BERKSHIRE HATHAWAY 2010 ANNUAL MEETING NOTES

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We spent the weekend with Warren Buffett along with 40,000 other folks from around the world who were attending Berkshire Hathaway's annual meeting on April 30, 2010. Mr. Buffett and Mr. Charlie Munger, Berkshire's Vice Chairman, were in great spirits as they answered questions for more than five hours. Here is a summary of my notes from the meeting:

PRE-MEETING MOVIE

Berkshire Hathaway always plays a movie prior to the meeting featuring newsworthy and humorous clips about the business, management and topics of the time. Many of the segments repeat year after year, but new material included in this year's movie is highlighted below:

This year's movie included a sneak preview of "The Secret Millionaire's Club," the cartoon Buffett will be starring in to help children gain financial literacy. Charlie Munger and Bill Gates made "fleeting" guest appearances.

As the newest addition to Berkshire's collection of companies, Burlington Northern Santa Fe enjoyed a long segment of the movie showing the storied history of Burlington against a scenic and musical background.

A clip from Buffett's interview with Hank Paulson on the financial crisis included Buffett's quip that George Bush understood the crisis better than most thought. At the time Bush uttered a sweet and short statement similar to the Gettysburg Address that captured the essence of the situation: "If money doesn't loosen up, this sucker can go down!"

A movie clip was shown from "Wall Street: Money Never Sleeps," Michael Douglas' new movie which reprises his "Greed is Good" Gordon Gecko role. Buffett made a cameo appearance.

A clip from an interview with Charlie Munger was played in which he bristled over the "perfectly screwy decisions" that led to the financial disaster. While it is popular to think that Berkshire found a trick to sidestep the problems of other financial institutions, Munger wryly noted that it wasn't brilliance on Berkshire's part but the ability to "just avoid stupidity." Berkshire makes its investment decisions by evaluating opportunity costs. Munger muttered it is just like in marriage, "You want to choose the best spouse you can find--who will have you. The rest of life is the same damn way!"

Jordon's Furniture ran a promotion last year that if the Boston Red Sox won the World Series, furniture purchased during a certain time period at the beginning of the season would be free. A clip was shown of a panicked Jordon executive calling Buffett to see if he had any ideas on what to do as the final game of the World Series was approaching and it looked like Jordon's might have to pay off on their offer. A comical clip ensued with Buffett being called in to pitch for the Red Sox against Yankee all-star, Alex Rodriguez. The first few Buffett pitches were pitiful and called balls by the umpire as the announcer woefully noted that Buffett only had three speeds to his pitches-- slow, slower and reverse. Others hooted that Buffett's pitches were falling like Acme Bricks and that they had seen Pampered Chefs throw faster balls. However, after Buffett drank some Coke and munched on some See's Candies on the pitcher's mound while watching Berkshire ad's for all of his companies flash across the electronic billboards, he found new energy and struck out A-Rod and won the World Series for the Red Sox! At the end of the game, they panned to a dejected Alex Rodriguez and asked him in Disney fashion, "Now that you have lost the World Series, what are you going to do?" He barked out, "I'm going to Omaha! I need to figure out this Buffett guy!" With that warm-up, the actual meeting commenced.

FIRST QUARTER RESULTS

Warren Buffett began the meeting with a preview of the first quarter results which showed that operating earnings increased 30% to $2.2 billion, aided by the contribution from the acquisition of Burlington Northern Santa Fe and improvement in most of Berkshire's businesses. Net earnings for the first quarter were $3.6 billion versus a loss of $1.5 billion last year. Buffett noted that a sputtering recovery had picked up steam in March and April with Berkshire seeing a good uptick in business, although he cautioned that there was still a long way to go. In discussing quarterly earnings, Buffett noted that he thinks it is a terrible practice for companies to manage their earnings to the penny that is "whispered" to Wall Street. At Berkshire, they don't worry about earnings per share or focus on quarterly earnings. When Buffett asked Charlie if he had any comments, he succinctly stated, "I agree with you." Buffett laughed and said, "That is why Charlie is the perfect Vice Chairman. They don't get any better!"

GOLDMAN SACHS

Buffett spent a great deal of time discussing the Goldman Sachs' Abacus transaction that has prompted a SEC complaint. Buffett felt there had been a great misreporting of the nature of the transaction, so he attempted to explain the transaction. He noted that there had been several losers in the Abacus deal. Goldman Sachs was a loser of about $90 million in the deal, although Buffett noted that Goldman only lost the money because they couldn't sell all of the deal. The main loser in the deal was a large bank, ABN Ambro, which is now part of the Royal Bank of Scotland. They lost money because they guaranteed the credit of another party, ACA.

Buffett noted that Berkshire has made lots of money guaranteeing credit, but they also have lost money at times. ABN Ambro took on about $900 million of risk for 17 basis points, which meant they received about $1.6 million in premiums for insuring the $900 million risk. Buffett added that it is hard to be sympathetic for a bank that made a "dumb credit decision." Many of the bond insurers had started out by insuring only muni bonds. However, when profits were squeezed, they entered the business of insuring structured financial products. They were like Mae West who said, "I was Snow White, but I drifted." They drifted into things they didn't understand as well and got into trouble. Berkshire, on the other hand, drifted into insuring muni bonds, but Berkshire never insured collateralized debt obligations or residential mortgage-backed securities.

Buffett then disclosed a Berkshire deal in which Berkshire insured $8.25 billion of municipal bonds in a variety of states with muni bonds from Florida and Texas making up the largest component of the deal. Berkshire insured that for the next 10 years that they will pay the bonds if the states can't. For that insurance, Berkshire collected $160 million in premiums. Buffett then revealed that it was Lehman who came to Berkshire seeking the insurance for the deal. Buffett said Lehman may have had a variety of reasons why they wanted the insurance:

1) They owned the bonds and wanted protection.
2) They were short the bonds.
3) Customers owned the bond and wanted protection
4) Customers wanted to short the bonds.

Berkshire really didn't care what the reason was that Lehman came to them for the insurance. Berkshire's job was to assess the bonds and determine the premium they would charge to provide the insurance if they chose to do the deal.

Buffett said that was the same thing ACA should have done when putting together the Abacus deal. Out of 120 bonds offered in the deal, ACA picked 80 to insure through mutual negotiation. All of the bonds ended up going south very quickly as the housing mania caused the bonds to blow up. ACA has a team to do the due diligence analysis on the bonds, so it didn't really matter who was on the other side of the deal, whether it was John Paulson, Ben Bernanke or Berkshire. ACA made a "dumb insurance decision."

