDIARY COMPANIES

Buffett was asked about the recent movement of subsidiary companies within Berkshire insurance units.

Buffett responded that they have a huge chunk of capital at National Indemnity. Berkshire moved certain subsidiaries up to the parent company as an extra layer of capital there makes it simpler in keeping all money invested.

GENERAL ADVICE TO YOUNG INVESTORS

When asked by a young investor what advice would you give to someone trying to network with influential people, Charlie curtly said, "Do the best you can."

When asked how to go about building a good reputation, Charlie said it takes a long period of time to build a good reputation. Most of us have to acquire it slowly. There is hardly anything more important than behaving well as you go through life.

Buffett said when you get old, you'll have the reputation you deserve. For a while you can fool people. The same applies to companies. A good reputation has helped Berkshire a whole lot. Berkshire has earned the reputation to be a somewhat different company. It has worked out that way.

When asked by a young investor how do you make lots of friends and get people to like you and work with you, Charlie laughed, "I was pretty obnoxious when I was your age and asked impertinent questions. The only way I could get people to like me was to get very rich and very generous."

Buffett joked, "Both Charlie and I were on the obnoxious side early on. I had some pretty good teachers. They were people I admired. If you want to be admired, take on some qualities of those you admire. Look around you at the people you like in your school, write down those qualities. Decide to be like a person that you like. If you don't like things in other people, get rid of that in yourself."

Buffett added when picking a marriage partner, the most important thing is not to look for intelligence or humor, but look for someone with low expectations.

With household formations below par, a shareholder asked if this was a secular change or a cyclical change. Will the U.S. become more like Europe where young folks live with their parents?

Buffett said it was more likely a cyclical change. Household formations have turned up. They always turn down during recession.

Charlie chuckled, "I have some grandchildren that I wish would marry someone suitable promptly."

When asked a question on saving, Charlie retorted, "If you don't know how to save, I can't help you."

Buffett said you need to develop good saving habits early on. They make an enormous difference in your life. Berkshire's goal is to present good saving habits in an entertaining way to young kids through a cartoon series, and he think it's actually having a good effect.

Encouraging good habits in your children early on with respect to money can change their lives. You can't start young enough on working on good money habits.

ASIAN INFRASTRUCTURE INVESTMENT BANK

A shareholder noted that currently the U.S. is not a member of the Asian Infrastructure Investment Bank while many European countries are. The shareholder wanted to know how that will impact U.S. multinational companies.

Buffett said he knew nothing on the subject and added, "Let's hope Charlie knows something about that."

Charlie grunted, "I know less than you do."

DOLLAR AS A RESERVE CURRENCY

Buffett said he thinks the U.S. dollar will be the world's reserve currency over the next 50 years.

Charlie said he is more nervous than many about the U.S. printing so much money and spreading it around in a helicopter.

BERKSHIRE HATHAWAY BRAND

Berkshire Hathaway has been rebranding many units like their energy, home services and auto units using Berkshire Hathaway in the name. Buffett was asked whether this could lead to reputational risk and whether Fruit of the Loom would be next and become Berkshire Hathaway undergarments?

Buffett acknowledged that they did create a Berkshire Hathaway home service operation, which is a franchise operation. Two years ago, they acquired 2/3 of the Prudential real estate operations with a contract to buy the remaining 1/3 of the operation. Since Berkshire was going to lose the right to use the Prudential name over time, they rebranded the operations with the Berkshire Hathaway name. Greg Abel asked about using the Berkshire Hathaway name for the diverse energy operations. With the Van Tuyl auto dealerships also being franchise operations around the country, it made sense to rebrand that operation using the Berkshire Hathaway name. Buffett said if they started hearing abuses from individual franchises, they would yank the Berkshire name from them to avoid any reputational risk. He had no ideas to make Berkshire Hathaway a household name. He added many of their companies use the tag line, a Berkshire Hathaway company. He said the Berkshire name will not turn into a huge asset.

Charlie added that brand names are worth a lot of money, but they would be crazy to try and sell Berkshire Hathaway peanut brittle instead of See's Candies, which has great value in their brand.

Buffett noted there will always be fights between retailers and brands. The brand has to stand for something in the consumer's mind. Private label has been around forever. Buffett recalled when Sam Walton sent him the first six-pack of Sam's cola. A brand needs to be nourished. RC Cola came up with the first diet product in the '60s. Despite private brands, Gillette ends up

with 70% of the dollar value of razors thanks to their strong brand. It is important to protect the brand in all ways. The great brands will survive.

RENEWABLE ENERGY

Asked whether distributed energy will be a threat to Berkshire's utilities, Buffett said distributed energy is something Berkshire pays a lot of attention to. The best defense is to have very low cost energy. MidAmerican has done a very good job of that. The figures in terms of people who converted to solar energy are minuscule. Huge improvements in solar storage would make a difference.

