Notes on 2011 Berkshire Hathaway AGM, prepared by Pat Dorsey

This document was prepared based on written notes, and cross-checked via a variety of blogs and other media sources that covered the 2011 meeting. Some comments from Mr. Buffett and Mr. Munger are verbatim, while other comments are paraphrased. Generally, I strove to get down meaningful points verbatim at the cost of missing other content, vs trying to cover every little thing. Editorial commentary is in bracketed italics, and represents solely my opinion.

Note that all questions pertaining to The Sokol Affair (sounds like a John LeCarre novel, doesn't it?) have been transcribed by Berkshire and posted to the company website at the following link http://www.berkshirehathaway.com/dlsokol/TranscriptSokolQuestions.pdf. I have pasted in the relevant material to this set of notes so that you have everything in one place.

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On with the show:

First Quarter Results for Berkshire Hathaway

As usual Buffett started off with a look at Berkshire's first quarter results, noting that most businesses are "getting much better," with two exceptions: businesses tied to residential housing, and insurance. "We are a cross section of not only the American economy, but we see a fair amount of what's going on internationally too."

The first quarter of 2011 was second worst quarter ever for insurance industry in terms of catastrophes. Buffett estimated that these would cost the reinsurance industry about $50 billion, and that Berkshire usually has a 3% to 5% participation in losses. In the annual report, Buffett predicted that normalized post-tax earnings for Berkshire should be about $12 billion, assuming break-even insurance underwriting. Given that catastrophe experience in the first quarter, Buffett felt that it is unlikely that Berkshire's insurance operations will break even in 2011. "For the first time in nine years, Berkshire is likely to have an underwriting loss this year."

Buffett noted that the insurance income line will likely dip as high-yielding loans made to Swiss Re, Goldman, and GE are called, while results should only get better for BNSF. "The competitive advantage of railroads is becoming more apparent by the day, especially as fuel prices rise."

Buffett then showed a slide of estimated insurance losses (pretax), which totaled $1.7 billion: $195 million from floods in Australia + Cyclone Yasi, $412 million from the Christchurch quake in New Zealand, and $1.1 billion from the Japanese earthquake. He noted that about $700 million of the Japan-related losses came from a contract with Swiss Re that gives Berkshire a 20% quota share of losses. Buffett also said that Swiss Re has told Berkshire that they will not be renewing the contract, but "I wish they had told me three months ago."

Turning to the recent tornadoes in the Southeast, Buffett said they would likely create about 25,000 auto claims, and with a 9% market share, GEICO would be affected. Buffett thinks it is unlikely that tornado-related claims hit the reinsurance industry.

Back to the NZ quake, Buffett said it caused about $12b in damage. After asking Munger how many people are in NZ ("About 5 million"), Buffett noted with 1/60 the U.S. population, the NZ quake was equivalent to 10 Katrinas.

Back to GEICO, Buffett reported that GEICO had fantastic policy growth – added 319,000 policies vs 218,000 last year – and that since each policyholder is worth about $1500, the increase in goodwill at GEICO was substantial (500mm). Buffett related this back to the annual report, in which he noted that the carrying value of GEICO's goodwill on Berkshire's books is $1.4 billion, and that number does not grow at all given accounting rules. However, Buffett estimates true worth of GEICO's goodwill to be closer to $14 billion, and that value grows with every new policyholder. "A policy holder at GEICO has significant value – some have been customers for 10 years or more. This value is not on the income statement or balance sheet, but there's a lot of value there. And that's in addition to the value of float."

[This comment revisits a common theme of Buffett's : Separating the numbers that must be recorded in financial statements due to accounting rules from the underlying economic reality. He has spoken before about the asymmetric nature of goodwill – it can be written down, but never up – which means that intangible assets like trusted brands that increase in value over time are perpetually undervalued on balance sheets. It also implies that Berkshire's recorded book value is understated, though I have not done the work recently to see by what amount.]

Buffett continued the theme of capricious accounting rules by discussing how marketable securities are valued and when other-than-temporary-impairments need to be recorded. Essentially, if a security trades below its purchase price for a decent period of time, it has to be marked down, and the loss passes through a company's income statement. As of March 31st, a portion of Berkshire's Wells Fargo shares were materially beneath their cost basis, and so Berkshire had to flow a $300 million loss through its income statement. This was despite the fact that another portion of Berkshire's WFC shares was $3.7 billion in the black, so on average, Berkshire has a gain in WFC.

[Buffett noted that Berkshire uses the specific identification method for tax purposes rather than the average cost method, which is what caused this unintuitive result.]

He wrapped up the discussion by suggesting that investors should ignore gains or losses in securities on a quarterly basis, and focus instead on the earnings from the operating businesses and the gain in book value.