Buffett went on to say that ironically the SEC complaint against Goldman Sachs probably helps Berkshire's $5 billion preferred investment in Goldman Sachs, which is paying Berkshire $500 million a year in interest. Goldman has the right to call the preferred stock at 110% of par at any time. If they did call the preferred stock, Berkshire would likely be earning $20 million on that $5 billion instead of $500 million given today's low interest rates. Buffett joked that the $500 million in annual interest equates to $15 per second and he started counting the dollars by saying, "Tick, tick, tick, tick!" He added, "I don't want those ticks to go away. They even go on at night while I'm sleeping. Tick, tick, tick!" Buffett noted the government is doing Berkshire a big favor by requiring Goldman to hold onto the preferred stock until they feel their capital is adequate. The recent developments with the SEC will likely delay Goldman from calling in the preferred stock. "Tick, tick, tick!" Buffett concluded, "We love the Goldman Sachs investment!"

Buffett acknowledged that the SEC allegation alone did cause Goldman to lose some worldwide reputation and likely hurt morale at the company. But Buffett doesn't believe that the allegation alone would cause Goldman to lose reputation from Buffett's viewpoint. However, if the allegation were to lead to something more serious at Goldman, then Berkshire would look at it.

As far as advice Buffett would offer Goldman, he quoted the motto: "Get it right, get it fast, get it out and get it over." He emphasized that the "Get it right" is the most important action to take in a situation like this.

Charlie added that while he thought the SEC complaint against Goldman was a "closer case" than Buffett thought, he still would have voted with the 2 SEC commissioners who voted against bringing the complaint against Goldman instead of with the 3 SEC commissioners who voted for the case to be charged. Charlie went on to say that every business should decline doing business that may be legal but is below their standards of business ethics. He noted that all investment banks "took on too many scuzzy customers and did too many scuzzy deals."

Buffett noted that Berkshire's experience with Goldman Sachs goes back 44 years. Berkshire has bought more businesses from Goldman than anyone else. In essence, Goldman helped build Berkshire. Berkshire also has done more trading with Goldman, and Buffett noted that when Berkshire trades with Goldman, they don't owe Berkshire a divulgence of their positions. Goldman acts in a non-fiduciary capacity when they trade with Berkshire. When it comes to acquisitions, that is a different story.

Buffett recounted Berkshire's first bond issuance in 1967 for $5.5 million of an 8% debenture for Diversified Retailing. It was Berkshire's maiden voyage in seeking to do a bond offering. He showed the tombstone which listed the lead underwriters for the deal with New York Securities and First Nebraska Securities taking the lead spots among the various underwriters on the deal. With Berkshire having trouble raising the $5.5 million, Buffett called Goldman Sachs and Kidder Peabody to see if they would participate in the offering. Each firm agreed to put up $350,000 making them the largest underwriters in the deal. However, they both were so “ashamed” to be part of such a little company that they asked that their names not be included on the tombstone. However, Buffet has never forgotten their help at that time and noted that he has a long memory for people who help Berkshire.

Buffett said he had not been contacted about the SEC’s investigation into potential insider-trading by the Galleon hedge fund. As part of that investigation, the SEC has phone records of a Goldman Sachs director, who allegedly may have leaked information about Berkshire’s investment in Goldman to Galleon. Buffett said all he knows about the case is what he read in the newspaper, and he can’t even pronounce the name of the fellow from Galleon being investigated.

As far as whether Goldman Sachs should have disclosed the Wells Notice they received from the SEC as part of their investigation of the Abacus deal, Buffett said that many boards don’t feel it is necessary to disclose the notices if they don’t believe it to be material to their operations. Buffett didn’t think the Abacus deal was material. However, Buffett did note that when General Re executives were served Wells Notices, Berkshire did disclose that information.

Charlie added that he also didn’t think the Abacus deal was material. He also noted that if all information had to be disclosed, there would be unlimited confusing reports.

When Buffett was asked if Goldman Sachs’ CEO, Lloyd Blankfein, were to step down, who he would choose as his successor, Buffett quipped he’d pick Lloyd Blankfein’s twin brother if he had one. He shrugged off the succession question saying he hasn’t thought about it at all.

Charlie commented, “There are plenty of people on Wall Street, I’d like to see gone, but Lloyd Blankfein isn’t one of them!”

Buffett quickly moved to the next question, joking he didn’t want Charlie to start listing names.

FINANCIAL REFORM

Charlie Munger noted that no one really knows what will happen with financial reform as most people haven’t even read the 1500 page bill, not even in Congress. A permissive government system and the nature of investment banks put them all in stress. Reform should change the system so it is less permissive. Banks hate the idea of losing flexibility so they don’t want to give up derivatives, but that is not good for the country. Charlie added that if he were in charge of financial reform, he would make “Paul Volcker look like a sissy!” He would reduce the activities of the investment banks. He noted we shouldn’t have financial statements that no one can understand. “Crazy complexity is unproductive!” Charlie thinks there should be a new version of the Glass-Steagall Act that limits what banks and investment banks can do. He added that if you give banks the flexibility “to do whatever they damn please, they will go plumb crazy, which is what they did.”

BERKSHIRE COLLATERAL REQUIREMENTS UNDER FINANCIAL REFORM

Berkshire Hathaway has $63 billion in notational value in derivatives (less than 1% of the derivatives of large institutions) and is not required to post collateral on the majority of those derivatives under the terms of the contracts. Buffett added that under proposed legislation to post collateral on retroactive contracts, Berkshire’s collateral requirements would still be zero since Berkshire would not be regarded as a “danger to the system.” After acquiring General Re, Berkshire had 23,000 derivative contracts but now has only 250. However, if Treasury requires that all past contracts have to be collateralized, Berkshire would lose money. Buffett likened it to selling a house to someone at a certain price and then the rules were changed saying that you now have to sell the house at that same price but you also need to furnish the house. There is a price to be paid for collateralized contracts. Buffett put up a Dec. 2009 slide of a quote by Treasury Secretary Timothy Geithner stating that the sanctity of past contracts needs to be maintained. So as the financial bill reads now, Berkshire will not need to put up a dime of collateral on its past contracts.

Charlie added that if collateral requirements for past contracts were changed, he believes it would be dubious that it would hold up constitutionally. Not only would it be unfair to tell someone who purchased a $1 million home that they now needed to pay $2 million for it, it would also be stupid. He doesn't think that the government is that crazy.

Buffett added that there is nothing peculiar to Berkshire opposing retroactive collateral requirements as there are hundreds of companies opposing it from IBM to 3M. Berkshire doesn't care if the government changes the requirements going forward as Berkshire will be indifferent to the collateral requirement if they are paid for it.

