BERKSHIRE HATHAWAY 2013 ANNUAL MEETING NOTES

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We attended the Berkshire Hathaway annual meeting held on May 4, 2013 in Omaha along with about 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. Here are my notes from the meeting.

FIRST QUARTER RESULTS

Warren Buffett began the meeting with a brief recap of Berkshire Hathaway's strong first quarter financial results with revenues up 15% and operating earnings up 42% (see our detailed first quarter analysis for Berkshire Hathaway on our website). Book value increased 5.5% from year end to $120,525 per A share. It was a good quarter as all of the businesses did very well. It was a benign quarter for the insurance companies in terms of catastrophe losses. Operating earnings from Berkshire's other big businesses were quite satisfactory.

In the insurance business, Berkshire Hathaway Reinsurance Group benefited from favorable foreign currency changes and an amendment to a life insurance contract with Swiss Re. The high point was the gain in closure rates and persistency at GEICO with policies in force significantly increasing to 473,910 in the first four months of the year. Buffett is hopeful that GEICO will increase its policies-in-force by one million policies this year. With each GEICO policy adding $1,500 in value to Berkshire, the little gecko's speedy start to the new year may add more than $1 billion to the value of Berkshire in 2013. Buffett encouraged the shareholders to go to the exhibit hall to get a GEICO quote to see if they could save money. He joked they should go anytime during the meeting, but preferably when Charlie was speaking.

Berkshire's railroad business, Burlington Northern Santa Fe (BNSF), also is doing very well with first quarter revenue up 6% to $5.3 billion and pre-tax earnings chugging 16% higher to $1.3 billion. Car loadings were up 4% in the first 17 weeks of the year compared to just a .4% gain for all of the company's rail competitors combined. It has helped that oil has been found near BNSF's railroad tracks. Buffett quipped at the annual meeting, "What better place to find oil?" BNSF will be moving more cargo in the decades ahead.

Berkshire Hathaway is now the fifth most valuable company in the country behind Apple, ExxonMobil, Microsoft and Google.

Berkshire acquired the remaining 20% of Iscar that Berkshire did not already own for $2.05 billion on April 29, 2013. Buffett said the business is doing terrific.

BOOK VALUE GROWTH

In response to a question about Berkshire's book value growing at a lower rate than the S&P 500 Index over the last several years, Buffett said if the stock market continues to do well in 2013, this will be the first period where Berkshire's book value growth has fallen short of the S&P 500's growth. He said, "It won't be a happy day, but it also won't discourage us." Berkshire's results do better in down years on a relative basis to the S&P and lag during strong up years for the S&P 500. While book value is a reasonable proxy for intrinsic value at Berkshire, there are significant gaps between book value and intrinsic value. For example, if GEICO adds 1 million policyholders this year, it will add $1 billion to Berkshire's intrinsic value and not a dime to book value. Accounting distortions also create gaps between book value and intrinsic value especially with large acquisitions like Iscar. Over time, Berkshire still needs to increase its book value at a rate better than the S&P 500 or investors would be better off in index funds.

Charlie added that Berkshire will do quite well over time, and he doesn't pay much attention to 3-5 year periods. Berkshire's businesses still have momentum, but won't do as well as in the past given the size of the company. Berkshire is slowing down, but the growth is still quite pleasant. Charlie, who is a young 89, chortled, "I'm trying to take care of my old age, which might come about at any time."

ISCAR COMPETITIVE ADVANTAGES

Buffett said Iscar's competitive advantages are brains and an incredible passion for the business. In 1951, Seth Wertheimer started the company in Israel at age 25. His raw material came from China, and he was selling his products to heavy industry like GM and Boeing. He had no great location advantage with the business in Israel. His competitive advantage was the incredibly talented people of the company who never stop trying to make customers happy. Buffett concluded, "Iscar is one of the great companies of the world, and we are fortunate to be associated with them." Charlie marveled at the robots and computers the company uses in its operations.

PRESERVING BERKSHIRE CULTURE

(Before the shareholder asked his question, he thanked Buffett for opening the doors early to the CenturyLink Center given the cold and rainy day. Buffett joked, "If we had a company that sold coats, we would have left you out there.")

Buffett said he does not worry that Berkshire's culture will be preserved as his successor will have more brains and passion for the business than Buffett. Succession is the number one topic at each Board of Director's meeting. The Board is in solid agreement on who will be Buffett's successor. Berkshire's culture has become more solidified each year. All Berkshire managers buy into the company's special culture. The culture is one of a kind and will remain one of a kind. People have self-selected into the company, and the wrong person will be rejected like a foreign tissue. Charlie warned the many Mungers in the audience that after he and Buffett were gone "Don't be so stupid to sell these shares!" Buffett chimed in, "That goes for the Buffetts, too!"

HEINZ DEAL

When asked if the structure of the Heinz deal meant that Buffett had low expectations for the stock market and that the common stock acquired would be dead money, Buffett said that was a totally inaccurate statement. He said the deal was formulated at an airport where he met Jorge

Paulo Lemann from 3G Capital. He and Lemann were both directors at Gillette and knew each other well. When Lemann sent him the proposed term sheet for the structure of the deal, Buffett felt it was an absolutely fair deal and didn't change a word on the term sheet. Berkshire paid a bit more than if Berkshire had done the deal alone, but felt the 3G Capital management team was unusually good and classy. Buffett liked Heinz's business and the design of the deal. Berkshire will earn lower returns on the common equity than the preferred stock, but Berkshire has a less leveraged position. Berkshire currently has more money than operating ability, so they are happy to have 3G Capital run the operations. Charlie just grunted that the assumptions in the question were totally wrong. Buffett laughed, "That will teach them!"

EXPANDING INSURANCE OPERATIONS WITH FORMER AIG EXECUTIVES

Buffett said Berkshire's goal is to take a greater share of the insurance market. Berkshire has a 7.5% participation rate in the Llyod's market with the prospects reasonable to give Berkshire a good cross section of the London market. In addition, four former AIG executives will write commercial insurance for Berkshire. They reached out to Berkshire in the past, and the time now seemed right for Berkshire to become a significant factor in the commercial world. This new business could generate a fair number of billions of dollars of business over time. With the right people and capital, Berkshire is ideally situated to grow the business. Charlie added that reinsurance is generally not a good business for most people, but the Berkshire business is very peculiar and profitable under Ajit Jain. Buffett added that the commercial business will be primary insurance that takes on large commercial risks.

GEICO VS PROGRESSIVE

Buffett was asked why GEICO does not use technology like Progressive's use of Snapshot, a technology that monitors a driver to set insurance policy rates. Buffett noted that successful insurance underwriting is evaluating the propensity of a driver having an accident. For auto insurance, GEICO assesses a number of variables in setting its pricing. For example, GEICO knows from statistics that a 16-year old male is more likely to have an accident than someone Buffett's age. Buffett joked that the 16-year old is more likely to have an accident by trying to impress the girl sitting next to him and laughed, "That doesn't work for me anymore!" While GEICO is watching how Progressive's Snapshot technology is working, their own variables continue to be useful with their selection process of new insured drivers working quite well. GEICO is able to sell its insurance at prices less than competitors, and Buffett is happy with GEICO's underwriting. Charlie grunted, "I have nothing to add."