<u>Sokol & Lubrizol Comments</u>

Before turning to the Q&A, Buffett said he wanted to say a few things about the Sokol situation.

[The complete transcript of the next section of the meeting is posted on Berkshire's website. As noted earlier, I am pasting it in here for convenience's sake. I've inserted editorial comments as appropriate.]

"WARREN BUFFETT: I'd like to just comment for a few minutes -- and this will be transcribed and up on the internet at our web page -- I'd like to comment for just a few minutes, and I'd like to ask Charlie then to give his thoughts on the matter of David Sokol and the purchase of Lubrizol stock.

You saw in the movie a clip from the Salomon situation and that occurred almost 20 years ago. It will be 20 years ago this August. And at the time, it was a Sunday, Charlie was there, and I was elected the chairman at -- what, about 3:00 in the afternoon or so I think on a Sunday at Salomon, and I went down to address a press group.

And almost the first -- somewhere in the early questions, somebody sort of asked me, you know, what happened? Well, I'd just gotten to Salomon fairly recently, so I didn't know too much about it but the phrase that came out of my mind then -- out of my mouth then -- sometimes my mind and my mouth are coordinated -- the phrase that came out of my mouth then was that what happened was inexplicable and inexcusable.

Now, it's 20 years later, and looking back on Salomon, I still find what happened inexplicable and inexcusable. You know, I will never understand exactly why some of the events that transpired did transpire. And to some extent, in looking at what happened a few months ago with Dave Sokol's failure to notify me at all that he'd had any kind of contact with Citigroup, in fact, he directed my attention to the fact that they represented Lubrizol and never said a word about any contact with them, and then the purchase of stock immediately prior to recommending Lubrizol to Berkshire, I think I -- for reasons that are laid out in the audit committee report, which I urge you to read *[If you have not read this, and are interested in the Sokol issue, it's worth the time]* and which is on our website , I don't think there's any question about the inexcusable part that Dave violated the code of ethics, he violated our insider trading rules, and he violated the principles I laid out -- I lay out every two years in a direct personal letter to all of our managers and which I've been doing for a long time. *[This is much more direct – and harsh – than Buffett's original press release on the Sokol issue.]* So I -- you can read the audit committee report about that.

The inexplicable part is somewhat -- well, it's inexplicable, but I'd like to talk about it a little bit because I will tell you what goes through my mind in respect to it. Certainly -- well, one interesting point is that Dave, to my knowledge, at least, made no attempt to disguise the fact that he was buying the stock. I mean, you know, you read about insider trading cases and people set up trusts in Luxembourg or they use neighbors who know neighbors or they use third cousins -- I mean, they have various ways of trying to buy the stock so that when it's later –- the FINRA supervising organization looks at the trading activity in the months prior to the deal, they do not see names that jump out at them as being associated with the deal.

To my knowledge, Dave did nothing like that so he was leaving a total record as to his purchases.

Now, I think at least usually -- and maybe always -- we are queried after any deal. We are asked who knew about it when, and we supply a list of whether it's people at the law firm or people that are in a secretarial position at our place or the law firm. We give them a list of everybody that might have known or did know about the deal prior to the public announcement and I -- I don't know whether they do that 100 percent of the time, but certainly it's my experience that you get that. And then a while later, you'll get a list of names of people that FINRA again has picked up as trading and they ask you if any of those names ring a bell with you, so they're trying to put together whether anybody did any inside trading ahead of time.

So the odds that if you're trading in your own name and you're on that list of people who know of a deal ahead of time, the odds that it's not going to get picked up seem to me are very much against you.

But, to my knowledge, Dave did not disguise the trading, which, you know, that's somewhat inexplicable that if he really felt he was engaging in insider trading and knew the penalties that could be attached to it, that he essentially did it right out in the open.

The second fact, which is less -- perhaps less puzzling, but Dave obviously has a net worth in very high numbers. He made I think close to $24 million. He earned it from Berkshire last year, and we got our money's worth, but he did get $24 million too.

So I would say that there are plenty of activities in this world that are unsavory that are committed by people with lots of money. So I don't regard that as totally puzzling. But I will give you one instance that does make it puzzling. It makes it very puzzling to me.

We bought MidAmerican at the end -- Berkshire Hathaway bought MidAmerican at the end of 1999, bought about 80 percent. Walter Scott who I just introduced and his family was the second largest holder, I think something over 10 percent, and then two operating people, Dave Sokol the senior one, owned or had options on a big piece and Greg Abel, a terrific partner of Dave's, also had a piece.