GREECE AND PREPARING FOR CURRENCY FAILURES

Buffett noted that Berkshire has currency exposure in various countries both on the asset side (Munich Re and Cologne Re) and the liability side (Lloyds of London). Buffett is not concerned about Berkshire's net position in Euros. Overall, Berkshire does not have any dramatic exposure to foreign currencies. Buffett, however, did acknowledge that the fallout from debt problems in Greece could be important to world economies.

Charlie added that Berkshire is agnostic to the relative value of currencies although he noted that Greece is "an interesting problem." He reflected on how after WW II, the U.S. helped rebuild Germany and Japan which was the "wisest decision ever." Today, governments around the world don't have as good credit as they once did. It is more dangerous to civilization when "governments blow credit." In the U.S., Munger stated, "We are nearer to trouble in credit than at any time in my lifetime."

Buffett noted that if a country can borrow in its own currency like the U.S. and Japan, the country will never default as they just print more money to pay back their debts. This can lead to inflationary problems but not default. However, if the world doesn't like weaker credits, they force the countries to borrow in other currencies like countries in Latin America had to do. Greece also can't print their own currency as they are part of the Euro experiment, which was started 20 years ago. Greece will be a test case for the strength of the Euro. Buffett said he doesn't know how this movie will end, but expects "high drama." Buffett concluded that countries can't run budget deficits at 10% of GDP for long time periods, but he's not sure how the world weans itself off high deficits.

Charlie warned that when one reads statistics on budget deficits, they should keep in mind that the deficits are "miles bigger" than reported as they don't include unfunded promises. He further warned, "If growth stops, God help us!"

SALE OF BERKSHIRE STOCK BY GATES FOUNDATION

Buffett makes annual donations of Berkshire stock to five charitable foundations, including the Bill and Melinda Gates Foundation with the goal of giving away all of his Berkshire stock to charity over time. When asked if the regular sale of Berkshire's stock by the Gates Foundation will put downward pressure on Berkshire's stock price, Buffett didn't think so. He noted that the shares he gives away each year amount to 1 ½% of Berkshire's shares outstanding. Even if the foundations sold the stock promptly, it wouldn't be anything unusual since most stocks have turnover of more than 100% each year. Buffett said if Berkshire's stock declines it is due to something other than the 1 ½% of the shares being sold by the foundation. Charlie added that the charitable sales are a non-event admonishing the questioner, "You have more important things to worry about."

INVESTING IN THE U.S. VERSUS INVESTING GLOBALLY

Charlie Munger said Berkshire finds things that are sensible and concentrates its investments there while letting the world economies fluctuate as they will. Charlie muttered, "Berkshire doesn't have a global asset allocation policy, unless Warren is keeping a secret." Buffett quipped, "Not that one!"

Buffett noted that the U.S. has made incredible progress over the last 200 years as our economic system "unleashes human potential and encourages ordinary people to do extraordinary things." He said the game is not over by any means in the U.S. and that it is not a zero-sum game as he hopes the rest of the world does just as well. Buffett concluded that he would be perfectly content if Berkshire was limited to investing just in the U.S. as there is still plenty of opportunity.

SUCCESSION PLAN FOR CHIEF INVESTMENT OFFICER

Buffett noted that the four external candidates to succeed Buffett as chief investment officer didn't distinguish themselves during 2008, but did pretty well in 2009. He also noted that they may not always be the same four people. If something were to happen to Buffett, it is critical that a Chief Executive Officer be named within 24 hours, and the Board knows who that would be. The CEO would then determine the CIO and that decision could be done on a more leisurely basis as Coca-Cola and Procter & Gamble won't go away just because Buffett does. The current CIO candidates are very able people who will do a good job managing money for Berkshire. Buffett joked that he just had a physical, and it drives his doctor nuts that he can't find anything wrong with Buffett given the way he eats.

Charlie added that he is quite optimistic that Berkshire's culture will last for a long, long time. Buffett agreed saying that Berkshire's distinctive culture both in management and shareholder ownership is self-reinforcing. He concluded, "We love it, and you will love it after I'm gone." As folks started clapping, Buffett exclaimed, "Hey, don't clap!"

INVESTING IN CAPITAL-INTENSIVE BUSINESSES

When asked why Berkshire has been shifting its investments towards capital-intensive businesses like Burlington Northern, Buffett acknowledged that it was a good question. He said that Berkshire is generating significant sums of money that are being invested in good businesses but not as good businesses as Berkshire had acquired in the past, which required little incremental capital to earn high returns. Wonderful businesses don't soak up capital-- that is why they are wonderful businesses. Berkshire is in the position where it can't find small companies that can" sop up" the money Berkshire is now generating. While Berkshire's capital-intensive businesses won't generate "brilliant" returns, they will generate good returns. Thus, Buffett doesn't think it would be better to return the cash to shareholders as he is still able to translate the cash into decent returns through investments like MidAmerican and Burlington Northern. While these investments are not Coca-Cola, Berkshire's shareholders' equity is still growing. He concluded, "I hope we don't disappoint you."

When Buffett asked Charlie if he had any comment, Charlie said, "I'm just as good as not knowing as you are."

INVESTING IN DEBT VS EQUITY

Buffett was asked why Berkshire chose to invest $300 million in Harley-Davidson debt instruments over its stock during the height of the financial meltdown. Buffett answered that he didn't know the value of Harley-Davidson's business, although he liked a business where customers tattooed the company's name on their chest. What he did know was that Harley-Davidson was not going out of business, so the 15% return on the debt was attractive. He knew enough to lend money, but not enough to buy the equity. It was a simple decision. If Harley didn't go broke, he would make good money.

Charlie noted that Berkshire serves as a fiduciary for many people, so they may be constrained when looking at distressed situations. However, he acknowledged that one should often buy the stock if they are willing to buy the bonds.

Buffett concluded that he sleeps better with senior securities. He is running Berkshire so it can withstand anything. Berkshire is positioned so that Buffett can do things when other people are paralyzed during market downturns.

CHANGING CORPORATE CULTURES

Buffett said it is hard to change a corporation's culture. Buffett noted that when he ran Salomon briefly, he tried to change the company's culture and would not receive an A+ for his efforts. It is much easier to start from scratch to build a new culture. At Berkshire it would be very difficult to change the company's culture as everything is designed to reinforce the corporate culture. With the luxury of time, Berkshire's culture has had decades to develop. Since 1965, Berkshire has added complementary companies which have bought into the company's culture.

Charlie grumbled, "The failure rate in trying to change a company's culture is 100%."