Charlie said we will use a lot more renewable energy. Fossil fuels won't last forever. Berkshire is aggressive and very well located in terms of renewable energy. To have 20% of power in Iowa coming from the wind is very desirable. Farmers like the extra income they get from wind power. While we need better storage, the technology has been improving. Renewable energy is not a threat but a huge benefit to humanity and to Berkshire. Charlie asked, "What the hell would we do when the fossil fuels are gone if we didn't have this?" There will be some disruption but more opportunity.

Buffett asked Greg Abel, the head of Berkshire Hathaway Energy (BHE), to comment on the topic.

Greg said Berkshire Hathaway Energy recently announced their 10th wind project in Iowa, with 58% of the energy that they provide to Iowa customers coming from wind in 2016. BHE now has more than \$18 billion committed to renewable energy capital expenditures. At NV Energy, they are committed to retiring 76% of their coal by 2019 and replacing it with renewable energy. Distributed generation will bring great opportunities to Berkshire which will embrace it.

Buffett explained that wind and solar power at present are dependent on tax credits. The market system would not produce solar or wind under today's economics. Because Berkshire Hathaway Energy is part of Berkshire Hathaway's consolidated tax return, it has been able to invest far more money in renewable energy than other utilities to take advantage of the tax credits. Among electric utilities in the U.S, MidAmerican Energy is very well situated.

MOST MEMORABLE FAILURE

Buffett was asked to reflect on the last 50 years and describe Berkshire's most memorable failure?

Buffett explained that he has discussed it many times in the annual report. Back in the mid-1990s, he acquired Dexter shoe business for \$400 million. The business value eventually went to zero due to competition. Even worse, Buffett paid for Dexter with Berkshire stock that would be worth \$6-\$7 billion today. He joked that he now likes to see Berkshire stock go down due to his stupidity. He said nobody at Dexter misled him in any way. He simply came up with the wrong answer. He added, "Any time we issued shares, it has been a mistake, right Charlie?"

Charlie agreed and said that is why they don't do it much anymore.

Buffett said another failure was that they probably could have pushed harder in earlier years. However, they had all of their own net worth and their families' and friends' net worth in the company. He said they have been very cautious in what they have done. They could have stretched a little. However, he said he would rather be 100 times too cautious and miss opportunities rather than take a 1% chance of wiping out his family's net worth. People looking at Berkshire's past will say they missed some big opportunities.

Charlie agreed by saying, "If we had used leverage, Berkshire would be a lot bigger. But we would have been sweating at night. It's crazy to sweat at night."

Buffett quickly quipped, "Over financial things!"

INFLATION

When asked about inflation, Buffett said he has been very wrong about interest rates. He would not have predicted that we could have 5 or 6 years with such low interest rates and/or negative rates. He added that 2%-3% deficits are sustainable, which is where we are now. However, the Federal Reserve has expanded its balance sheet from \$1 trillion to \$4 trillion since the financial crisis. So far nothing bad has happened other than savers have been killed by low interest rates.

He said, "We are operating in a world that Charlie and I don't understand. Berkshire will do better than most companies. We are prepared for anything. If we see unusual opportunity, we are prepared to act. We are sitting with over \$60 billion in cash now. We will be very willing to act if economic turbulence of any kind occurs."

Charlie said, "We have made very little progress in life trying to outguess macroeconomic factors." He added that the trouble with making economic pronouncements is that people think they know something. He snorted that it is better to say, "I'm ignorant."

Buffett concluded that Berkshire is prepared psychologically and financially no matter what happens.

A related question asked which businesses are the best to own in an inflationary environment. Buffett responded the best business is one that you buy once and subsequently do not have to keep making capital investments. Real estate in general is a good example. If you built your own house or bought one 55 years ago, it was a one-time outlay. You then get an inflationary expansion in value. At businesses such as utilities or railroads, they keep eating up more money with depreciation charges inadequate during inflationary times. Any business with a heavy capital investment tends to be a poor business generally. A brand is a wonderful thing to own during inflation. See's Candies built their brand years ago. The value of a brand increases during inflation, as do any strongly branded goods. Gillette bought the entire radio rights to the World Series in 1939 for \$100,000 when they broadcast the Yankees vs. Reds. Impressions of Gillette products were made during the Series that lasted for decades. A great investment that

was made in 1939 dollars paid off in 1960-1980 dollars. Similar impressions on millions of minds now would cost a fortune.

Charlie agreed but said if inflation ever gets completely out of control, we have no idea how it would end up. The twosome of great inflation followed by the Depression brought us Hitler. He stated, "We don't want inflation because it's good for See's Candies."

DEFERRED TAXES

Buffett was asked if Berkshire's \$37 billion in deferred taxes should be viewed as permanent float. Buffett said that Berkshire's unrealized appreciation of securities is part of the deferred taxes. These gains could be realized over time. Accelerated depreciation has been around a long time in the utility business. Because of deferred taxes, less money goes out the door so Berkshire does not have to borrow as much. However, Buffett doesn't think Berkshire benefits enormously from deferred taxes. It is not a hidden form of equity.

Charlie added that if corporate tax rates change, it would be a book entry and not mean much.

Buffett concluded that the float from the insurance business is a terrific asset but deferred taxes not so.