And Walter Scott -- and I've told this story privately a few times but not -- I don't think I've done it publicly. Walter Scott came to me a year or two after we'd bought it, and Walter said, I think we ought to have some special compensation arrangement for Dave and Greg if they perform in a really outstanding manner.

And he said -- I think maybe he suggested something involving equity and he saw me turn white. *[Big laugh here from the audience, given Buffett's reluctance to part with Berkshire shares.]* So he said, Why don't you design one and let me know.

So I just scribbled something out on a yellow pad. It didn't take me five minutes. And we call it sort of in honor of Charlie, although he didn't know about it, we called it the Lollapalooza, and it provided for a very large cash payout, which I'll get to in a second, based on the five-year compounded gain in earnings, and we were starting from a high base, in other words this was not from any depressed level, and we set a figure that no other utility company in the United States was going to come close to. But if that figure were achieved, we were going to give $50 million to Dave and $25 million to Greg Abel.

And I had Dave come to the office and I said, Here's what Walter and I are thinking, and, What do you think of this plan? And it had these figures on per share that -- that like I say, move forward at 16 percent compounded per year, and then I say, Here's the payout.

And he looked at it for just a very short period of time and he said -- he said, Warren, this is more than generous. But he said, There's just one change you should make.

And I said, What's that?

And he said, You should split it equally between me and Greg instead of being $50 million for me and $25 for Greg. It should be $37 and a half a piece.

So I witnessed -- and Walter witnessed, you can talk to him about it -- we witnessed Dave voluntarily, without any -- Greg had nothing to do with it, he wasn't there, we saw Dave transfer over 12 and a half million dollars, getting no fanfare, no credit whatsoever, to his, in effect, junior partner.

And I thought that was rather extraordinary, and what really makes it extraordinary is that $3 million, you know, ten or so years later would have led to the kind of troubles that it's led to. I find -- that -- that is really the fact that I find inexplicable and I think I'll probably -- you know, it's 20 years after Salomon. Twenty years from now Charlie will be 107, and we won't mention what I'll be, but I -- I think 20 years from now I will not understand what causes a man to voluntarily turn away 12 and a half million dollars to an associate without getting any credit for it in the world and -- and then ten or so years later buy a significant amount of stock the week before he talked to me. *[Buffett's voice changed a little at this point. To me, he sounded hurt and betrayed, but maybe I'm playing armchair psychologist too much.]* And when he talked to me about Lubrizol, it was either the 14th or 15th, he says it was the 14th, and I have no reason to disagree with that. The only reason I couldn't say specifically was I had eight university groups, 160 students in on that Friday. That's the only thing it shows, and I spent most of the day with them. And the 10K and the 10Q that got printed out on Saturday have that date on them, the 15th, when I looked at Lubrizol for the first time.

You might be interested in knowing I've been looking up 10Ks and 10Qs for 20 or 30 years, but I don't know how to print them out. *[You'd think Bill Gates might have taught Buffett how to find the print button….]* Fortunately, Tracy Britt was in the office. I said, Tracy, can you print this damn thing out? I don't know how to do it yet. That is why I don't know if it was the 14th or 15th. The 10Q says the 15th.

But at that time when Dave called me on it he said nothing about contact with Citigroup or anything of the sort and he -- and I said, I don't know anything really about the company.

He said, Well, take a look at it. It -- you know, it might fit Berkshire.

I said, How come? He said -- he said, I've owned it and it's a good company. It's a Berkshire type company.

And, you know, I obviously made a big mistake by not saying, Well, when did you buy it, but I think if somebody says I've owned the stock, you know it sounds to me like they didn't buy it the previous week.

[Buffett has been criticized for not asking an extra question or two at this stage, but I think those criticisms are unfounded. Berkshire's highly ethical environment was described by Munger at last year's AGM as "…a seamless web of trust that's deserved on both sides." In that context, I think Buffett can be excused for not quizzing his top lieutenant about how long he had owned a security being discussed as an acquisition candidate. It would be like asking your doctor if the diploma on his wall is real – there are some things you shouldn't have to ask about.]

So there we are with a situation, which is sad for Berkshire, sad for Dave, still inexplicable in my mind, and we will undoubtedly get more questions on that. We'll be glad to answer them. Charlie do you have any thoughts on this?

CHARLIE MUNGER: I think it's generally a mistake to assume that rationality is going to be perfect even in very able people. We prove that pretty well regularly.

WARREN BUFFETT: Do you have any explanation for the irrationality?

CHARLIE MUNGER: Yeah. I think hubris contributes to it." *[Wham! Munger never ceases to amaze me with how he can encapsulate so much into so few words.]*

[The first shareholder question was, not surprisingly, about the Sokol issue. Here it is, copied from the transcript on Berkshire's website. Lots of detail here, so skip it if the Sokol stuff is not of interest.]