COMPETITIVE ADVANTAGE OF AJIT JAIN

A shareholder questioned whether National Indemnity would be able to continue to grow its float if Ajit Jain retires. In other words, he wanted to know if National Indemnity would maintain its competitive advantage without Ajit Jain. Buffett praised Ajit Jain by saying he has maximized the competitive advantage of his business and added significant value to Berkshire. Ajit also has schooled his 30-person cadre to run a disciplined operation. While Ajit can't be replaced, that doesn't mean that the reinsurance business won't continue to be a special operation that will be able to operate effectively.

Buffett noted that every year he thinks the insurance float has peaked with it now approximating $60 billion. Although every day float runs off, the float is still growing. Berkshire is the premier insurance operation in the world. While Buffett doesn't expect float to increase significantly without further acquisitions, the float may stabilize around $60 billion.

INVESTING IN INDIA

Buffett noted that there are limitations to Berkshire investing in the insurance business in India due to government regulations. Next March, Buffett plans to go to India with Iscar to review Iscar's operations there. Buffett does not rule out investing in India either directly or through stocks.

Charlie added that one trouble with India is that the government has a fair amount of paralysis. He noted that China will grow much faster than India as the Chinese government causes less paralysis. Charlie likes India but not its paralysis.

Buffett concluded that Berkshire should figure out ways to do business in India. His preference would be to invest in the insurance business both in India and China, but it depends on the laws. While there is no shortage of drivers around the world, both India and China restrict foreign ownership in their insurance companies to 24.9%. Berkshire would rather work hard on 100% ownership like with Geico, which has seen its market share grow from 2% to 8.5% in recent years. There is still plenty to do in the U.S. with Geico. Berkshire has looked at possibly expanding into Canada, but since there is still so much opportunity just in the U.S., Berkshire has also passed on Canada.

Buffett concluded by saying, “People in India, China and the U.S. will all be living better in 20 years.”

INFLATION

Buffett said he may be biased, but he believes the prospects of significant inflation have increased due to government action during the financial crisis. He also noted that the dollar has depreciated more than 90% since he was born, and Charlie reminds him that the U.S. has still done pretty well. However, weaning ourselves from the medicine of massive debt undertaken by the government during the crisis may be a harder problem than dealing with the original problem. High deficits relative to GDP will cause inflation as he noted in his Aug. 2009 Op-Ed piece, “The Greenback Effect” in *The New York Times*. If he was betting, he would bet on higher inflation in the future. Through the Op-Ed piece, Buffett was flashing a yellow caution light.

Buffett said there is no single measure to evaluate inflation. However, once inflation gets going, it can become self-reinforcing. He reminded shareholders of the inflationary period in the 1970’s which only was brought under control after Paul Volcker “took a sledgehammer to it.” He said we may see a re-run of the 1970’s if inflation “gets into the saddle.” It will be very hard to predict how fast it will accelerate. The trend is not destiny as we have the power to change the course through policies enacted by elected officials.

Charlie added that one’s own earnings power will help protect against inflation. Buffett concluded that money can be inflated away but talent can’t.

PREVENTING FINANCIAL MAYHEM

Buffett said we will see financial mayhem from time to time. It is not a function of IQ. We can’t modify the madness of mankind which occurs from time to time. It is good to provide financial lessons early in life. That is why Buffett is participating in the “Secret Millionaire’s Club” cartoon designed to improve financial literacy for children at the elementary level. Buffett says if he can reach 2%-5% of kids and help them develop healthy financial habits, the cartoon will be a success. Ben Franklin taught those types of financial habits, and we’re lucky if parents also teach good financial habits.

Charlie added that McDonald’s has succeeded better than universities in educating young folks on responsibility. McDonald’s hires people that are marginal and trains them to go to much higher job levels. Our society owes much to McDonald’s employment culture.

TAXES

A shareholder asked why Buffett is in favor of higher taxes on the wealthy, yet he plans to donate all of his wealth to charity, which avoids paying taxes. Buffett noted that the government could impose a wealth tax to prevent that kind of “tax dodge.” Currently, Buffett has an unused tax carry forward over $7 billion due to his charitable giving and recommended others use his “tax dodge.” He is giving all his money to charity as he believes it will do a lot of good. He noted that if he gave it all to the government instead of charity, society wouldn't be better off. He concluded that to reduce the deficit and solve today's problems, the U.S. will need to increase taxes and reduce expenditures.

NETJETS

Buffett said Berkshire will make mistakes from time to time. The biggest mistake at NetJets was to continue to buy planes at "fictitious prices" in terms of the prices Berkshire could sell the planes. NetJets didn't prepare properly for the industry conditions. They took on to much inventory and let operating costs get out of line. However, Berkshire is now operating NetJets at a profit greater than $50 million in the first quarter due to a better business plan and the efforts of David Sokol.

Buffett noted another mistake Berkshire made was with its textile business which took him 20 years to fix. He said he was like Rip Van Winkle when it came to the textile business.

Charlie added that when you buy 30 businesses, 95% of the time the acquisitions work out fine by leaving the original people in charge. One failure won't change Berkshire's culture on acquisitions.

BYD INVESTMENT

When asked how the decision was made to invest in BYD, Buffett turned over the question to Charlie saying he deserved 100% of the credit for that investment.

Charlie indicated that Berkshire would not have made the investment 10 years earlier due to the nature of the business. He joked it shows that old men can learn. He added that David Sokol helped the learning process.

CEO COMPENSATION

Buffett said Berkshire uses no compensation consultants when determining compensation. Each business has different characteristics. For example, the insurance business requires negative capital to run due to its float while Burlington Northern is a capital-intensive business. Berkshire has some businesses that are so easy that "a chimp could run them" while other businesses are so hard that Alfred P. Sloan couldn't operate them.

Berkshire has to determine a sensible compensation plan for each business. It is not rocket science, but requires the ability to differentiate the businesses. If Berkshire had a human resources department, it would be a disaster. All it requires is common sense and interaction with management to agree on which measures add value to the company.

Charlie noted that at GE and in the Army, a centralized payment plan works for them. At Berkshire a decentralized plans works which makes Berkshire "peculiar." Charlie chuckled, "We like it that way." Berkshire doesn't want folks to feel that headquarters is imperial.

Buffett noted that at Berkshire there are managers that make $10 million or more annually. It is a matter of treating folks fairly. Berkshire wants to pay managers for widening their moat around their businesses. He noted that no manager has left Berkshire over compensation.

DEALING WITH UNETHICAL BEHAVIOR

Buffett said if unethical behavior is discovered in a Berkshire unit, management jumps in to investigate. Berkshire has a hotline and encourages folks to report any unethical behavior. Any alleged bad behavior is immediately investigated. Charlie added that Berkshire cares more about unethical behavior than most businesses and action is taken.