Another question arose on Progressive's Snapshot, which claims the technology can provide 30% rate cuts to its best customers. Buffett said again he did not believe that Progessive's selection method of customers was better than GEICO's selection metrics. He then recounted the story how Peter Lewis, the founder of Progressive, said his first loss came from a redheaded fellow, so he refused to insure anyone with red hair for awhile. GEICO looks at a lot of variables and uses a different approach than Progressive. GEICO is obtaining a disproportionate number of new policyholders and their rates of underwriting are attractive. Charlie snorted, "We aren't going to copy every oddball thing a competitor does!" Buffett concluded, "If I were going to start a new insurance business, I would copy GEICO." He said GEICO hopes to gain 1 million new policyholders this year, which would represent two-thirds of all the growth in the industry, while saving people money. Buffett said he couldn't say enough good things about Tony Nicely, GEICO's CEO.

BUSINESS WIRE

Buffett said he thinks it is a mistake for the SEC to allow companies to disclose corporate information on social media. The key to fair disclosure is that the information is released accurately and at the same time for everyone. For example, he said he didn't want to have to keep going to Wells Fargo's website repeatedly to find out if they had released any new information and then have someone else beat him to the information by ten seconds. He said Berkshire will continue to do very well with Business Wire, and they will not consider selling the business. He said he wished he could clone Cathy Tamraz, Business Wire's CEO. Berkshire will continue to put out all their information on Business Wire to ensure it is accurate and released simultaneously to all investors. Charlie muttered, "I am avoiding Twitter like the plague."

BERKSHIRE'S SIZE

Doug Kass, the short seller of Berkshire stock who was invited to ask questions, noted that he sees Berkshire buying larger businesses which are relatively high-priced. He said Berkshire used to hunt gazelles and now is hunting elephants. As a result, he sees Berkshire morphing into a stock that resembles the market index.

Buffett said that there is no question that Berkshire can't perform as well as they have in the past given the size of the company. Although in bad markets like in 2008, size can be an advantage. Buffett took exception to the comment that Berkshire is paying fancier prices for businesses than they have in the past. Buffett said Berkshire does pay "up" for good businesses. He acknowledged that it is tougher as Berkshire gets bigger to earn as high of returns as they have in the past. Even with the diminution of returns compared to the past, Berkshire's performance will still be satisfactory. Charlie retorted that Berkshire cannot do as well on a percentage term as they did in the early days due to the company's size. He added that if you look at big companies of the past, their record is not so swell. However, he believes Berkshire can do well despite getting big because Berkshire has a better system of managing the company. Buffett said that he feels good about the acquisitions Berkshire has added over the last five years, including the Heinz deal. Berkshire currently owns eight businesses that each would be Fortune 500 companies on their own.

THE U.S. DOLLAR AS A RESERVE CURRENCY

Buffett said he didn't know if the U.S. dollar would lose its status as the world's reserve currency, but if it does, it likely won't happen over many decades, if ever. Charlie added that there are advantages for countries to have the reserve currency. England used to have the advantage and now the U.S. does. He does not think it would be all that significant if the U.S. eventually loses the reserve currency. He quoted Keynes, "In the long run, we are all dead." He added every great civilization eventually passes it on.

CORPORATE PROFITS AS A PERCENTAGE OF GDP

Buffett was asked about the sustainability of corporate profits as a percentage of GDP, which are currently in the 10% range, when he had previously said in a 1999 *Fortune* article that corporate profits greater than 6% of GDP were wildly optimistic. Buffett said today's corporate profits as a percentage of GDP are pretty unusual especially given the economic background and are quite extraordinary based on U.S. history. He said this shows that America's corporate tax rates do not make us uncompetitive in the world. American business has done very well since the economic downturn. He said it will be interesting to see if current corporate profit levels can be maintained. Buffett said while corporate profits have come back strong since 2008, employment has not. This will lead to much public discourse. While corporate profits levels will likely trend down, this does not have to be all bad as GDP will grow. Charlie said he would not be surprised if corporate profits as a percentage of GDP in the 6% range are on the low side. He wryly observed, "Just because Warren Buffett wrote something many years ago does not make it a law of nature." Charlie also believes that U.S. corporate tax rates are disadvantageous to U.S. business with the rest of the world bringing down their corporate tax rates. He said he would be glad to have a lower corporate tax rate. Buffett laughed, "He is the Republican, and I am the Democrat."

IS BERKSHIRE BECOMING UNWIELDY?

Buffett was asked if Berkshire is becoming too unwieldy to manage for Berkshire's successor given many of the small businesses being acquired like the local newspapers and small companies like Oriental Express. Buffett said his successor will likely modestly organize things in a different way for reporting purposes. He said his successor understands the major Berkshire units very well. He added that a little change in reporting will take care of things for the smaller businesses which may be only generating $5-$10 million in earnings.

Charlie said it would be unwieldy for Berkshire to have so many businesses if they were imperial. However, at Berkshire they have "decentralization to the point of abdication." He grunted, "So what difference does it make on how many subsidiaries we have?" Buffett added that Berkshire is looking to buy businesses that have at least $75 million in net earnings. He said the best acquisitions were the bolt-on acquisitions done by the various Berkshire business units. He also noted that when Berkshire can buy an additional $2 billion of Iscar or $1 billion of Marmon, the company obtains more earning power without any more work. Berkshire just ends up with more of a good thing. Charlie stated, "What we are doing with a small corporate staff is impossible, but it isn't because it works."

CONSEQUENCES OF FED'S $85 BILLION MONTHLY SECURITY PURCHASES

When asked what the consequences will be of the Federal Reserve's $85 billion monthly security purchases, Buffett quickly handed the question to Charlie. Charlie bluntly answered, "I don't know." Buffett rapidly responded, "I have nothing to add." Charlie noted it will be difficult to unwind all of the monetary stimulus. Buffett said we are in uncharted territory with the Fed's balance sheet ballooning to $3.4 trillion. He added that it is always harder to sell securities than to buy them. While all this liquidity has been created, the banks are just letting the liquidity sit there. Wells Fargo is not happy as they are unable to make loans due to insufficient demand from creditworthy borrowers. Buffett said he has a lot of faith in Ben Bernanke, but he is running a risk. However, he may be handing off the risk to the next guy as he may not be at the Fed when the unwinding takes place. The monetary stimulus has the potential to be very inflationary, although it hasn't been yet. The Federal Reserve probably wishes their monetary policies had been a bit more inflationary with some Fed members disappointed that we haven't seen more inflation. When the market gets the signal that the Fed is starting to curtail its monetary easing policies, it will be the shot heard around the world. All assets will then be re-evaluated. Charlie added that macroeconomists have been surprised that interest rates have been kept so low. In Japan, low rates have led to 20 years of stasis. Economists should be cautious about printing money in massive amounts. There should be more worry about inflation. Charlie suspects it will be harder than easier to unwind the stimulus, and that the world will have more trouble.