<u>Question #1</u>

"CAROL LOOMIS: So I will begin. I don't think that anybody will be surprised that it is a Sokol question.

And actually, the -- this particular long-term shareholder believed, as Warren has believed, he says, I do not see why he should have been expected to ask Sokol about his Lubrizol stock holdings when he said he owned the stock. That wouldn't have been a natural question. But when you found out the details of his stock purchases a short time later, I do not understand your reaction. Surely you realized immediately that these facts were going to become known and that they were going to damage Berkshire's reputation, something you had said repeatedly you would be ruthless in protecting. Be ruthless probably would have meant your firing Sokol on the spot, but you didn't do that. And then you put out a press release that many Berkshire shareholders that I have talked to found totally inadequate. You have always been very direct in stating things. You were not direct in that press release except in praising David Sokol. Otherwise you stated some facts and behavior that you said you didn't believe was illegal. And then you ended the release, leaving us -- now maybe you thought somehow we were going to read between the lines -- without expressing any anger about what had happened. Why were you not incensed? If you were, why did you not express your anger? Why did you handle this matter in the inadequate way you did?"

"WARREN BUFFETT: Yeah. The -- the -- it wasn't really immediately thereafter. I learned on March 14, which was the day we announced -- now bear in mind his first conversation when he said he owned the stock was January 14. In between January 14 and March 14, Dave gave no indication that he'd had any contact with Citigroup of any kind and as we learned later, I mean, he went -- they met in maybe October or something like that where -- and talked about possible acquisition candidates for Berkshire. But none of that -- he told me at one point, he said Evercore and Citi represent Lubrizol. One of them represents the directors and one of them represents the company, and not a word about any contact.

On March 14, when the deal was announced in the morning, I got a call from John Freund. John Freund is probably here today. John Freund works for Citi in Chicago, and he handles -- has handled the great majority of our business in equities for decades, and I've got a direct line to him. I talk to him frequently. And he called and said congratulations and -- you know and -- and aren't you proud of our -- words to the effect.

You can talk to John directly, although I've been told that the Citi lawyers have told him not to talk, but that -- knowing the press, they probably can work something out of him.

The -- he's -- essentially his words were that -- that Citi's team had worked with Dave on this acquisition, and they were proud to be part of it, et cetera, et cetera.

And this was all news to me, so that set off some yellow lights, at least.

And the next day, I had Marc Hamburg, our CFO, call Dave, and Dave readily gave him the information about when he had bought the stock and how much. Marc also asked him what the participation of -- of Citi had been in reference to Berkshire's side of the transaction, and Dave said that while he -- he thought he called a fellow there to get their phone number, which turned out to be somewhat of an understatement.

Now, during the period when we announced the deal on March 14, Lubrizol is the one that needed to prepare a proxy statement. We were not issuing shares at Berkshire. So there was no proxy statement, no -- nothing of this -- that sort on our part.

The Lubrizol legal team, Jones Day, went to work with Lubrizol management to start preparing the proxy statement. We eagerly awaited to see the first draft of that because I was going to be leaving for Asia on Saturday, which, I guess, would be the 19th, and I wanted to see what Lubrizol had to say about this whole Citi matter or anything else. The most interesting part of every proxy statement is something that says -- it's basically the history of the transaction, and it's -- it's the first thing I read on any deal because it gives you a blow-by-blow of what has taken place.

And as Marc Hamburg can tell you, I kept -- and our law firm can tell you, I kept urging them to get that to me before I took off for Asia.

We got that the afternoon of Friday the 18th, and it had a fair amount of material in it about Dave's involvement with Citigroup. Then at that point -- I believe it was at that point -- our law firm got involved, Munger Tolles got involved, in their input to the Lubrizol lawyers as to what we had seen that was different or what we had seen that they didn't know about that we could add.

Ron Olson, a director of Berkshire and partner of Munger Tolles, was on the trip to Asia. So we got on the plane on Saturday the 19th and traveled over the next week until the 26th. And we knew at that point that his partners at Munger Tolles were interviewing Dave, as -- maybe some other people too, but certainly Dave, and I believe that he was interviewed at least three times about both the stock purchases, the history of things with -- of his relationship with Citigroup and they were assembling this information.

I don't have a BlackBerry or whatever it may be. Ron does. So he would get some information as we were over there, and he was getting some input but -- and we decided that when we got back we would need to have a prompt meeting of the Berkshire Board about this matter and we would also learn what -- the full details, at least, of what Bob Denham and maybe other attorneys at Munger Tolles learned from their interviews with Dave.