Buffett noted that Berkshire sends out a periodic letter to each business unit CEO asking them for suggestions on their replacement if something were to happen to them. In the letter, Buffett reminds management that Berkshire won't trade reputation for money. He also reminds them that if any issue is even close to the line from an ethical standpoint, they should call him. Buffett concluded that with 260,000 people working for Berkshire, Berkshire will have things happen. However, Buffett wants to do everything he can to protect the reputation of Berkshire.

Charlie added that Berkshire has earned a great reputation. The idea is not just to make money at any cost. Berkshire "celebrates wealth only when it is fairly earned." If that philosophy is also embraced by shareholders, it is very helpful.

REGULATED RETURNS

Buffett said both Burlington Northern and MidAmerican Energy operate in regulated industries. Over the years, the railroads have adapted to a 10.5% return on invested capital (including debt) business model. This isn't a crazy trend as we need railroads to continue to invest to improve their infrastructure. Both the country and the railroads have a common interest in making much needed investments. To do so, the railroads need to be allowed to earn a decent return on their investments. Utilities are generally allowed to return 11%-12% on shareholders' equity. While railroad returns have more downside due to recessions, utility returns tend to be more certain as demand generally doesn't typically fall off significantly even during recessions.

Charlie added that railroads are an example of a hugely successful system in terms of regulated businesses. The railroad system has been rebuilt in the last 30-40 years to operate more efficiently with new tracks and new trains which now can operate twice as long and twice as heavy. Railroads have adapted well to needs thanks to wise regulations and wise management. That has not always been the case, but the existing system has worked well for all of us.

INSURANCE RISKS

Buffett said its insurance business insures significant risks from earthquakes and hurricanes. The Chilean earthquake is an example of the types of losses that might be seen. However, Berkshire's peak risk for hurricanes and earthquakes is down considerably. This is not due to Berkshire's diminished appetite to insure risk but because rates are currently not attractive. Berkshire has a $5 billion risk appetite, and Buffett reminded us that Berkshire lost $3 billion on Hurricane Katrina and $2 billion on 9/11. However, those losses didn't impact Berkshire's capital position. In the insurance business, Berkshire is willing to take risk and get lumpy earnings.

Charlie added that Berkshire seeks insurance business that will occasionally provide big losses, but they also want Berkshire to be rich enough so that any big loss is just a blip on Berkshire's overall financial condition. By being able to insure large risks, Berkshire enjoys a big competitive advantage in the insurance business as other insurance companies can't do it. Charlie chuckled that after enduring a big loss, Buffett knows he can look in the mirror the next morning and say, "Our shareholders still love you."

DERIVATIVES

Charlie thinks the function of derivatives is overrated. While derivatives are convenient for hedges, he thinks most should be restricted to trading commodities and currencies on regulated exchanges. He exclaimed, “If all derivatives vanished from the face of the earth, it would be a safer place!”

Buffett noted that some businesses like Burlington Northern want to use derivatives to hedge fuel costs. Buffett doesn’t think there really is any need to use hedges as they likely only provide the business with a slight edge over 100 years. However, if Burlington and MidAmerican want to employ hedges in their businesses, he will let them do it.

In discussing derivatives, Buffett put up the 1935 quote by John Maynard Keynes from Chapter 12 of his book, *The General Theory of Interest, Employment and Money*: "Speculators may do no harm as bubbles on a steady stream of enterprise. But the situation is serious when enterprise becomes the bubble on a whirlpool of speculation.”

Buffett believes derivatives on the S&P 500 index has led to the speculation that Keynes warned about. Back in 1982 when Congress was considering these derivatives, Buffett sent a letter to Dingell warning of the increased speculation this would bring to the stock market. Buffett said this would turn the market into more of a casino. And there were plenty of people that said, yeah, but it's more fun having a casino.

In a 1982 *Fortune* interview, Buffet also publicly stated that in his judgment, a very high percentage, probably at least 95%, of the activity generated by these contracts would be strictly gambling in nature and not good for capital markets. S&P 500 contracts also get better tax treatment than investing in stocks as 60% of their gain is treated as long-term, which he found nonsensical as many of the contracts aren’t held longer than 10 minutes.

Charlie added that the tax treatment is neither fair nor sensible and just shows how a small group can be effective at lobbying if others are indifferent. He groused, “You shouldn’t watch sausage making or legislation making!”

In a subsequent interview, Buffett explained further: “After the 1929 Crash, we decided that people buying stocks on 10 percent margin was dangerous for the economy, and we passed a law that said the feds should set margin requirements. And then what did we do in 1982? We validated an S&P 500 contract which let people gamble in untold numbers on tiny margins, all the while maintaining 50 percent margins with the Fed. It was crazy. But we took the safety net of high margins away from the stock market and nobody said a word. Buffett added, “I'm in favor of having leverage limited with organizations that can produce dangers for the system. And I actually think leverage ought to be -- extreme leverage ought to be prevented for individuals speculating in the market. We decided that was dangerous back in 1934 and I still think it's dangerous, and we totally negated the benefit of that legislation when we let the S&P 500 and the derivatives come in to the game big time.”

SYNERGIES BETWEEN BERKSHIRE BUSINESSES AND HIRING PRACTICES

A shareholder wanted to know why Dairy Queen stores in Omaha served Pepsi instead of Coke and didn’t accept American Express cards. Buffett quipped that most Dairy Queen stores do sell Coke--“at least the enlightened ones.” Buffett further commented that Berkshire does not direct their subsidiaries on their operational decisions. Charlie added, “We really like it that way!”

When an investor asked what qualities he needed to be able to succeed Buffett, Buffett joked, “Probably the ability to shoot me.” Buffett doesn’t make any decisions on who gets hired at Berkshire’s subsidiaries. Berkshire is not a very good employment agency with just 21 people at headquarters. Charlie added that there is “no indication that we would be good at hiring either!”

An investor asked why Berkshire didn't hire more people to provide folks with hope. Buffett responded, "Berkshire hires people when we have something for them to do." Berkshire can't serve as a socialization safety net. Berkshire is currently now in a net hiring mode. However, Buffett doesn't expect unemployment to away fast.

Charlie added that if Berkshire created jobs just to help human hope, over time it would reduce human hope.

INVESTING IN CHINA

When asked what the most important thing Berkshire has learned about investing in China, Charlie said it was the unusual people at BYD. Buffett quipped that he learned that Sprite outsells Coke 2 to 1 in China. Buffett noted that on a growth per capita basis China will grow tremendously in the future after showing little progress in improving their standard of living for the past 170 years. Charlie chimed in that he always knew that the Chinese had enormous ability for rapid growth. The Chinese will be a huge credit to civilization. However, even he had underestimated how rapidly China would set records for advancement.