THE IMPACT OF ZERO INTEREST RATES ON BERKSHIRE

When asked about the impact of zero interest rates on Berkshire's business, Buffett said, "Interest rates are to asset prices like apples are to gravity." The zero interest rates have helped Berkshire as people make different decisions when they can borrow at zero rates. Interest rates power everything in the universe. Borrowings on the Heinz deal were done at lower rates than they could have been. If the Fed wants to inflate asset prices, they will keep interest rates low for a long time. With the 30-year bond at 2.8%, it makes houses more attractive to purchase which may be a smart policy, but unwinding the monetary stimulus will be difficult. Buffett said he doesn't know what will happen if the Fed said they wanted to sell $85 billion a month. He said watching the Fed is like watching a good movie, as you can't predict what the end will be once monetary stimulus is curtailed. Charlie added that he doesn't expect interest rates to stay this low. He said the low interest rates hurt Berkshire's float and cash holdings. Buffett said Berkshire at the end of the first quarter had $48-$49 billion in cash, which did not earn anything as he keeps the funds in U.S. Treasuries since he never stretches for yield. He said if interest rates were to get back to the 5% range, Berkshire's cash could earn $1-$2 billion. While our country has benefited significantly from the Fed policies following the financial meltdown, the question remains on whether they can reverse their monetary policies successfully.

COMMERCIAL INSURANCE ACQUISITIONS

When asked if Berkshire would consider acquiring commercial insurance operations, Buffett said there are not many big commercial insurers to acquire. The price to acquire a commercial insurer is far higher than what Berkshire can pay to develop its own large commercial insurance operation. In addition, Berkshire will then not pick up the bad habits of the other company. He believes it is better to build a commercial insurance operation, if he can find the right people such as the former AIG executives who recently joined Berkshire. He believes that Berkshire will have a good and significant commercial insurance operation in a short time.

UNREGULATED DIGITAL CURRENCIES LIKE BITCOINS

When asked about Bitcoins, Buffett said he doesn't know a thing about them. Charlie grumbled, "I have no confidence at all in Bitcoins as a universal currency." Buffett joked, "Of the $49 billion in cash we hold at Berkshire, I haven't moved any into Bitcoins."

MULTI-LEVEL MARKETING COMPANIES

When asked if Pampered Chefs is a multi-level marketing company like Herbal Life which has been in the news, Buffett said he doesn't know a thing about Herbal Life. He said multi-level marketing companies often just sell products to distributors, which then require Level A distributors to sell to Level B distributors. He said Pampered Chefs is a million miles away from that type of structure as the company sells its products to end users. They hold thousands of parties each week, where people use the products they buy. Buffett did note that the SEC should investigate companies which prey on the hopes and dreams of folks through pyramid schemes. Charlie succinctly summarized, "There is more likely to be flim-flam in selling magic potions than in selling pots and pans."

BERKSHIRE'S RETURNS BASED ON BUFFETT'S REPUTATION

When asked if Berkshire's returns may be impacted when Buffett is no longer around to negotiate deals based on his reputation, Buffett said his successor will have more capital to work with especially when markets are in distress. He said there is no question that his successor will have unusual capital in turbulent times. With this capital, his successor will have the ability to say "Yes" quickly to attractive deals. Berkshire is the "800" number to call when there is panic in the market and a company needs significant capital. This happened in 2008 when Goldman Sachs and GE called, and Berkshire was able to negotiate favorable deals. It will happen again. When the tide goes out and you can see who is swimming naked, the naked swimmer will call Berkshire. Buffett believes the Berkshire brand will continue to generate attractive returns without Buffett having to be at the helm.

Charlie noted that in the early days Berkshire earned attractive returns because Buffett was a value investor who had little competition. Today, Berkshire earns attractive returns because Berkshire is a good home for good companies, again with little competition. Charlie stated, "It is ridiculous to think the past is what we should have stayed in."

SELLING TO BERKSHIRE

When asked what was the key to a company like See's Candies selling their company to Berkshire, Buffett noted that there was a death in the family, which put See's up for sale. Charlie also persuaded Buffett to buy See's Candies. Charlie added, "We do not buy companies from unwilling sellers."

BERKSHIRE COMPETITIVE ADVANTAGES

Charlie said that Berkshire ability to stay sane when others like to go crazy is a competitive advantage. He said that as Berkshire gets bigger, they continue to use the Golden Rule with subsidiaries, which is rare in corporate America. This also provides Berkshire with a competitive advantage. Being a good partner with shareholders is a competitive advantage. Charlie chuckled, "All of this is a good idea. I wish we had done it on purpose!" Buffett recounted a story of a fellow who wanted to sell his company but did not want to sell it to competitors or private equity firms, who he did no think would treat his employees fairly when he was gone. He called Berkshire as the "default" buyer, which is a competitive advantage for Berkshire as they have no competitors and can provide a permanent home to valued employees.

BURLINGTON NORTHERN SANTA FE (BNSF)

When asked if BNSF's coal tracks could be redeployed given the slowdown in coal shipments, Buffett said if no coal is moving, BNSF will lose some tracks. Much of coal usage will depend on the price of natural gas. When asked if crude oil moving by rail still has room to grow, Buffett said he initially thought that oil rail transport was just going to be a blip. However, he now thinks there will be much rail usage for oil shipments for a long time. Buffett noted that oil can move faster by rail than by pipeline. With different market prices, there will be lots of flexibility in moving oil by rail. Matt Rose, the CEO of BNSF, said he expects the coal rail franchise to stabilize. BNSF currently has 10 loading stations for crude transport with 30 destinations now and another 30 destinations in negotiation. BNSF currently transports 650,000 barrels per day and expects that to increase to 750,000 barrels by year end with the BNSF railroad on the pathway to ship 1.2-1.4 million barrels per day.

HARLEY-DAVIDSON NOTE

Buffett joked that he would like not to answer his mail when the Harley-Davidson 15% note comes due in 2014. Berkshire was able to negotiate this transaction when the corporate bond market was frozen in 2008. So with the note coming due, it is now a time-depleting asset. Buffett said we won't see anything like that deal again for awhile, but we will see some deals like that in the future. Buffett said when he negotiated the deal, he did not think that Harley-Davidson would go broke. He joked any company that can get its customers to tattoo their brand on their chest can't be bad.