And we back on -- I guess it would be Saturday the 26th and on the 28th we were going to bring Charlie into it before calling a board meeting. But there would have been a board meeting that week and then about five or so in the afternoon, a letter was delivered by Dave's assistant which really came out of the blue.

[It's fascinating to me that the letter was delivered by Sokol's assistant. You've worked for Buffett for a decade and you can't resign in person? My goodness.]

And I -- he said to me he felt he was retiring on a high point and he gave the reasons why he was retiring which I laid out and so on. I don't know whether the questioning the previous week had affected his attitude. He would say not. But in any event, we had that resignation.

That resignation as is -- I believe it may have been put in the audit committee report -- may have saved us some money. If we'd fired him, the question would be whether it was with cause or not with cause, and we would have said it was with cause, but that might have very well gotten litigated and a retirement did provide, in effect, the same non-level of severance payments that a firing with cause provided.

[Does this imply that Sokol would have been fired, had he not resigned? Interesting question.]

So I drafted up a press release, which has since been the subject of at least mild criticism, and I laid out the good things that Dave had done, which he had done for the company. He'd done many good things, some extraordinary things. And then I laid out some actions which I said, based on what I knew then, did not seem to me to be unlawful, and I talked with both Charlie and Ron about that. Ron would have been more careful in that wording. I'm not sure Charlie would have been. I'll let him speak for himself on that.

And we ran it -- I ran it by Dave Tuesday morning just to be sure the facts were accurate, and he said -- he objected much to something I put in where I said that I thought that he was, in effect, had had his hopes dashed for succeeding me and that was part of the reason, and he said that was absolutely not true, that he had no hopes ever of succeeding me and that I -- you know, basically he was telling me what was in his mind, and I shouldn't be trying to second-guess what was in his mind. So I took that part out.

But he affirmed all of the other facts in that letter and then I took it out, I sent it to him a second time to make sure that he was okay with the facts, and he said that they were accurate.

Now, in there was included the fact that Dave had no indication that -- that Lubrizol had any interest in an approach from Berkshire and that, at least according to the final Lubrizol proxy, is not the case. I have not talked to anybody except John Freund at Citigroup, so I have no idea what took place with the investment bankers at Citigroup except what I read in the Lubrizol proxy. But the Lubrizol proxy now says that Dave did know that Lubrizol had an interest on December 17.

But both in the two chances he had to review it and then when he went on CNBC on a Thursday and talked for a half an hour, he made no attempt to correct any of the facts in it.

Now, on Wednesday when we put out the report, we had to have a board meeting first. It was news to the board. They got the release a little bit ahead of time and then we had a board meeting. We also delivered -- we, through our law firm, we phoned the head of the enforcement division of the Securities & Exchange Commission and told them exactly the facts regarding the stock purchases and anything else that they might have cared to know.

So I think we acted in that case, very, very promptly, to make sure the Securities & Exchange Commission and the top of the enforcement division was well-versed on what had taken place to our knowledge to that point.

So from our standpoint and my standpoint, Dave was gone, minimum severance costs, minimum chances for lawsuits about compensation due him and we had turned over some very damning evidence, in my view, to both the public and to the SEC.

What I think bothers people is that there wasn't some big sense of outrage or something in the -- in the release and, you know, I plead guilty to that. I -- this fellow had done a lot of good things for us over 10 or 11 years, and I felt that if I'm laying out a whole bunch of facts that are going to create lots of problems for him for years to come, that I also list his side of the equation in terms of what he'd done for Berkshire.

And I -- and as I said a little bit earlier, you know, one thing I didn't even lay out was this extraordinary act where in effect he turned over 12 and a half million dollars to a fellow employee. So that's the history of my thinking on it.

Charlie, do you want to add anything?

CHARLIE MUNGER: Yes. I think we can concede that that press release was not the cleverest press release in the history of the world. The facts were complicated, and we didn't foresee appropriately the natural reaction. But I would argue that you don't want to make important decisions in anger. You want to display as much ruthlessness as your duty requires, and you do not want to add one single iota because you're angry. *[I thought this was wonderful piece of wisdom.]* So Tom Murphy, one of our best directors -- one of our best directors always told the people at Cap Cities, you can always tell a man to go to hell tomorrow if it's such a good idea. So the anger part of it -- and I don't think it was wrong to remember the man's virtues as well as his error.

WARREN BUFFETT: I might add as an aside Charlie and I have worked together for 52 years, and we have disagreed on a lot of things. We've never had an argument. I need Tom Murphy's advice to remind myself of it on other things, but with Charlie it's never been necessary."

Question #2 – QE2

Q: What will be effect of the government ending QE2 in June on the market and on the economy?

Buffett: No secret what they're going to do – most public operation in history in terms of timing and amount purchased. "If something is that well known by all participants in the market, any effect has been discounted by now."