CHANGES TO BERKSHIRE HATHAWAY'S ANNUAL REPORT

An investor wanted to know why Berkshire no longer discloses the "look-through" earnings of its investments. Buffett said Berkshire provides four logical breakdowns of Berkshire's various businesses and tries to communicate as much information to investors as they would want if their positions were reversed. At the same time, he doesn't want the annual report to become unwieldy and tries to keep the letter to shareholders to about 12,000 words. He doesn't repeat the reports on look-through earnings and the breakdown between investments per share and operating earnings every year in an effort to conserve 1,000 words. He is guided in writing the annual report by writing the letter to his two sisters, who are two intelligent and interested investors but who may not be familiar with all the financial lingo. He quipped after starting the letter, "Dear Doris and Bertie," he crosses out their names and substitutes "Dear Shareholders."

Charlie added that details in the annual reports change as facts change. Look-through earnings used to be much more important to Berkshire's overall results than they are now. Buffett agreed by saying look-through earnings now account for only about 15% of total earnings.

ROTH IRA CONVERSION

When an investor asked whether it made sense to do a Roth Ira conversion, Buffett said he didn't have an IRA. Charlie jumped in and succinctly said that he had an IRA and "I will convert it to a Roth IRA." Buffett tried to get him to explain further by saying, "I don't understand." Charlie retorted, "You don't need to!" Buffett laughed, "If Charlie says it is true, than it must be!"

NEWSPAPERS

Buffett said the money to run a newspaper comes from its advertising. Newspapers are no longer the only game in town when it comes to advertising. Given the distribution and print costs, the math no longer works on newspapers. Buffett said "it blows your mind" to see how many people are dropping newspaper subscriptions. It's not just young people. Back in the 1970's, nothing looked more bulletproof than the newspaper industry as advertising went to the papers as the only microphone in a town. However, the newspapers primacy has withered away.

Charlie recalled that the independent papers once were dominant with impregnable economic strength. As we lose the newspapers, "It is very sad, but there is nothing we can do about it."

CAREER IN INVESTING

A young person asked whether it was worth pursuing a career in investing as competition seems to be driving down investing opportunities. Buffett responded that there may be fewer fifty-cent dollar bills around but there will always be investment opportunities available if one is not working with large sums of dollars. He pointed to a company that Charlie manages, The Daily Journal. The Daily Journal maintained about $15 million in cash for many years. Then the financial meltdown occurred and Charlie took advantage of the downturn with the 2009 annual report of The Daily Journal showing that the $15 million in cash had been converted to equities which within six months had increased to be worth $45 million. Investors need to be prepared for opportunities when they come around.

Buffett also noted that investment management has conflicts as asset gathering often becomes more important than asset management.

Charlie growled that people should take the high road when it comes to money management as it is much less crowded.

MUNICIPAL BONDS

An investor was worried about whether muni bonds would default in 5-10 years and whether the federal government would need to bail out some states. Buffett said if the bonds are insured by Berkshire, then the investor needn't worry. He then cited Harrisburg, PA's recent default and that Assured Guaranty is now paying the interest on those muni bonds. The worry is that there may be contagion with other muni bonds defaulting. Bond insurers need to worry about contagion. Some bond insurers have enormous liability for the exposure they have assumed. Berkshire is not getting paid fair premiums for insuring muni bonds currently so they are curtailing their muni bond insurance. Buffett believes that it will be hard for the federal government to turn away a state that gets into trouble after bailing out GM and others.

Charlie quoted Ben Franklin, "It is hard for an empty sack to stand upright." Charlie said bad behavior is contagious and that he would rather be with the disciplined and prosperous crowd like those attending the Berkshire annual meeting.

RETURNS FROM EQUITIES OVER THE NEXT DECADE

Buffett said in October 2008 he was premature on buying stocks, but he still knew that it was way better to own stocks than cash or bonds. While he doesn't know what stocks will do over the short-term, he still would rather own stocks over the next 10-20 years than bonds or cash as he is very unenthusiastic about the latter. Stocks should at least provide a modest, positive return.

Charlie added that it is a cheerful thought to think that equities are the best of bad lots. He believes we are in a long period of time of ordinary returns which won't be that exciting. Investors should lower their expectations on returns. Berkshire, however, will still seek companies with competitive advantages that can be purchased at reasonable prices. "We will find some."

MOODY'S

Buffett said the rating agencies have incredible business models with significant pricing power and little incremental capital needs. The world needs the rating agencies although they succumbed to the same mania of the rest of the financial world. The rating agencies didn't see the national housing collapse. It is hard to think contrary to the crowd. With hindsight, there is now a backlash towards the rating agencies. If the agencies are not forced to change their businesses totally by new regulations, they will still be good businesses. Berkshire doesn't pay attention to credit ratings by the agencies as Berkshire does its own credit analysis.

Charlie added that the rating agencies had been a constructive influence in the country for many decades. However, "They drifted with the stupidity of the times. " The rating agencies over believed in ridiculous models from academics, who were huge contributors to the system's failure.

OIL

Buffett noted that oil was discovered in 1850 and changed the world. Since then, we have been sticking straws in the earth with 5,000 wells in the U.S. today. Oil has contributed to the prosperity of the world. However, the world will not be as dependent on oil over the next 100 years. There is a lot of potential to meet energy needs through solar power and in other innovative ways. The world has a bright future with tremendous opportunities for future growth.

Charlie added that with the technology today, the world can get ahead without oil if necessary. "It is not that horrible if we run out of oil."

Buffett concluded by saying that any adjustment in oil usage will be gradual.

KRAFT AND CADBURY DEAL

Buffett said he didn't like the deals Kraft did on buying Cadbury or selling its pizza business, but added, "We make dumb deals at Berkshire, too." Charlie agreed and muttered that "Our dumb deals were department stores and Irish banks."

Buffett went on to say that Kraft selling the pizza business was "particularly dumb" as it was tax inefficient and didn't make sense. Buffett hated to see Kraft give up a great business for Cadbury at a fancy price. However, he said Irene Rosenfeld, the CEO of Kraft, is a perfectly capable manager. As to her $26 million in compensation, he said Berkshire has rational compensation practices while other companies do things differently.

Berkshire owns a lot of Kraft and still believes it is selling for less than its parts…especially if you value the parts they way Kraft valued Cadbury.