TODD COMBS AND TED WESCHLER

Berkshire's investment managers, Todd Combs and Ted Weschler, each received another $1 billion to manage on 3/31/13. Buffett only sees what investments they make after they have already made them. They are in charge of their own investment decisions with some restrictions, such as not investing in American Express due to Berkshire's already substantial position in the company and overall restriction on acquiring more shares. Buffett said Ted and Todd buy things he wouldn't buy. However, they can manage their portion of Berkshire's money by determining what positions to acquire and the position sizing, as they feel appropriate. Buffett said he wouldn't have a problem if they decided to put all the funds they manage in one stock. Charlie said, "I have nothing to add."

DECISION MAKING

When a shareholder said he heard Buffett made a list each day of 20 things and then focused on the top five things on the list, Buffett just laughed. He said he doesn't think he has ever made a list and doesn't prioritize decision items daily. He said he and Charlie like to live simple lives, and they know what they like. For example, both of them like to read a lot each day. Charlie added that making lots of decisions each day is tiring. They live on autopilot and don't waste time on decision making. Their operating method is to ingest a great deal of caffeine (Coca-Cola) and sugar (See's Candies). Charlie chuckled, "When we write a book on nutrition, it will be a big seller." With all the caffeine and sugar, Buffett is never tired when he does make a decision.

NEWSPAPERS

A shareholder questioned the purchase of the Omaha-Herald asking if there weren't investments with higher rates of return than newspapers. Buffett said Berkshire will get a decent rate of return with their newspaper investments, especially since they get to write off the intangible assets with the acquisitions for accounting purposes. Buffett said he expects the after-tax returns will meet or beat 10%, even though he expects earnings to decline for the newspapers over time. He said the newspaper investments won't move the needle at Berkshire with their combined $100 million of pre-tax earnings power, but they also don't require an extra ounce of attention. He is buying the newspapers at very low prices, which he must do given the declining earnings. Charlie said to Buffett about the newspaper purchases, "It is an exception, and you like doing it!"

BREAKING UP IS HARD TO DO

Buffett was asked if it might make sense for his successor to break up Berkshire Hathaway after he was gone as Henry Singleton did with Teledyne prior to his death. Buffett said Berkshire is probably the easiest company to manage overall due to its decentralization and given the talented managers running each business. He said he does not anticipate any major change in Berkshire, as breaking up Berkshire would deliver a poor result. Charlie said Singleton was a genius. He built Teledyne up as a conglomerate and then managed it very logically on the way down. However, Singleton managed Teledyne on a much more centralized basis than Berkshire is managed. At the end, Singleton wanted to sell his remaining companies to Berkshire, but he wanted Berkshire shares in exchange, which Buffett was unwilling to part with. Charlie concluded, "Just because Singleton was a genius, he didn't perform better than Berkshire's business." Buffett added that Singleton "played the market" beautifully, which is not the way Berkshire operates. Singleton issued shares when his stock was overpriced and bought them back when the shares were underpriced. Charlie growled, "I like our system better."

U.S. COMPETITIVENESS

A shareholder asked what the biggest threats to U.S. competitiveness were. Buffett said U.S. healthcare costs represent 17.5% of GDP while healthcare costs for most other countries represent 9.5%-11.5% of GDP. This is a major problem for U.S. competitiveness with the rest of the world…a big disadvantage for the U.S. At General Motors, healthcare costs added $1,500 to each car, which provided them with a disadvantage to Toyota. Overall, though, the U.S. has done very well compared to most countries in terms of competitiveness. Charlie said the grossly swollen security and derivatives markets represent a challenge to U.S. competitiveness. He said it is "perfectly crazy and revolting" to have so much talent go into the derivatives business.

HEALTHCARE COSTS

Asked about the impact of the Affordable Care Act (ACA) on Berkshire's 300,000 employees, Buffett said he really didn't know. Berkshire has 70+ subsidiaries, and he couldn't think of any units that did not provide healthcare coverage although perhaps some of the smaller newspapers recently acquired did not. He said healthcare costs are huge for Berkshire with costs up 10%-12% for some units. Healthcare is one area that Berkshire might consider centralizing. Whatever happens with ACA will also happen to Berkshire's competitors. Currently, Berkshire does not try to control healthcare costs at headquarters. Charlie chimed in, "We like the decisions to be made near the firing line."

SOLAR POWER

A question was asked about Berkshire's capital spending in its regulated utilities given competition from solar power. Charlie said he could confidently predict that more solar power will be generated in deserts (where Berkshire has been investing in solar projects) than on rooftops in rainy places. Charlie suspects that there is "twaddle" in the talk that utilities will be run from rooftops in cloudy areas. Berkshire will do fine with its investments in solar power. Greg Able, the CEO of MidAmerican Energy, said that their utilities are still competitive with rooftop costs with lots of protection. He is confident that MidAmerican systems are valuable to customers and Berkshire shareholders.

IS BERKSHIRE'S SUCCESS DUE TO TIMING?

Bill Gross from PIMCO had written an article that said his investment success and Berkshire's might be attributable to the favorable timing of their past investment horizons. Buffett acknowledged that being born a male in the U.S. was a huge advantage. The timing could not have been better. He said his Dad was a security salesman and when stocks declined dramatically in 1929, there wasn't much business for his father. There also wasn't any TV, so "Here I am, "Buffett joked. He chuckled that he was very lucky that the Crash of 1929 came along. For decades after the Crash, people were turned off by stocks, similar to what has happened since the Tech-Wreck of 2000 and the financial meltdown of 2008. However, Buffett said he envies the baby that is born in the U.S. today as it is the luckiest baby in the world. There is the opportunity to do very well in the investment field. A person that has the passion for investing will do very well. We live far better today than we have in the past. Charlie added that Buffett's competition in the early days was weak, and it is not as weak today. Buffett did have an advantage in his success from timing. However, in 2008-2009, there were many high IQ professional investors that sat out of the investment opportunities that arose, while Buffett took advantage of the opportunities. Charlie said to Buffett, "You were drowning in investment opportunities when I first met you. Now we have to wait for them." Buffett laughed, "Now we have the money and no ideas!"

ADVICE FOR YOUNG INVESTORS

A young shareholder asked with hindsight what advice Charlie and Warren would have given themselves when they were younger. Charlie stated, "Stay rational!" Buffett added, "Work where you are turned on." Charlie joked that they both started working in the Buffett grocery store, but they couldn't get promoted there even with the family name on the door. Buffett added that luckily they then found things they really liked to do. He said he and Charlie have had so much fun running Berkshire that it is almost sinful. Charlie noted that they are atoning for their sins of having so much fun by giving all of the money they made back to charity.