"A huge market force will be withdrawn…purchases will not be in the market but the issuances will still be what they are now. It will be a different market, but a different market that has been anticipated."

Question #3 – More Sokol *[again, pasted from Berkshire's transcript]*

"BECKY QUICK: I'd like to ask a question that comes from Ram Tarakad from Sugarland, Texas. He says, Good morning, Mr. Buffett and Mr. Munger. You have always put great emphasis on hiring and retaining managers that not only have exceptional talent but also adhere to the higher standards of corporate ethics and behavior. Recent events surrounding Mr. Sokol's actions have demonstrated that we were not very far from a situation where someone running Berkshire Hathaway had great talent but lacked the other quality that has made Berkshire the envy of the business world. In some ways we are relieved these events happened when you were still at the helm. But coming back to the succession plan that you have in place, how can you ensure that there are no more Sokols in the lineup of successional managers that you have. "

"WARREN BUFFETT: Yeah, he made an assumption there about Sokol being the next in line, which I'm not sure was warranted, but he certainly was entitled to think that he was a candidate, and there are -- that is one of the reasons that I think it's a good idea if my son, Howard Buffett, who would have no -- get paid nothing and have no activities in the company be the chairman after I'm not around because you can make a mistake in selecting a CEO.

I mean, I think the odds of us making a mistake are very, very low. And certainly the candidate that I think is the leading candidate now, I wouldn't -- I would lay a lot of money on the fact that he is straight as an arrow.

[If you pinned me down, I would guess this is Ajit. Of course, that guess and a nickel will get you a cup of coffee.]

But mistakes can be made. You know, the -- the Bible says the meek shall inherit the earth, but the question is, will they stay meek. *[laughter]* You know -- and the idea of having an independent chairman who would be voting a lot of stock -- because even at my death, because of the concentration of A stock and so on, the executors would have a very significant block of stock, and if some mistake were made, it would be easier to change if not only a very large block of stock were available to express an opinion but also if the chairmanship was not locked in with the CEO.

It's gotten less tough to change CEOs at companies where either their moral or their intellectual qualities are found lacking but it's still difficult. If -- you know, it's particularly difficult if they turn out to be a mediocre CEO. If the person is really bad, you know, people will rise up sometimes and -- particularly if they have meetings without the CEO present. But it's not an easy job to displace a sitting CEO who also holds the chairman's position and controls the agenda and all of that. So I think an independent chairman, particularly one that represents a very large block of stock and has no designs himself on taking over the place is a safety measure for the possibility, however remote, that the wrong decision is made. But I will tell you that the directors at Berkshire will be thinking every bit as much about the quality of the person as a human being as they will be thinking about their managerial skills because it's vital that you have somebody at Berkshire, in my view, that is running the place that really cares more about Berkshire than he does about himself in terms of advancement. And I think we have multiple candidates that fulfill that and the idea of an independent chairmanship is a -- is, you know, part of the belt and suspenders. Charlie?

[I thought this was a good chance for Buffett to be a bit more open about succession than he has in the past, and I was a bit disappointed not to hear more. It's understandable that he may not want to create the kind of public horse race that took place at GE post-Welch, given the personal animosity that can engender, but as a shareholder, I feel a bit in the dark. If I'm going to trust anyone to make a good decision, Buffett and the Berkshire Board are pretty good choices, but still….]

CHARLIE MUNGER: Well, you know, your idea about the Buffett family has a precedent. The Rockefellers left the management of Standard Oil many, many decades, and they -- but they did intervene once and that was to throw out, what was it, the head of Standard of Indiana, and it was on moral grounds. So that sort of thing can happen and you have another string in our bow.

<u>Question #4 – Circle of Competence</u>

Q: If you were going to live another fifty years, what one sector or asset class would you want to add to your circle of competence?

Buffett: Should be a large one…If I could really become an expert in the tech field, that would be fantastic. Tech is going to be a huge field, with a few big winners and a lot of losers. The degree of disparity of results is likely to be very dramatic, so if I had the skills, that would add a lot of value.

Munger: It would be either tech or energy.

Question #5 –Even More Sokol (well, Lubrizol)

"ANDREW ROSS SORKIN: This question comes from a shareholder named Ralph Cutant who asks, In your press release, your original press release, you noted that Dave brought the idea of purchasing Lubrizol to me on either January 14 or 15. Initially you said I was unimpressed. You went on to note on January 24th you sent another note to Dave indicating your, quote, skepticism about making an offer for the company. However in a very short period of time after Dave's discussion with Lubrizol's CEO, you, quote, quickly warmed to the idea. Please clarify what caused you to, quote, warm to the idea so quickly if this didn't strike you as being a great business at first glance what changes? And what was David Sokol's role in convincing you?"