Charlie recalled when Xerox acquired Crum and Foster, an insurance company. He described that as the "dumbest deal of all time." Managers often think another business is easier to manage than what they already own. At Berkshire, "We have avoided slight subsets of stupidities like armies of lawyers to advise on such deals."

INTEGRITY

Charlie said a lack of integrity led to the financial crisis. Integrity is very important and the easiest way to make money. He added, if there is God, Cardinal Richelieu has much to answer for. If not, he has done well.

Buffett noted that the excuse that "everyone else is doing it" is the toughest thing to avoid. A good example of that was when companies were not expensing stock options on the income statement. After intense lobbying, the accounting standards board initially backed off on their requirement that stock options be expensed. Instead they allowed companies to choose whether to expense the options (the preferred method) or just disclose the option expense in the footnotes. Given the choice, 498 of the 500 companies in the S&P 500 chose not to expense the options because "everyone else was doing it."

Situational ethics is huge. Another example Buffett provided were companies carrying out EPS calculations to four or more digits so they could round up their EPS by a penny. At Berkshire there is no budget, which is designed to prevent weakness in human behavior such as management teams making short-term decisions just to meet a budget instead of focusing on the best decisions for long-term growth.

Charlie noted that so much bad behavior doesn't come from malevolence but from the subconscious. A cure is very difficult. During the financial crisis, no one owned mortgages, which were quickly packaged up and sold, so no one took responsibility. "People didn't realize they were immoral." No one is apologizing.

HOW TO BE GREEDY WHEN OTHERS ARE FEARFUL

An investor wanted to know how to be greedy when others are fearful as he also was fearful that we were facing a global financial meltdown and couldn't take advantage of a buying opportunity. Buffett said it is natural that when other people are fearful, that you may get scared, too. If so, however, you won't make much money. You just become your broker's friend. If you don't look at stock quotes daily, then you won't get fearful. If you own a farm, you don't look at what price you can sell it every day. When stock prices go down, Berkshire will buy more stocks.

Charlie said you gain more courage after you have handled a hardship. He advised the fellow, "Get your feet wet a little with more failure."

Buffett concluded by saying that it would be better if there were no stock quotes at all. Stock prices don't tell you anything about the value of an investment. What counts is buying a good business at a good price and forgetting about it for a long time.

SOLAR ENERGY

Charlie said solar solutions are coming because they are so obviously needed. At the same time, he has always passed on solar panels for his home as he expects them to get cheaper. Buffett quipped that at 86 Charlie shouldn't wait much longer. Charlie retorted, "I need to think long term, and I'm going to miss you terribly." He then went on to tell the joke about the husband who asked his wife if she would still love him if he lost all his money. She answered, "Of course, honey, I'll always love you, but I will miss you terribly."

Charlie went on to say that ethanol was a "stunningly stupid idea" and another example of our politicians failing us. However, he does believe that we will create an enormous electrical grid in this country and that solar power will solve our energy problems.

Buffett quipped, "I have nothing to add."

UNDERVALUATION IN BERKSHIRE'S STOCK PORTFOLIO

An investor said he and his wife were having an argument as to whether the investments in Berkshire stock portfolio were undervalued or not and asked for help in solving the debate.

Buffett said the degree of undervaluation in the stock portfolio is not dramatic. The undervaluation has been exceeded much more in prior periods. Berkshire expects to do reasonably well with its investments.

Charlie muttered, "I can't solve domestic dribbles. I always just accepted the other point of view."

OPTIMISM

An investor asked why with Berkshire's outlook for inflation, government debt, increased regulations, and the need for reduced return expectations, they are still optimistic that our children will live better than we do?

Charlie said the solar energy solution "makes me very optimistic." Berkshire's culture will still work over the long term which is another source of optimism. The living standards in China and India are rising. He stated, "If I can be optimistic when I'm nearly dead, surely the rest of you can handle a little inflation!"

BUFFETT'S MEDIA EXPOSURE

A shareholder asked if Buffett's time with the media is the best use of his time for Berkshire shareholders. Buffett said "probably not" but he does lots of things like playing bridge online 12 hours a week in the evening which may not be the best use of his time for shareholders. Buffett said he believes broadcasts of his comments communicates his message better than when he is quoted in print, which may be edited to not reflect his thoughts properly. He referred to Lloyd Blankfein's joke that "Goldman Sachs was doing God's work." A comment he is sure Blankfein wishes he could take back after the printed media treated the comment seriously rather than as a joke. Buffett now prefers being on TV so that there is a permanent record in his own words of his comments. Even then, he has to be careful of broadcasts. Charlie Rose interviewed him on the acquisition of Burlington Northern. They had footage of Grace Kelly and Marilyn Monroe riding the rails and Buffett quipped that he would have paid more for Burlington if they had thrown in Grace Kelly and Marilyn Monroe. However, when they edited the show, they were running six minutes over the time allotted so they took out the footage showing Grace Kelly and Marilyn Monroe on the trains but left in Buffett's comment, which made him appear to be a lecher.

LOYAL SHAREHOLDERS

Buffett said anyone can buy stock in a public company. Buffett believes it is important to let shareholders know what kind of place Berkshire is. He mentioned how Phil Fisher said that if a restaurant advertises French food, customers won't be satisfied if they go into it and only find hamburgers being offered. Berkshire wants shareholders that think like "we do" not investors that just focus on earnings every quarter. Buffett exclaimed, "We do have the best shareholders who believe they are buying a business and consider themselves partners in the business."

Charlie added that what happened at Berkshire is an accident. They started investing money for family and friends and morphed into a public company although they still treat shareholders as family. If a public company has the average institutional investor who looks at performance every six months, they will have unreasonable expectations and management won't love their shareholders.

Buffett chimed in that at Berkshire they are blessed not to have an Investor Relations department. It is much better to get shareholders in sync with your management style than to try an attract new shareholders all the time.

ZERO PERCENT INTEREST RATE POLICY

Buffett acknowledged that it is difficult for investors to earn .1% on their cash these days with interest rates kept so low. If those rates had been in place when Columbus landed, investors might have managed to double their money by now. Low interest rates won't go on forever although it feels like forever for folks invested in fixed-income investments. Their purchasing power is getting eaten away. Buffett said he wouldn't want to be the Fed chairman or Treasury Secretary.

Charlie added that the situation is amusingly depressing. Stocks are going up because money returns are so lousy. If the low interest rates can't last, then stocks will go down. If low interest rates do last, then we might find ourselves mired in a Japanese type of situation. "What a cheerful message!"

Buffett agreed saying that with interest rates so low, there is pressure to push stock prices and real estate prices up. For people having to live on short-term rates, it is agony.