RATIONAL INSURANCE OPERATIONS

Buffett stated that Berkshire is an unusually rational place. Berkshire has the benefit of managing for the very long run without outside influences pushing them to make irrational decisions. Insurance operations should be conducted rationally. Other insurance companies often are pushed by Wall Street to increase their volume to meet short-term earning targets when it doesn't make sense to do so. Berkshire has in the past contracted its insurance volume by up to 80% when pricing wasn't favorable. With no external pressures, it is a great way to operate. Berkshire never wants to do anything stupid in insurance. Pricing has to be right for major catastrophe insurance. It is hard not to be rational at Berkshire. Charlie added that it is very hard to shrink an insurance operation by 80%, but it is required when people go crazy. Buffett noted how irrationality during the Internet craze in the late 1990's was also hard to resist for folks who wanted to jump on the bandwagon. Berkshire doesn't have the pressure to do what others do. Charlie added that they don't covet their neighbor's ass asking, "How much fun can you have being envious?"

NEW COMPETITORS IN INSURANCE

When asked about new capacity being added to the insurance business by hedge funds, Buffett said, "We hate dumb competition." Hedge funds have entered the insurance business in the last few years. By operating in Bermuda, they are able to avoid U.S. taxes. With the new capacity, hedge funds can bring down insurance prices in the short term. It has happened before.

Berkshire does business where they can earn an underwriting profit. Berkshire cannot afford to go along with the crowd when it comes to insurance or investments. “It is irritating to have dumb competitors.” In insurance, the standby costs are not huge. It is not like idling a steel mill, so Berkshire will wait out cycles of inappropriate pricing. Charlie added, “With our cranky methods, we have built the best insurance operation in the world, so why should we change?” Berkshire has the best people in the world in their insurance businesses. Buffett said, “We hit the jackpot!”

WOMEN ARE THE KEY TO AMERICA’S PROSPERITY

Buffett recently wrote an article available on Fortune.com on his views that women have not had the same shot as men in the world. Over the years, a lot of improvement has occurred. He recalled how Katherine Graham, the CEO of The Washington Post, was very intelligent but still had self-doubts about her abilities. Society had imprinted on her that women could not run a business as well as men, even though The Washington Post’s stock had risen forty-fold under her leadership. Women have had to deal with both interior and exterior obstacles, although these obstacles are beginning to crumble. The country is moving in the right direction in utilizing the talent of women. Women are the key to America’s prosperity.

DODD-FRANK REGULATIONS

When asked if Dodd-Frank regulations are impacting Berkshire’s insurance operations, Buffett said, “No, as the insurance businesses were already highly regulated.” Dodd-Frank regulations are impacting the capital ratios for larger banks more than small banks. This will impact the return on equity for the banks Berkshire has invested in. With these higher capital ratios, the U.S. banking system is stronger than anytime in the last 25 years. Many of the troublesome loans are gone, and U.S. banks are now dramatically stronger. Buffett said he does not worry about the U.S. banking system being the cause of the next bubble. It will be something else. Buffett feels very good about Berkshire’s bank investments, even though they won’t earn as high returns as years ago. Charlie muttered, “I’m less optimistic about the banking system over the long term. The more bankers want to be like investment bankers, the worse our life will be.”

HEDGE FUND BET

Prior to the lunch break, Buffett updated his $1 million bet for charity with a hedge fund that the S&P 500 Index could beat a group of carefully chosen hedge funds over a 10-year period due to the high fees imposed by hedge funds. Halfway through the bet, the S&P 500 Index has a cumulative gain of 8.6% vs the hedge funds .1% return. More information on the bet can be found at longbets.org.

INVESTMENT INTENSITY

Buffett said you have to love something to do well at it. He said, “I love to think about Berkshire and its managers. It is part of me.” You can’t change the game from its scorecard. Proceeds come with the scorecard. He said none of his intensity or passion about making investments for Berkshire has been lost. Charlie said in the early days, Buffett did not know as much about American Express as he does now. As a result, his initial research in the company was more intensive. However, knowledge becomes cumulative. Buffett agreed, noting that what he learned about GEICO in 1951 he still finds useful. On accumulating knowledge about American Express, he recalled a golf outing with the CEO of Hertz, who complained that there was no way he could get rid of American Express or their fees as his business relied on people using the American Express cards to rent cars. After hearing that, Buffett knew American Express was his kind of company.

QUANTITATIVE INVESTMENT FACTORS

When asked what his top five quantitative investment factors are that he uses to analyze a stock, Buffett said he always looks at the business over the stock. Helping the evaluation is having cumulative knowledge about many businesses. The variables he looks at will vary depending on the type of business he is evaluating. He said, “Certain things will shout out at us to look further.” He said if you were recruiting a basketball team, you would look at the seven foot player before the 5 foot 4 inch fellow. While he came up with the idea of investing in Bank of America when he was in his bathtub, the bathtub was not the critical factor. He has been following banks for 50 years. In evaluating a bank, he looks at different metrics than when evaluating an industrial company. Not one size fits all when looking at investment criteria. For example, some brands travel well like Coca-Cola, and others do not like See’s Candies. In 2011, Bank of America was subject to lots of rumors, which were driving the stock price down. Buffett thought an investment by Berkshire in Bank of America might be helpful to Bank of America, and it would be a good investment for Berkshire. So Buffett gave Brian Moynihan a call even though he had never met him. When making investments, investors should have a good idea of what a business might look like in 5-10 years, and Buffett felt that he had a good idea of what Bank of America’s business would look like in the future.

Charlie added that he doesn’t know how to buy stocks based on ratios. He said you need to know how a company functions. Buffett agreed that he doesn’t know how to use a computer to screen things for investment purposes. He said when they make a stock investment, they look at the business as if they were going to buy the entire company. He wants to first know what the business will look like in 5-10 years and how sure he is of it. Then he looks at the price versus the value he is receiving to be sure he has an adequate margin of safety. Charlie added that he knows what Burlington Northern Santa Fe’s competitive advantages will be 15 years from now, but Apple’s competitive advantages 15 years from now are too hard to know. Buffett agreed that they are 100% confident in the competitive advantages of BNSF and GEICO. Charlie said that competitive advantages are not often disclosed by math. Buffett agreed, saying he didn’t know how well he would do managing money just by numbers. Charlie retorted, “You would do it poorly!”

NEW NORMAL?

When asked if they believe in the “New Normal” as espoused by Bill Gross at PIMCO whereby future market returns will be much less than in the past, Buffett said he doesn’t pay any attention to macro forecasts. He doesn’t make investment decision on information that no one really knows. Why spend time talking about things you don’t know anything about? Buffett said, “I like Bill Gross, but I don’t pay attention to his forecasts.” Buffett maintains his general feeling that America will continue to work well. He does know that BNSF will carry more carloads 5-10 years from now and that Berkshire will have an asset with incredible replacement value. To ignore what you do know versus what you don't know in forecasts doesn't make much sense. What Buffett does know is that people will do very well owning good businesses if they buy them at the right price. Charlie said if the questioner was worried about the New Normal, he should just plan on working a few years longer. If the New Normal resembles the last decade, then things could be worse.