TELEDYNE AND HIDDEN INCENTIVES

Buffett was asked what he learned from the unwinding of the Teledyne conglomerate. Buffett said he learned a lot from watching Henry Singleton, the CEO of Teledyne.

Charlie added that Singleton was a lot smarter than either of them. He played chess blindfolded. However, Buffett did better than Singleton in investing as Buffett was always thinking about securities. Charlie laughed, "Warren was able to get by with his horrible deficit in IQ to Singleton." Singleton had very clever incentives for key executives. In the end, he had three different departments get into scandals. They went too far in dealing with the government due to the wrong incentives being put into place.

Buffett added that they believe in the power of incentives. However, they try to avoid hidden incentives that make people misbehave. He noted that they have seen more than once really decent people misbehave because they felt there was a loyalty to their CEO to deliver certain numbers. At Berkshire, they try to eliminate incentives that would cause people to misbehave for financial rewards or ego satisfaction.

Charlie noted at the end, Henry wanted to sell Teledyne to Berkshire for Berkshire stock. He chuckled, "He was smart to the end."

Buffett recounted a story about Jack Ringwald of National Indemnity, who was a marvelous man. Ringwald's good friend and tennis partner at the firm was in charge of processing claims. When his friend would come into Jack's office to tell him he had received an insurance claim of \$25,000, Jack would start berating the fellow by telling him the claims were killing him. Jack was joking, but the fellow started hiding the claims because he didn't want to face the tirades they caused. This caused the company to misreport its results. The fellow had no financial

interest to misbehave, but he just didn't like Jack kidding him about failing him. Managers need to be careful about the messages they send employees. If you tell your managers you never want to disappoint Wall Street, they start fudging figures. Berkshire tries to avoid all that.

In a related question on setting incentives to encourage long-term thinking, Buffett said they run Berkshire by thinking of the next 100 years. The managers know they are making decisions for the long term. While they don't ignore the short term, they know what really counts is where the company will be in the next 3-10 years and not where it is now.

IS BERKSHIRE TOO BIG TO FAIL?

Buffett noted that European regulators are looking at insurers generally in terms of whether they are systematically important financial institutions (SIFI), or in other words too big to fail. Nine or so insurance companies deserve special attention. The Financial Stability Oversight board is looking at large banks in the U.S. and companies like GE and Met Life. No one sees other large companies like ExxonMobil, Apple or WalMart as SIFI. The definition of a non-bank SIFI would be that 85% of revenue comes from financial matters. At Berkshire, only 20% of revenues do. The real question is whether problems at Berkshire could destabilize the financial system in the country. Berkshire has not been approached about being a SIFI, and there is no reason in logical terms to think Berkshire would be designated as a SIFI. Berkshire will always conduct their business in a way that the problems of others can't hurt them in a significant way. During the financial crisis, Berkshire was the only party supplying help to the financial system with their investments in Goldman Sachs and GE during the heat of the crisis. Berkshire is unique in terms of the safety they have built into their operations in terms of cash and everything else. It's a moot question. Buffett said, "I don't think Berkshire Hathaway comes within miles of qualifying as a SIFI."

Charlie added that there is still too much risk in much of high finance. Trading derivatives is a lot like running a bucket shop or gambling parlor. It is nonsense that derivatives help spread risk. There is still danger in the financial system. He said, "Our competitors don't like it that they deserve regulation, and we don't." There is danger in that, too.

Buffett added that the new Dodd and Frank regulations actually weaken the power of the Fed and Treasury in terms of the actions they took in 2008. Those powers were needed to keep our system from going into utter chaos. It was important that folks believed the central banks when they said whatever needs to be done will be done. The fact that people believed Hank Paulson when he said money market funds wouldn't break the buck due to government guarantees is what kept the financial system from going down in a panic. You need someone to believe or panics will accelerate like you wouldn't believe. Bernanke and Paulson kept the panic from accelerating during the financial crisis. In the old days, banks would have to pile up gold outside of the bank to prevent panic and runs on the bank. Dodd and Frank regulations weaken the government guarantees terribly.

ONLINE WORKERS' COMPENSATION INSURANCE

When asked about online workers' compensation insurance, Buffett said they will find out what the consumers want. Berkshire is experimenting with online workers' compensation insurance. He doesn't think the channel conflict is a big problem. GEICO has done well with online auto insurance. Berkshire also writes commercial auto insurance through GEICO. Selling insurance changes over time. With GEICO, they went from selling auto insurance through direct mail to TV and the phone and then to the Internet. The world moves on. The key in selling insurance is to save people money and provide good service. Whatever method does that in the most effective way will be what wins.

VALUE INVESTING IN CHINA

When asked if value investing applies to China where markets have doubled, Buffett said investment principles don't stop at borders. The same investment principles should be applied to investing in China or anywhere else. Investors should focus on looking at a stock as a business and seek to own high quality businesses with competitive advantages over the next 5-10 years. Investors should also look at volatility in the stock market as opportunities.

Charlie noted there is history of great volatility in the Chinese stock market. When things get bouncy, China looks a lot like Silicon Valley. The more China copies the way Berkshire invests, the better it will be for China.