VALUING A BUSINESS

An investor wanted to know how one gets better at valuing a business and determining a margin of safety. Buffett said that when he started out, he knew nothing about valuing businesses. Then Ben Graham taught him a way, but the universe of those types of investments dried up. Although Buffett did say about 5-6 years ago, he discovered Korean stocks that were selling at such cheap prices that he could follow Graham's approach once again, and Buffett diversified by buying a package of 20 of the Korean stocks. Charlie then helped teach him about buying businesses with a durable competitive advantage. Buffett said you don't need to know how to value all businesses. It is not how big your circle of competence is, but that you know where the perimeter is. You need to only know how to value a few businesses that you can understand with those businesses likely to be around for 10-20 years. If you buy them with a margin of safety, you should do fine. You just need to avoid the dumb things and know your limitations.

Charlie said that if you want to get good at valuing businesses, you need to think and learn a lot and practice a lot. You need to keep learning as the world changes. Accumulated experience will help make sure you never fail utterly. You also need the right temperament to watch value rise slowly. Charlie said he started valuing businesses when he was a little boy. He remembers watching a friend who did no work but grew quite prosperous. Buffett joked, "Your ideal!" So how did this boy do that? He gathered up and rendered dead horses. There was no competition! Charlie quickly learned that's the best kind of business.

BUSINESSES WHICH PROVIDE THE BEST RETURNS ON CAPITAL

Buffett repeated that a good business doesn't require much capital to be invested in the business. He said some of Berkshire's businesses have negative capital requirements like Blue Chip Stamps and Berkshire's insurance businesses which provide float. He also described how a magazine is a type of business with negative capital as subscribers pay in advance and not much capital equipment is needed to produce the magazine. See's Candy also doesn't require much capital, but Buffett hasn't figured out a way to get people to eat 10 pounds of candy every day.

Charlie bluntly stated, "The formula doesn't change. Monopolies are the best businesses."

ACQUISITIONS

An investor asked if Berkshire's phone has been ringing with companies wanting to sell their businesses to Berkshire. Buffett said the phone doesn't ring very often at Berkshire since his requirement that companies have at least $75-$100 million in earnings weeds out a lot of phone calls. If Buffett receives 3-4 phone calls in a year, then it is a good year. He said, "We're as interested as ever in acquisitions. We would love it if the phone rang with a big deal."

Charlie added that Berkshire has been successful and helped by "human revulsion." People don't want to sell their businesses to somebody else that won't care for their employees. Berkshire gets offered companies by people who won't sell their business to anyone else. Buffett chimed in that Iscar is a good example as they were willing to sell to Berkshire or not sell at all.

Buffett described the options for selling a business. When companies seek to sell their businesses they may sell to a competitor, who might dismantle the company after a founder had spent 30 years building the company. They might sell their business to a leveraged buyout firm, which looks at the business as a “piece of meat to be resold.” Or they can sell the business to Berkshire which promises them a permanent home.

Charlie added that deal making at Berkshire will be slower, but it is not over. He remarked, “That’s not so bad given how much richer we all are.”

WHAT QUESTION WOULD YOU ASK YOURSELF

An investor wanted to know what questions Charlie and Warren would ask if they were in the audience.

Charlie said he would ask about the BYD investment as Berkshire typically doesn’t invest in the developing edge of a new technology. Charlie said the investment shows their capability for learning. The investment has worked out very well and will help solve significant problems of the world. He gushed about the disciplined people at BYD, “It has been a pleasure to be associated with such people.”

Charlie also said he would have asked about Burlington Northern. He said the deal was a better deal for Burlington shareholders than Berkshire shareholders but also noted that the deal will be satisfactory for Berkshire shareholders. Both Burlington and MidAmerican have brought in a fair amount of engineering into Berkshire.

Buffett said he would ask, “Can you keep using the capital you are generating for a long time?” He answered the question by saying it is extraordinarily hard to add value when you get as large as Berkshire will be in the next 10-15 years. While a portion of the money can still be invested, there is a limit. There will come a time when Berkshire can’t use 100% of the capital it will be generating. At that point, Berkshire will do what is in the best interest of shareholders.

HOW TO BUILD WEALTH

Buffett said the best way to build wealth is to follow your passion. You should love what you do. For Buffett, it was “dumb luck” that his father was in the stock brokerage business. This led to Buffett reading investment books much sooner than he likely would have. He then recounted the story of Rose Blumkin (Mrs. B) who ran the Nebraska Furniture Mart. Immigrating to the United States, she didn’t go to school a day in her life, but she loved what she was doing. She started the business with $500 and turned it into a $400 million sales operation. He laughed about how he was invited to her house for dinner and found that all her furniture in her home had green price tags hanging on them. She said it made her feel at home. The power that was within her produced amazing things.

PRAGMATISM

When asked by a shareholder what is the unified management theme that runs through both their work and life, Charlie answered: “It is pragmatism. It suits out temperament and it works better. It is just that simple. It is the fundamental algorithm of life.”

HIGH-SPEED PASSENGER RAIL

Buffett doesn’t think high-speed rail in the United States is economically viable as it has to compete with auto and air travel. In the U.S., we don’t have point-to-point density to make it economically feasible unless the rail system was heavily subsidized. Therefore, he doesn’t think private firms will devote resources to it due to the economics. The math doesn’t work for money that wants a return.

Charlie added that it is dubious that the costs can be overcome for high-speed rail. While it works great in Japan and Canada, it is a different calculus. In Los Angeles, it would be a bottomless pit.

COSTS OF EARTHQUAKE INSURANCE

Buffett said he didn’t know what the costs would be if a Chilean-type earthquake were to hit California. In Chile 40% of the damage was from the tsunami and 60% from the quake itself. Buffett did say that an extreme earthquake in California could approach $100 billion in costs. Fire after the earthquake would likely result in the most damage. In insurance lingo, the event would be known as “Shake and Bake.” No matter what happens though, Buffett reassured folks that Berkshire will be well prepared to cover its share of the costs. There will be huge catastrophes, but Berkshire has so much earnings power that they will be able to cover insurance costs. Even if a $250 billion catastrophe struck, Berkshire’s exposure would likely be 3%-4% of the event which is a maximum exposure of $10 billion.

GLOBAL FINANCIAL MELTDOWN

A shareholder asked what impact a global financial meltdown would have on Berkshire. Buffett answered that in 2008, we came close to a meltdown. However, things work out in our system unless the gears get completely off track. Buffett said huge amount of debt in the system won’t “do Berkshire in.” However, in the event of a nuclear attack, “Who knows?” Berkshire can withstand anything that any company can.

Charlie retorted, “I’m not worried about it.”

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