FRUIT OF THE LOOM

A question was asked about Fruit of the Loom's increased competition from Gildan. Buffett said Fruit of the Loom must keep their costs down and focus on brand building. They need to keep their customers happy with their price points. Over the last 10 years, non-branded underwear has been hurt by competition. However, Fruit of the Loom has strong brand recognition. Their products are also hard to beat on costs. Over the next 5-10 years, Buffett expects their men's and boy's underwear to hold up. It is not a business that can coast, but Buffett expects it to do reasonably well. Charlie commented, "With the number of products Berkshire sells, we won't win every skirmish with market share."

GOOD INVESTMENT BOOKS

A shareholder asked if Buffett would consider publishing his letters to his partners from his early investment days and if other good investment books could be recommended. Charlie said during Berkshire's early partnership, they ran a concentrated portfolio and investors would no longer recognize most of the names of the positions held at the time. Buffett said over time, he probably has held 400-500 names, but only made real money on ten of them. By the age of 11, Buffett had read every investment book in the Omaha library. Ben Graham's "Intelligent Investor" was the book that provided him with his bedrock investment philosophy as it teaches how to think about stocks and the stock market. Graham said investors should look at stocks as pieces of a business, and that the stock market is there to serve you and not instruct you. Phil Fisher's book, "Common Stocks and Uncommon Profits," also provided good instruction on seeking to invest in businesses that you could ride for decades, instead of trying to invest by going from flower to flower. Buffett said he reads for enjoyment, but his life would have been different if he hadn't read the two books mentioned.

AIRLINE INVESTMENTS

Bill Miller from Legg Mason sent in a question asking about Buffett's thoughts on the airline industry now that the industry has concentrated into four top carriers, which are now generating high returns and free cash flow. He also asked if there would be a benefit to NetJets associating with a major airline. Buffett said he did not believe there would be any benefit to pair NetJets with the airlines. Buffett said just because there is consolidation in an industry does not preclude the remaining players from doing stupid things, citing Freddie Mac and Fannie Mae. Even Coca-Cola and PepsiCo, the only two real cola players, sometimes price their products at ridiculous prices. However, there are certain industries where consolidation will result in the remaining players doing very well. However, the airline industry has low incremental costs per seat and high fixed costs. It is a labor-intensive, capital-intensive business offering a commodity product.

Since the airline industry was started, it has been a death trap for investors. Capitalists should have shot Orville Wright down when he took his first flight and saved investors significant money. If there is only one airline remaining and no regulations, then it might become a wonderful business. Buffett remains skeptical that it is a good business now. Charlie said that when the railroad industry consolidated, it became a wonderful business, although he and Warren proved to be slow learners in recognizing that fact. He said Bill Miller might be right about the airline industry, but he would put it into the "too hard' pile. Buffett added, "We like things where change is not rapid and where competition will not take away the business." Charlie agreed, "You cannot create another railroad, but it is easy to create another airline." Buffett said over the years they have seen dozens of proposals to get into the airline industry. For some reason, it is an industry that attracts people, but the record has been dismal with a number of bankruptcies, including U.S. Airways which has gone bankrupt twice.

SHARE REPURCHASE

Buffett said a company's intrinsic value should be the deciding factor on share repurchases. At Berkshire, book value provides a reasonable tracking of intrinsic value, so that is why Berkshire set the policy of repurchasing shares at 1.2 times book value or less. Berkshire always wants to hold a substantial cash balance, approximating $20 billion currently. Then, they want to reinvest cash to take care of existing business needs. Berkshire will then look to allocate capital to acquisitions that create value per share. After that, share repurchases done at a significant discount to intrinsic value would make sure money for Berkshire. Charlie added that if cheapskates like them are willing to pay 1.2 times book value for Berkshire, then that represents good value. Buffett said they haven't done much in share repurchases as the stock price has traded in a reasonable range to intrinsic value in recent years. However, he said "If Berkshire's stock price does sell at a significant discount to intrinsic value, we will buy it."

CHARLIE IS NOT MOVING TO OMAHA

When Charlie was asked if he would consider moving back to Omaha to be closer to headquarter, he said, "No, the phone works quite well." Buffett joked, "We know how the other guy thinks. We don't even need the phone." Charlie added that he feels like Rip Van Winkle when he comes back to Omaha for the meetings given all the changes in Omaha.

CLIMATE CHANGE

Buffett said he believes that the climate is getting a lot warmer, and that there is a reasonable chance that the global warming people may be right. He said he doesn't know the answer, but he doesn't think it makes a real difference in assessing their insurance rates from year to year. Berkshire has a general bias to be pessimistic in pricing catastrophes and natural disasters. However, global warming is not a real factor in setting current insurance pricing. Charlie said as a Cal-Tech trained meteorologist, he thinks carbon pricing is pretty unpractical. To change habits, carbon taxes would work better. Europe puts high taxes on motor fuels and stumbled on the right policy. "The U.S. should have higher taxes on motor fuels," Charlie proclaimed.

SHORT- SELLING

Doug Kass said that short-selling could be a value-added investment tool for Berkshire and pointed out that Todd Combs had done short-selling in the past. Charlie interrupted, “Todd Combs had so much success, he stopped doing it!” When Kass suggested that Berkshire give him $100 million to demonstrate his short-selling skills with profits going to charity, Charlie emphatically said, “The answer to your question is NO!!” Buffett added, “We are no stranger to short-selling. We failed at it.” While a lot of money can be made by short-selling, Berkshire does not like “trading agony for money.”

FAIR PRICE FOR HEINZ DEAL

When asked about the price paid for the Heinz deal, Buffett laughed, “We usually feel we pay too much. However, if the business is compelling, we gag and get there on price. Generally, if we buy a wonderful business that stays a wonderful business, we have found that we could have paid substantially more.” A wonderful business is one that earns high returns over time and is able to deploy more capital at high returns. Those types of businesses are relatively unusual but the best businesses of all. In those cases, investors should probably stretch to buy the business. See’s Candies is a good example of a business Berkshire stretched to buy.

Buffett noted that the stock market will offer you more opportunities to purchase wonderful businesses than negotiated purchases of entire businesses. In the stock market, a Flash Crash can happen to give you an opportunity that would not occur in the business market. Buffett said, “We like to buy great businesses to hold forever.” Charlie chimed in that if you want to win you have to keep learning all the time.

$16 TRILLION IN DEBT

An 86-year old veteran pleaded with Buffett to quit eating hamburgers for health purposes. He then asked with Buffett’s thriftiness, how he could support President Obama with big government’s $16 trillion in debt. Buffett joked, “You have to give Bush some of the credit for the $16 trillion, too.” Buffett then said he has found over the years that it is totally unproductive to discuss politics as half of the people in the room will agree with you and the other half won’t.