Buffett advised young Chinese investors to stand back and value stocks as businesses. It's an easy game if you can control your emotions. Invest when stocks are cheap and sell when others become enthused. The Chinese market may be more speculative than the U.S. which lends itself to greater extremes but this should produce greater opportunities.

Charlie said he thinks China would be wise to dampen the speculative booms. He added that value investing will never go out of style. He asked, "Who in the hell doesn't want value when you buy something?" It looks easier, but it's harder.

Buffett said that investors should buy based on a long-term perspective. No one buys a farm thinking they are going to make money on it the next week.

OPTIMISM ON THE U.S.A.

A shareholder asked Buffett how he remained optimistic on the U.S. with the risk of chemical, nuclear, biological and cyber security problems, a term Buffett has sometimes dubbed as CNBC.

Buffett admitted there are great threats to the U.S. but also noted that we have a terrific economic system that unleashes the brains of the American people. People get upset because we are just having 2% growth with 1% population growth. This country has a wonderful future. However, It can all be nullified by mad men, sociopaths and religious fanatics who wish to have access to weapons of mass destruction. We already have a huge number of people that wish harm on the U.S. who will look for more ingenious ways to hurt our system. They will not go

away. We need an extremely vigilant security operation in the U.S. That's something we live with. The luckiest person in the world is still the baby being born in the U.S. today. We live in a country that will do successfully well if we ward off the threats.

Charlie noted that the U.S. is a favored nation and that we have lived in an ideal era. But we should not get too smug, as China has come up faster than any nation. He cannot think of anything more important than future collaboration between the U.S. and China. It's very important that we have good relations, trust and work together to avoid bad consequences that come from other people's mistakes. We'd be crazy not to collaborate for our general safety and the benefit of the world.

MANAGEMENT SKILLS OF THE CHIEF INVESTMENT AND CHIEF EXECUTIVE OFFICERS

Buffett said a chief investment officer should have an array of skills. However, he would not vote to put someone in charge of Berkshire whose sole experience is in investments. It is very unlikely that the Chief Investment Officer will be the next CEO of Berkshire. The chief executive officer also needs significant operating manager experience. Buffett said he has been a better investment manager due to also being an operating manager and vice versa. If he had done investments all his life, he would not have done as well.

Charlie added that the operating companies have become more important at Berkshire. It is better to have a CEO with operational experience but also with a good investment understanding.

TODD COMBS AND TED WESCHLER

Todd Combs and Ted Weschler are investment managers at Berkshire, and Buffett was asked about their investment process. Buffett responded that both Ted and Todd are very smart about business and investments. They understand reality and know competitive strengths. On top of that, they have qualities of character that are important. Buffett has seen dozens of investment managers with good track records. He cited Bill Ruane at the Sequoia fund, where a \$10,000 investment grew into more than \$4 million. He was a great investment manager and also a terrific human being. You want people that do more than their share and don't claim credit for things they don't do. Ted and Todd fit that bill.

Charlie added that Ted and Todd are already helping in the acquisition of businesses for Berkshire and helping to oversee them.

Buffett said they both know the right way to deal with people. Todd was involved in the Phillips 66 deal and Ted with the recent German acquisition. Buffett stated he has run into other high IQ people who are dysfunctional. They self-destruct in trying to make money they do not need. Todd and Ted are trustworthy and identify more with Berkshire than themselves.

HEDGE FUND BET

As is customary before the lunch break, Buffett provided an update on the 10-year bet he had with Protégé Partners, a hedge fund manager. The bet was that the S&P 500 Index could beat a

group of hedge funds carefully chosen for the bet, as Buffett did not expect their high fees would be overcome by managerial brilliance. For the seven years ended 12-31-14, Buffett is winning the bet as the S&P 500 has provided a cumulative 63.5% gain vs the 19.6% gain of the hedge funds. Buffett noted that the hedge fund managers have not done badly, but their investors have paid a big price.

INSURANCE ACQUISITIONS

When asked if Berkshire would make commercial insurance acquisitions, Buffett said Berkshire will not take over a large commercial insurance company. They already have the ideal commercial insurance business in Berkshire Specialty which has more capital than anyone else. It can be a very big operation in 5-10 year.

Charlie added, "I certainly agree with you." Buffett laughed, "That's how he keeps his job!"

GLOBAL WARMING

Buffett was asked whether global warming is a risk factor for Berkshire's insurance operations. Travelers has cited climate change as a risk factor in their regulatory filings.

Buffett said the SEC requires companies to put risk factors in their regulatory filings. Lawyers tell you to put in everything so that it all is covered in case of litigation. Berkshire prices their property-casualty (PC) insurance every year. It is not like a life insurance company. If you buy whole life insurance, you set a price for the future. PC insurance is set one year at a time. Buffett sees nothing that tells him on a yearly basis that global warming is something to cause a price change. It isn't that global warming isn't very important. It just does not change the situation in anyway in a one-year period of time. If Berkshire were writing a 50-year wind storm policy in Florida, then they would think about global warming in terms of potential hurricanes, but it has no material effect on the next year. It's not something Berkshire would put in the 10K as a threat.