WARREN BUFFETT: Yeah, the -- it wasn't that it didn't -- it struck me as a business I didn't know anything about initially. You know, you're talking about petroleum additives. I -- I never would understand the chemistry of it, but I -- but that's not necessarily vital. What is important is that I understand the economic dynamics of the industry. Is there -- are there competitive ~~molds~~, *[uh, that would be "moats"]* is there ease of entry, all of that sort of thing. I did not have any understanding of that at all initially.

As a matter of fact, I suggested to Dave, I said, Charlie is a lot smarter about oil than I am. Why don't you give him a call because I don't -- you know, I -- I just don't know anything about that business.

And I talked to Charlie a few days later, and I -- I don't remember whether I asked him whether Dave had called or anything but I mentioned to Charlie, and Charlie says, I don't understand it either.

So when I talked to Dave later he had not talked -- he had not gotten a hold of Charlie. I told him, Forget it. He's as bad as I am.

What Dave passed along to me after having that dinner with James Hambrick *[Lubrizol's CEO]* and which I later confirmed in a lunch when James Hambrick came out here on February 8, but it was the same thing, I -- I thought -- and I still feel -- I thought I got a good understanding of industry dynamics and how the business had developed over time, what the role of oil companies was and would be in relation to a chemical additive.

The oil companies are the biggest customers. They sell base oil to a Lubrizol, but they buy the -- they are the big customers, and they have gotten out of the business to quite a degree, although there's two of them left in it.

So this industry had consolidated over time. I looked at the question of ease of entry. You know, every time I look at a business -- when we bought See's Candy in 1972, I said to myself if I had a hundred million dollars and I wanted to go in and take on See's Candy could I do it. And I came to the conclusion, No, so we bought See's Candy. If the answer had been yes, we wouldn't have done it.

I asked myself that same question, you know, can I start a soft drink company and take on Coca-Cola if I have a hundred billion dollars, you know. Richard Branson tried it some years ago in something called Virgin Cola. You know, the brand is supposed to be a promise. I'm not sure that's the promise you want to get if you buy a soft drink *[huge laugh here]*, but in any event, I felt after my conversation with Dave subject to a second conversation with James Hambrick, but covering the same ground, that it's not impossible at all for people to enter this business but in terms of the service that -- and the relatively low cost of what Lubrizol brings to the party, and in terms of people trying to break into a market and take them on -- and it's not a huge market, it's probably only about a $10 billion market overall, I decided there's probably a good size ~~motor on this.~~ *[I'm pretty sure this should be "good size moat around this," given that the context of the discussion was LZ's competitive advantages.]* They've got lots and lots of patents, but more than that they have a connection with customers. They work with customers when new engines come along to develop the right kind of additive.

So I felt that I had an understanding -- didn't understand one thing about chemistry than when I started, but I felt I had an understanding of the economics of the business, the same way I felt when the Iscar people talked to me. I mean, who would think you can take some Tungsten out of the ground and shine it and put it in little carbide tools and that you could have some durable competitive advantage, but I decided Iscar had some durable competitive advantage after looking at it for a while.

That's the conclusion I -- I have come to the conclusion that -- and Charlie as well -- that the Lubrizol position is the dominant -- or the No. 1 company, not dominant, but the No. 1 company in terms of market share and that business is sustainable and that it's a very good business over time. It helps -- you know, they are helping engines run longer, run smoother, you know. You know, when metal is acting on metal, the lubricants are important, and they're always going to be around, and I think Lubrizol will be the leading company for a very, very long time. And that's the conclusion I came to.

I did not have a fix on that, nor did Charlie, prior to Dave relaying onto me what he had learned at that dinner, which incidentally, Lubrizol had been telling the world -- I mean they made investor presentations and all that quite extensively over the years. I simply hadn't paid any real attention to it. And when it was explained to me, I thought I understood it, and I still think I understand it. I think Lubrizol will be a very, very good addition to Berkshire, and I saw James Hambrick just yesterday and despite the turmoil around this, they are very enthused about becoming part of Berkshire, that they regard it as the ideal home.

Charlie?

CHARLIE MUNGER: Yeah, you know, Iscar and Lubrizol, to some extent, are sisters under the skin. You've got very small markets that aren't really too attractive to anybody with any sense to enter and (inaudible) *[I got this down as "fanaticism"]* in service, so if you have any more like that why, please give Warren a call.