However, he said the amount of deficit spending and stimulus was appropriate given the threat of the greatest panic of our lifetime. He knew things were bad when GE called Berkshire as their last stop, and Fannie Mae and Freddie Mac failed. How we get off the stimulus is a problem, but less of a problem than the austerity that would have ensued without the stimulus. Charlie said he agreed completely. Buffett said George Bush issued the 10 greatest words to describe the panic at the time, “If money doesn’t loosen up, this sucker is going down.” Buffett said leaders of both parties came up with policies that were useful during the panic. After World War II, our country faced a higher ratio of debt to GDP than it does today, and the country has done satisfactorily since then. “We have encountered far worse than now, “Buffett added. We will do fine, but with lots of bickering. However, 10-20 years from now things will look better than today. Charlie added that the current stimulus programs are very confusing. He grumbled, “If you aren’t confused, then you don’t understand.” He also lamented the focus on the debt/GDP ratio saying that no one ratio is in the stars as far as forecasting ability. He also noted that the off- the- book debt is worse than the debt that is on the books. Charlie said the great problems will go away if GDP were to grow at 2% per annum, but that we need policies to enable us to grow at that rate.

BENJAMIN MOORE

When questioned if Benjamin Moore is losing its competitiveness and market share, Buffett said the paint company is not losing market share in the high-end of the paint business, which is a relatively small percentage of the overall paint industry. Benjamin Moore uses a dealer system. The Big Box stores approached Berkshire about distributing Benjamin Moore in their stores, but Buffett felt that would have double-crossed their dealer policy. He said the dealer policy works with Benjamin Moore. Management was changed at Benjamin Moore when former management was looking to gut the dealer system. Charlie agreed that the dealer system has worked well. Buffett does not expect Benjamin Moore to gain a much higher market share, but the company will still provide Berkshire with good profitability. Charlie exclaimed, “I wish we could buy five more businesses tomorrow like Benjamin Moore!”

INDEX FUNDS

When asked it the top 20 companies in America could outperform an index fund, Buffett said the 20 best stocks would probably match index funds. He said investors should become experts on businesses or buy equities. Equities will do well over time, but amateur investors often get excited at the wrong time. There is nothing wrong with being an amateur investor and just buying an index fund. Charlie agreed, noting that it is important to know one’s circle of competency. He said, “If you think you know more, it becomes dangerous.”

MULTI-BILLION DOLLAR GIFTS OF BERKSHIRE STOCK

Buffett said he gives away 4 ¾% of his stock each year to charity. This represents less than 1% of the market value of Berkshire’s stock, so he said his gifts were “peanuts” in comparison to Berkshire’s market cap. He said his multi-billion dollar gifts of Berkshire stock will not impact Berkshire’s stock price when the shares are sold by the charities. Berkshire’s average trading volume is $400-$500 million a day, so $2 billion sold over a year won’t impact Berkshire’s stock price. Charlie added, “There is nothing more insignificant than $2 billion to an old man.” Buffett agreed, noting that the $2 billion has a lot more utility to other people than it does in his safe deposit box.

READING THE TEA LEAVES ON THE ECONOMY

Buffett said Berkshire is willing to go any place where they can make money. However, he thinks Berkshire will find most of it opportunities in the U.S. because of the huge number of businesses here. Over the last four years, Buffett has seen a gradual improvement in the economy. It has been slow progress in the U.S. economy. While the economy has not come roaring back, it has not faltered. The overhang in housing ended about a year ago with some improvement in housing prices. He expects the economy to continue to move forward slowly. He does not see a surge, but also not a stall for the economy. There may be four to five times in a lifetime that investors see incredible opportunities in the equity markets. At those times, investors need to be able to act fast both with financial ability and mental fortitude.

ATTRACTING INVESTORS WITHOUT A TRACK RECORD

A young fellow asked Buffett for advice on how to get people to invest with him without an investment track record. Buffett recommended that he develop an audited track record as early as he can. Buffett said he looked at Berkshire's other investment manager's track records that he could believe and understand. Buffett added, "To attract money, you should deserve money. You should be able to explain that your record is based on sound thinking." Charlie said that most people start investing money with their family and friends. Fees charged should also be reasonable. Buffett noted that if Todd and Ted charged the normal 2% and 20% fees of hedge funds at Berkshire, they each would earn $120 million even if they just put Berkshire's money in the ground. Charlie complained that the arithmetic of hedge fund fees attract the wrong people.

AJIT JAIN

Buffett was asked about the special skills of Ajit Jain, who heads several reinsurance businesses at Berkshire, and whether he was Buffett's successor. Buffett dodged the last part of the question and noted that Ajit's business won't be without him for a long time. Charlie said, "If Ajit wasn't with us, we would not be as good." Buffett noted that was the same with a number of other Berkshire managers, too. Berkshire operated for 20 years without Ajit, and Buffett joked, "If Ajit had come along in 1965 instead of 1985, we would own the world!"

HOWARD BUFFETT AS FUTURE NON-EXECUTIVE CHAIRMAN

When questioned about the operational and investment experience of Howard Buffett, who is slated to become Berkshire's non-executive chairman when Warren Buffett is no longer around, Buffett said Howard is taking the role in case a mistake is made in choosing Berkshire's next CEO. Howard's job will not be to run operations or make investments, but to be the protector of Berkshire's culture, which is an enormous responsibility. If the Board of Directors need to make a change in the CEO, it is good to have a non-executive chairman in position to help make that change. There has been an enormous improvement in corporate governance with the requirement that the board meet at least once a year without the CEO attending the meeting. The Board is a social group, and it is sometimes difficult to discuss a CEO's shortcomings if he or she is present. Charlie added, "The Mungers are much safer with Howard there." Howard will feel the responsibility of his role as the Board owns enormous amounts of Berkshire stock and much of the stock will go to help others in the world. Charlie noted that CEOs can perform well in 9 of 10 aspects, but still have deep flaws. Buffett joked, "The meek shall inherit the earth, but will they remain meek?" Charlie recounted a story of a California CEO who took over a company and described him as the only man who could strut while sitting down.

LOW INTEREST RATE ENVIRONMENT

Buffett acknowledged that the problem faced by people invested in cash is brutal given the low interest rate environment. The loss of purchasing power is staggering. Savers are huge victims of the Fed's low interest rate policy. Buffett said he feels sorry for folks who have clung to short-term investments as ¼% rates on a $1 million portfolio only generates $2,500 in income, not what they would have anticipated for retirement income. Buffett believes owning businesses through stock investments makes more sense than fixed-dollar investments. This made dramatically more sense a few years ago when the stock market was down and the Fed said it would keep fixed rates low for a long time. The fallout of low interest rates has hit people in a hard way. Low interest rates make a good argument for owning productive assets. Charlie grumbled, “The Fed’s policies (following the financial crisis) had to hurt someone, and savers were convenient.”