Charlie added that he doesn't think it's totally clear what global warming will be. There's a lot of guesswork. It's not that global warming isn't happening. We can make all kind of crazy extrapolations that are not necessarily true.

Buffett said, "I do not want our underwriters to be thinking about global warming, but who owns the property. If you insure Marvin the Torch, the building is going to go regardless of global warming."

ENERGY INVESTMENTS

A shareholder noted that Berkshire has lost money on several energy investments such as ConocoPhillips and ExxonMobil. These are cyclical businesses. The shareholder asked whether future energy investments should be done by Greg Abel, CEO of Berkshire Hathaway Energy (BHE).

Buffett said BHE has energy in their name, but they are really in a different business than ConocoPhillips or Exxon. BHE is looking for an opportunity to spend big money on energy and

will do so in the future. When Buffett offered to buy MidAmerican in 1995 for \$35 per share, he told them he didn't change his offer prices. They continued to negotiate hard and said you have to give us something. Buffett agreed to pay \$35.05 per share and told them they could say they got the last nickel out of him. Today, BHE earns \$30 per share, and it will earn \$35.05 per share before too long.

BHE is not at all analogous to the other two energy investments. Berkshire wrote the ConocoPhillips investment down, because auditing rules required them to do so. Berkshire actually made a little money on the investment as well as on ExxonMobil. Berkshire will not very often buy oil and gas stocks and has not distinguished themselves on oil and gas stock investments. Buffett will look at available opportunities and make decisions on buying something and sometimes he will change his mind. Berkshire has made a little money on oil and gas stocks and has passed up one or two other opportunities where they could have made a lot of money.

Charlie added that the ExxonMobil investment was not a bad cash substitute with interest rates so low.

TAX CODE

When asked if the U.S. needs a simpler tax code, Buffett said it takes 218 members of the House and 51 US Senators to make the change and the President to sign the legislation. Despite current tax rates that all the corporate chieftains complain about, the share of corporate profits to GDP is at a record. Corporate taxes 40 years ago were 4% of GDP and today they are now running about 2%. Buffett thinks Congress is capable of working out something to make the tax code more rational. If spending is 21%-22% of GDP, we should raise 19% of GDP in taxes. We can run a 2%-3% deficit. However, if you take 19% of a \$17.5 trillion economy, you're talking real money. How much you get from where is a fight up the line.

In terms of cash parked abroad, companies can bring it back to the U.S., but they will have to pay the corporate tax rate on it. Buffett thinks there can be a much more equitable tax code in terms of corporate tax. However, he would not shed tears on the current corporate tax rate as American businesses are still prospering. Paying 2% of GDP is not an onerous number, when corporations are earning 15% on tangible equity. Equity holders are being treated well, especially in comparison to savers who are only getting ¼% or ½% on CDs.

Charlie added that he lives in California, where there's a 13.5% tax on capital gains. He thinks that's ridiculous as it is driving rich people out of California. Hawaii and Florida have enough sense to know that rich people don't commit a lot of crimes, they make a lot of medical expenditures and they don't burden the public school systems. He asked, "Who the hell doesn't want rich people coming into their state and spending money?" He concluded that California has a stupid tax policy, but he doesn't think the federal tax policy is bad at all.

Buffett said he thinks there is a good chance for corporate tax reform within a year.

WEALTH OF NATIONS

When asked what he learned from reading *Wealth of Nations*, Buffett said he learned economics from it. Bill Gates gave Buffett an original copy of the book. Buffett said if you read Adam Smith, Keynes, Ricardo, and “Where Are the Customers’ Yachts,” you will have a lot of wisdom.

Charlie added that Adam Smith has really worn well. He is one of the wisest people that ever came along. He demonstrated the productive power of the capital system. The lesson was really learned when communism failed so spectacularly.

Buffett agreed saying the power of capitalism has improved productivity. The idea is that you let other people do what they do best at and stick to what you're best at. You should work in the field that is most productive for you.

Charlie agreed by noting that Buffett did not do his own bowel surgery.

GEICO

When asked questions about the actuarial models used at GEICO, Buffett said GEICO can beat other insurance quotes 40% of the time. No company will be the lowest in all cases. Berkshire has their own underwriting variables. Age is one of them. Competitors use different variables or use different underwriting weightings. When evaluating drivers, GEICO knows 16-year-old boys are as bad as you will get to insure. 16-year-old girls don't tend to show off. GEICO will come up with different rates than competitors. GEICO gives out quotes on the phone every week and provides the lowest quote most often. Since GEICO has only 11% of the market, they have lots of future policyholders to gather. Buffett proclaimed, “It is definitely worth 15 minutes to call GEICO. “

ALTERNATIVE INVESTMENTS

An investor noted that reinsurance has changed over the years and is now considered an alternative investment and asked Buffett what he was planning to change or to do to take advantage of the situation?

Buffett joked, “Wouldn't our competitors like to know?!” He admitted that there's a lot of capital that has come into reinsurance, and as a result, the reinsurance business is not as good as it was due to less attractive pricing. It's a fashionable asset class. It's something you can sell people. It has become a non-correlated asset that has been sold to pension funds. You can go to Bermuda and run a hedge fund and sell reinsurance. The reinsurance business in the next 10 years will not be as good as it has been over the past 30 years. The business prospects have turned for the worse, but there is not much Berkshire can do about it. However, there are certain deals that only Berkshire can do. There have been eight \$1 billion reinsurance deals over time, and they all have been done by Berkshire.

Charlie added that competition is getting more advanced with promotional finance searching for a robust narrative.

Buffett agreed, saying Berkshire could have the opportunity to go out and be promotional with their reinsurance since they have the best reputation in the field. However, that is not Berkshire's game.

NETJETS

Buffett was asked to comment on the lengthy dispute with the NetJet pilots who were picketing outside.

Buffett said NetJets is a good business. The pilots have a good job. NetJets sells planes to owners. The investment is held in large part by the owners themselves. At Berkshire they have had hundreds of labor unions over the years. In 50 years, Berkshire has had three strikes that he could remember: one in the textile business, one at the *Buffalo News* and one at See's Candies. He said Berkshire has no anti-union agenda whatsoever. NetJets has sensational pilots. Buffett has flown NetJets for 20 years. It's human nature to have differences in opinions on salaries. The average NetJets pilot makes \$145,000 a year working seven days on and seven days off. They also are paid for their time to get to their bases. They get paid well compared to competitors. It's understandable that employers/employees will have differences from time to time. NetJets' volume is up in terms of flying. It's a first class operation that is focused on safety with their pilots getting more training than others. Buffett said the contract will get settled.

Charlie added that NetJets pilots are wonderful, dutiful and no one ever indicated that he was dissatisfied with his life. Charlie said, "I'm not sure the union is fairly representing the pilots."

DURACELL ACQUISITION

A shareholder noted that the core Duracell battery business has been in decline. Buffett was asked whether he would have done the deal without the tax considerations in swapping Procter & Gamble-PG stock for Duracell.

Buffett said both PG and Berkshire Hathaway had tax advantages in doing the deal. Berkshire held stock in PG for over five years. The exchange is somewhat similar to a real estate exchange. However, Berkshire will not get a new tax basis on Duracell like in a 1031 real estate exchange. Berkshire will keep the lower tax basis on Duracell. There wouldn't have been a transaction if it wasn't for the fact of the exchange arrangement. The battery business will be around for a long time, even though it is a declining business. Buffett expects Berkshire to do fine with the Duracell business. The deal probably won't be completed until the fourth quarter of 2015. P&G couldn't be better to work with on the deal.

ESTATE PLANNING

When Buffett was asked about his prior comment of leaving kids enough so they can do anything, but not enough so they can do nothing, Buffett said he promised to give over 99% of his wealth to charity. The estate tax exemption has been moved up. He said estate planning is a very individual thing, and he might have a different feeling if he were a small business owner. When you get to figuring out what to do with your money, options are limited. As Charlie has

said, "There's no Forbes 400 in the graveyard." Buffett said a bunch of stock certificates put in a safe deposit box can't do anything for him in life as he has everything in the world he wants. However, they have enormous utility to other people in the world. He asked, "Why should they sit there for me or some fourth generation when they can do a lot of good now?" Everybody has to develop their own feelings about it. Ask yourself where will your money do the most good? It can be pretty dramatic for what it could do for millions of people. Buffet said he and Charlie like their fairly simple lives.

Charlie said when the politicians changed the rules to increase the estate tax exemption to \$5 million; it was a very constructive change in the law. We should not assume our politicians are always crazy.

DISTRIBUTE EQUITY INVESTMENTS

A shareholder asked if it would be legally permissible for Berkshire Hathaway to distribute the long-term equity investments to shareholders in the future.

Buffett said under the IRS Code, there's no way a company can distribute appreciated securities to shareholders. They can spin off business to shareholders.

CORPORATE PHILANTHROPY

When asked how corporations can increase their philanthropy, Buffett said shareholders should determine their own philanthropic activities. He said individuals can determine how to give their money to charity better than companies. While Buffett encourages all Berkshire companies to continue their philanthropic work, he does not think it's his business to write a check to his alma mater through company funds. Berkshire is a partnership. They had a system some years back where shareholders could designate an amount to be given to the charity of their choice. Berkshire had to give up the program when it adversely impacted some of their businesses.

Charlie added, "My case for giving away someone else's money is also quite restrained."

EURO

When asked if the Euro has been positive or negative for Europe and whether France should quit the Euro, Charlie said Europe had a noble goal in establishing the Euro, but it's a flawed system to put countries so different together. They have countries in there that shouldn't be there. France is not the problem. The big strains are in Greece and Portugal. He wryly said, "You can't form a business partnership with your frivolous, drunken brother-in-law."

Buffett said European monetary policy was a good idea that still needs a lot of work. If there are flaws, they need to face them. We wrote a Constitution that took a few Amendments. Buffett said he doesn't think the fact that the Euro wasn't perfectly designed should condemn it to being abandoned. We could have had a common currency with Canada. We would have worked it out. However, we couldn't have had a hemisphere-wide currency. Buffett actually thinks it is desirable to have a Euro currency with rules applied consistently. There were rules on the Euro originally that were broken early on by the Germans and French, not the Greeks.