IBM’S MOAT

When asked about IBM’s moat (competitive advantages), Buffett acknowledged that he does not understand IBM’s moat as well as he does companies like Coca-Cola, Wrigley or Heinz. However, he feels good about his investment in IBM. There is nothing to preclude companies like IBM or Microsoft from being successful. He likes IBM’s financial policy and believes the business will do well over time. He did note that IBM has large pension obligations, which he would prefer that they not have. He said pension liabilities are always more certain than pension assets. Charlie agreed, citing the case of Japanese life insurance companies which had agreed to pay 3% interest rates and now find they can’t pay them. He noted that Berkshire’s life insurance operations are pretty small. Buffett stated, “You always want to be in a position to accept an option, not to give one.” With that in mind, 30-year mortgages currently look like a good deal for home buyers. However, life insurance companies are facing some big problems.

INVESTING SMALL AMOUNTS

A shareholder noted that Buffett had said that his investment philosophy was 85% Ben Graham and 15% Phil Fisher and that if he were investing small amounts, he could earn 50% returns. Buffett said if you only have $1 million to invest, you can look at very small things with opportunities out there to earn high returns. However, given that Berkshire has $12-$14 billion in cash coming in annually, he doesn’t even think about those types of small investments. Charlie chuckled, “I am glad that I am through with that problem.” He noted that he now can make big returns on the float of his income tax.

EMERGING MARKETS AND CHINA

When asked about how he looks for investments in emerging markets or China, Buffett said he doesn’t start out looking for investments in emerging markets or specific countries. It also is not his strength to invest in emerging markets. He said if he could only invest in the United States, it would be no great hardship. Charlie added that dividing up the world by countries or regions to sell investments is a good way to generate commissions but not much else. Buffett concluded investors should just look for good businesses at attractive prices.

HOUSING BUBBLE

When asked if another housing bubble might be appearing, Buffett said we are not remotely near a housing bubble now. The whole country went crazy before on housing. Legislation encouraged Fannie Mae and Freddie Mac to do things they shouldn’t have been doing. At the time, skeptics looked like idiots while speculators made money. Folks jumped on the bandwagon as they saw their neighbors making money on housing. Overwhelmingly, people got caught up in a grand illusion, which will happen again but not now in housing. Given the low interest rate environment, Buffett would still recommend people buy a home to live in at the current time. Charlie explained that the main problem during the past housing bubble was that as things got crazier and crazier, the government did not pull way the punch bowl before everyone got drunk, but instead they increased the proof. Buffett added that humans will make the same mistake again. While the housing bubble contributed to the financial crisis, the real problem was when people got fearful all at the same time and began pulling money out of even their money market funds. Confidence came back slowly, one person at a time. When folks get greedy, they tend to get greedy in mass, too. Buffett stated, “Charlie and I don’t get caught up in what others do. When we see falling prices, we see it as an opportunity to buy, but we don’t go on margin.” Leverage in housing was the underlying problem of the housing bubble.

INVESTMENT OPPORTUNITIES IN THE EUROZONE

Buffett said he is willing to look for investment opportunities in the Eurozone. Last year one of Berkshire’s subsidiaries did make a bolt-on farm equipment acquisition in Europe for about $100 million. The current Eurozone woes may create further opportunities for Berkshire to buy businesses there as Europe is not going away. The major flaw occurred when the Euro was designed. While the currency was synchronized, not much else was synchronized among the European economies. Charlie derisively exclaimed, “Letting Greece into the European Union was like using rat poison as whipping cream! It was an exceptionally stupid idea!” He further explained that Greece used “extreme fraud” in their financial reporting to get into the European Union. He concluded that Europe will muddle through its current problems in the next 10 years. Buffett added, “We would be delighted to buy a big business in Europe.” Charlie quickly replied, “I hope you will call me first if it is in Greece.”

SOCIAL MEDIA

When asked about social media’s impact on Berkshire’s business, Buffett said half of the people in the audience could answer the question better than him. He then explained that the Internet has greatly changed GEICO’s business. He said they need to listen to their customers, and if customers want to buy insurance over the Internet, Berkshire has to be prepared to sell it to them that way. Buffett noted, though, that he was amazed at how fast the business changed. He then joked that it would be a terrible mistake for Berkshire to put Charlie and him in charge of social media. Charlie added that he hates the idea of teenagers using social media to immortalize forever the dumbest things they do. He warned, “There is a time when ignorance and folly should be hidden!” He also grumbled that when people multi-task like crazy, none of the tasks are likely to be well done. Buffett jokingly concluded, “Is there anyone we have forgotten to offend?”

FINANCIAL STATEMENT FRAUDS

When asked how to identify fraud when reading financial statements, Buffett said he has seen frauds in insurance businesses when financial statements show insurance reserves going down suspiciously right before the company sells new stock. Financial statements can reveal how people play with numbers when they are promoting a stock. Buffett said there are so many ways to cheat with accounting, especially with financial institutions. Charlie agreed saying that some of the folks are not trying to be deliberately fraudulent, because they are deluded into believing the accounting. Buffett said he is not sure that he finds financial statements today as useful as they were 20-30 years ago. Charlie agreed saying that big bank financial statements are hard to understand because they have so many footnotes and gobbledygook. Assets often are only good until they are reached for in the banks. Buffett then recounted the story of Salomon Brothers, which had on its balance sheet a "plug number" that had grown to $180 million on its $4 billion capital base. The $180 million was just plugged in to make the balance sheet balance, which Arthur Andersen somehow seemed to overlook when auditing the balance sheet. Charlie grumbled that funny things can happen in accounting. He likened accounting to what happened in Italy when too much mail piled up in the post office…they just threw it away in carloads. Buffett warned Charlie that he should not name countries, but Charlie chortled, "It happened in Italy!"

SOUTH AFRICA

When asked if he would make investments in South Africa, Buffett said if he understood the nature of a business there, he wouldn't preclude it. Charlie noted that someone had bought a basket of all the small banks in South Africa and had made money. However, Buffett said it wasn't their specialty.

TRANSFER OF WEALTH

With the greatest transfer of wealth occurring now between generations, Buffett was asked about his comment that you should leave your children enough money to do anything they want but not so much that they do nothing. Buffett said that more kids are ruined by the behavior of their parents than by the amount of their inheritance. He said the amount of money is not the determining factor, but how parents behave. He said he has loosened up on how much his children will receive. He thought it was crazy for kids to have to read the will after the parents are dead to find out what they inherit. He thinks parents should have the kids read and understand the will before the parents die. Buffett believes his money has more utility to society than leaving it all to the kids. Charlie quickly added that you don't want to discuss the will with the children before you die if you are going to treat them unequally.

STOCK SPLIT

When asked if Berkshire would split the A shares, Buffett said the creation of the Berkshire Hathaway B shares effectively created a stock split in the stock. Then after the BNSF purchase, the B shares were split 1500 for one. Buffett added that the Berkshire Hathaway A shareholders can split their shares anytime by converting the A shares to the B shares. Charlie growled, "I would not hold your breath for us to change."

With that answer to the last question, what did not change was another great Berkshire Hathaway annual meeting!