Charlie noted that it was investment banker aided fraud that permitted some countries to come up with the balance sheets to join the Euro.

Buffett said he thinks the Euro can survive, if they can figure out a way to conduct monetary policy with more cohesion. In its present form, it will not work.

Charlie concluded the topic with “I think I've offended enough people.”

SILVER

When asked about the value in silver, Buffett said he does not follow the silver market much anymore. At one time Berkshire owned silver, and Buffett knew about silver's supply and demand, but he hasn't paid much attention to it for a long time. It is a small market.

Charlie chided, “It's a good thing. We didn't do too well in it.”

ACTIVISTS BREAKING UP BERKSHIRE

When asked if activists would try to break up Berkshire in the future, Buffett said if Berkshire is run right, there won't be a premium in breaking it up. Buffett does not think the value of the parts is greater than the whole. There are a lot of benefits in terms of having the companies file the same tax return. The best defense against activism is good performance. There has been so much money pouring into activist funds in the last few years, that people are really reaching as to the kind of companies they are talking about breaking up. Buffett's shares will get dispensed after his estate is settled. By that time, Berkshire's market value will be so great, all the activists combined won't be able to do much about breaking up Berkshire. Berkshire should be a place where firms can dump their activists.

Charlie said there is more stupid stuff written and done by activists on urging companies to repurchase their shares when the price is greater than the value. If you have a partnership, and the partner wants to sell out to you at 120% of what it's worth, you wouldn't do it. However if you look at the history of share repurchases, the activity falls off when stocks are cheap. Share repurchase activity has become very contorted.

Buffett agreed. He said companies should use their capital to take care of their business needs and only repurchase their stock when the price is trading substantially below intrinsic value. If Berkshire were to trade at 1.2 times book value, Berkshire will buy back bushel baskets of Berkshire stock, but not at 2.0 times book value, as it would not be worth that price.

Charlie ended the discussion. “It's hard to think of any activists that I want to marry into the family.”

AMERICAN EXPRESS

When asked how American Express will protect its competitive moat given the impact of mobile payments and the loss of Costco as a customer, Buffett said American Express will be subject to lots of innovation and various modes of attack. It's a very special company. Ken Chenault, the CEO, has anticipated changes and guided the company into different markets. There's a lot

of loyalty with American Express cardholders. Buffett is very happy with American Express. He is happy when the stock price goes down, so American Express can buy back shares more cheaply.

Charlie added, "I liked American Express a little better when they had less competition, but that is life."

Buffett described Berkshire's history in owning American Express, noting they did wonders for Berkshire back in the 1960s. American Express has an incredible history of adapting to change. They established a better image for cardholders. They are very nimble and very smart in terms of meeting challenges. Buffett concluded, "I'm delighted we own 15% of the company."

UNWINDING DERIVATIVES

When asked whether he would consider unwinding his derivative investments early or paying down debt with the vast amount of cash on the balance sheet, Buffett said he expects that he will get calls that will put the cash on the balance sheet to work. The calls, however, occur infrequently. If Berkshire could unwind the derivatives, they would do so, but he expects that the contracts will unwind naturally. Berkshire has virtually no debt to pay down, and logically, they should take on additional debt at these low interest rates.

Charlie said they would love to feel capital constrained, but that has not happened in a long, long time. It would be glorious.

CHINESE CAR DEALERSHIPS

When asked to compare Chinese car dealerships with U.S. auto dealerships, Buffett said he didn't know the dealership situation in China. He also said he did not think Berkshire would get significant benefits of scale as they buy more auto dealerships. He said what Berkshire needs are managers in those individual dealerships to run first class businesses independently.

Charlie said he did not think Berkshire would be very good at running dealerships in China.

Buffett said there are 17,000 auto dealerships in the U.S. and Berkshire owns 81 of them. He said Berkshire paid a full but fair price for Van Tuyl, which he thinks is the best there is. In the future, Berkshire may buy a lot or very few more auto dealers, depending on price developments. If Berkshire is going to be in the car business, auto dealers will have good and bad years.

INTERNET USAGE

When asked about Internet usage, Buffett said, "I love the Internet!" He uses the Internet to search and to play bridge. He said it has been a huge change in his life. He added that if he had to give up his plane which cost \$1 million a year or the Internet which cost \$100 a year, he would give up his plane.

Charlie added that everyone will do more on the Internet, although he does not like multi-tasking. He chuckled, "I am so stupid I have to think hard for a long time on one thing." The Internet is here, like it or not.

Buffett noted how the Internet has changed GEICO's business dramatically. It affects all their businesses to one degree or another. People get pessimistic about America. The game is not over yet. There will be all kinds of things that will make life better.

INEQUALITY OF INCOME

Buffett said it is extraordinary in the U.S. to see how far we've gone in terms of income. He was born in 1930, and the average income /GDP in the U.S. has gone up sixfold. Someone making \$9,000 is now making \$54,000 per year. Buffett believes that everybody that is willing to work should have a reasonable opportunity for a decent livelihood in a country like the U.S. He said he has nothing against raising the minimum wage. There are such things as supply and demand. If you were to move the minimum wage up dramatically as a form of price fixing, you would change the opportunity of people very dramatically as it would likely reduce the number of jobs. He thinks reforming the earned income tax credit would work better.

Charlie chuckled that you just heard the Democrat's version of addressing the inequality of income, and Charlie was one Republican that agreed. He added that if you raise the minimum wage a lot, it would hurt the poor.

RISING COLLEGE COSTS

When asked about the affordability of college given rising college costs, Charlie said the average American family affords it by going to less expensive schools and getting subsidies. It is a big problem to have colleges raising prices to what they can get.

Buffett said most people have to struggle through it. When the Great Recession came along, all the colleges were overstaffed and laid off people. Without the right incentives, colleges will keep raising prices.

Charlie said there's a big tendency to have prices rise. People rationalize that the service is worth it. He thinks there's a lot wrong in our higher education system. Right-sizing is not all bad. There's not a college in America that wants to go back to their old habits. He advised students to figure out their best option. Fordham and Villanova will do what they do. As long as it works, they will keep raising their prices without the right incentive.

STRUCTURAL CHANGES IN CHINA

When asked about structural changes needed in China, Buffett said, "I think China will do fine over time."

Charlie added, "I'm a big fan for what is happening in China. One of the things they did in China is to stop corruption, which was the smartest damn thing I've seen a big country do in a long time. You don't want to be run by a den of thieves. China is widely copying Singapore....it's

a wonderful thing. I'm very high on what's going on in China. They've actually shot a few people. That really gets people's attention.”

Buffett said it's totally miraculous what has happened in China over the last 40 years in terms of having moved so far so fast.

Charlie added that it has never happened before in history that a country so big has come so far. 80% of China was illiterate when I was a young boy. A few people made an extreme contribution to it, including the politicians in Singapore. Berkshire also copies bright people.

Buffett noted that for close to 200 years China didn't go any place. The last 40 years show the human potential when you find a system that unleashes it. When you see that, it has to have a powerful effect of what happens in the future. It's amazing that you can have people go nowhere for centuries and then it explodes. China and the U.S. are going to be the super powers for as far as he can see. It's good that the Chinese have found a way to unlock their potential. It's imperative to see each other's virtues rather than flaws. We need to remember that we are both better off if the other one is doing well.

REASON FOR SUCCESS

When asked what the most important reason for their success was, Buffett attributed it to a great teacher and exceptional focus. He also enjoyed the game which was enormously fun. Investing is actually a pretty easy game, but it does require a certain emotional stability. Buffett went through stock manuals when he was young searching for investments. Between ages 7 and 19, he had enthusiasm for investing but not guiding principles. Then he read *The Intelligent Investor* by Ben Graham, which described an investment philosophy that made total sense. It wasn't more complicated than that.

Charlie agreed that investing is an easy game if someone has the temperament for it. If you amass a fortune in life by being shrewder than others, it's not enough in life.

Buffett agreed and said running Berkshire has been far more fun than just an investment. Managing Berkshire is incredibly more satisfying.

Charlie said, “If you're good at investing your own money, I hope you move on and do more.”

Charlie said he had an unfortunate channeling device into the investment world when he realized he was never going to succeed as a movie star or actor. His grandfather provided him with the idea that your main duty is to become as rational as you can be. Since he was good at that and no good at anything else, he was steered into something that worked well for him. Confucius said we owe a moral duty to rationality, which is why Charlie likes Confucius. He had the same idea years ago. Berkshire is a temple of rationality.

Charlie said, “If you have ignorance and keep it, it's dishonorable to stay stupider than you have to be. You have to be generous where it's crazy not to be.”

Buffett said what matters the most to him now is that Berkshire does well for their million shareholders. It's enormously enjoyable to Buffett to be building a company that gets bigger and better each year. He wouldn't be happy if Berkshire were doing poorly.

Charlie agreed. He said, "It's easy to lose a little of our own money, but we hate losing somebody else's. That's a very desirable attitude."

Buffett said what bothers him is something that actually costs Berkshire long-term value.

Charlie added, "A good doctor doesn't like it when a patient dies on the table either."

WALL STREET JOURNAL

When asked about the *Wall Street Journal*, Buffett said Dow Jones owned the *Wall Street Journal (WSJ)*. In the early years, the *WSJ* had competitive advantages with their newspapers and they also owned the news ticker. However, they totally missed an opportunity to dominate financial news with Michael Bloomberg taking financial information away from them with his Bloomberg machines. The *WSJ* was family-owned but lawyer-controlled. The lawyers had no imagination on what to do with financial information, so Dow Jones let the world pass them by. The family did end up with \$6-\$7 billion when they sold out to Rupert Murdoch, so they did not destroy their fortune.

Charlie added that the fortune could have been \$100 billion with Tom Murphy, the former CEO of Capital Cities/ABC, in charge.