[In my opinion, there are some subtle but very important insights from this discussion regarding how companies create and maintain economic moats, or durable competitive advantages. First, companies can often have moats if they operate in small/niche markets that may only have a large enough profit pool to support two or three players, since potential new entrants are deterred by the decreased returns on capital their entry will cause. Genuine Parts or Blackbaud would be good examples. Second, companies can often have pricing power if they sell a good or service that is a small part of the customer's total cost, but which has a disproportionately large impact on quality/success of the deliverable. Lubricants are a pretty small part of the total cost of running a tractor or bus, but things get ugly fast if they don't work well. Same goes for automotive paint sprayers (Graco), industrial fasteners (Fastenal), or commercial kitchen sanitation solutions (Ecolab). Third, companies can increase customer switching costs by bundling service into a product sale (Otis elevators, Rolls-Royce jet engines, etc). Sorry for the lengthy editorial comment, but moats are my thing.]

Question #6 – BERKSHIRE's valuation

Q: I estimated the value of Berkshire's investment portfolio plus operating businesses at ~185k. Since the shares only trade for ~124k, are they a value trap?

[Every year, a German-speaking shareholder asks a question about valuing Berkshire. Never fails.]

Buffett: You've received signals once or twice that we said we would buy in our stock…obviously was below the bottom of a conservative range of intrinsic value. The only reason we'll buy back stock is when it's cheap. "That is not standard practice in corporate America…corporate America to some extent buys stock more aggressively when it's high than when it's low. They may have some equation in their minds that escapes my reasoning power."

"We do not regard Berkshire as overpriced."

Very recently had a "very very large international company" that might have been interested in doing something with Berkshire, very nice company, but bigger than we could handle unless we used a lot of stock…we won't use the stock. Think shareholders would come out behind…they would be poorer because our stock is a currency, and unless it's fully valued, it's a big mistake to use it as a currency.

[This was interesting news. Not a lot of companies over 50b market cap, and with characteristics Buffett likes.]

Had to use stock for BNSF, and it was painful. If LZ had wanted to use stock, we would not have done it. We would have been giving away part of the businesses we already own…you can draw your own conclusions about our calculation of intrinsic value from that statement.

Munger: We have not permanently lost ability to do interesting things with our wealth…we won't always be as inactive as we are now.

Buffett: Could you see us using stock in the next few years?

Munger: If the business were good enough, of course. But businesses we already own are so good it's not wise to part with them to get businesses that aren't so good.

[Pretty clear that Buffett thinks Berkshire is, at most, reasonably valued. Given his reluctance to do even a very nice large deal involving stock, perhaps it would not be a stretch to say he thinks it's somewhat undervalued. Perhaps.]

<u>Question #7 – The future's so dark, I need a spotlight</u>

Q: When Buffett talks about the America's future in a general way, he's always very positive despite our tremendous problems. How can such a lousy long term economy make you so happy?

Buffett: "How can you be anything but enthused about this country?" Standard of living for average American has increased six for one since he was born in 1930. "We have a system that works magnificently, though it does get gummed up once in a while." Told a great story about future father-in-law sitting him down before marriage and telling him, "Warren, you're going to fail, but it's not your fault." Father in law was sure Democrats were going to take the country down the road to Communism. "If you and Suzy starve, you would have starved anyway."

When he got out of school in 1951, two people he admired most in the world – his father and Ben Graham – told him not to work in stocks bc there had never been a year when the Dow ended above 200, and that's where it was then.

"We will always have a list of 10-15 things at the start of the year as to why the country can't possibly work well. But the power of capitalism is incredible…that's what's bringing us out of this recession. "

"The game isn't over, it's not like the potential of America has been used up. What's happened is that the rest of the world has caught on to some extent"…China turning economies loose that have been dormant for centuries. "Not growing faster because the people are smarter or work harder, because they have tapped into a system that works marvelously over time"…Over the next hundred years, we will have 15 or 20 lousy years, but we will be so far ahead of where we are now that it will be unrecognizable.

[lots of applause]

Munger: “Europe survived the Black Death where about a third of the people died…the world is going to go on.”

Buffett: “You got anything more encouraging than that to say, Charlie?”

Munger: “You can be cheerful even if things are slightly deteriorating.”

<u>Question #8 - inflation and returns on capital</u>

Q: Which is better in an inflationary environment -- a high return on capital business like sees or coke, or a business with an irreplaceable hard asset that has pricing power, like a dam or railroad?

Buffett: The former is superior. “If you can have a wonderful product that requires very little capital to grow, and will do more dollar volume, as will happen in an inflationary environment even if you don’t have unit growth... that is a wonderful asset to have.” Your own earning power is a wonderful protection as well, because your services command more money with no additional investment.

Normally not enthused about businesses that require a lot of capital investment.

The ideal business...See’s candy was doing $25 million in volume when we bought it, and sold 16 million pounds of candy...well, close to $30 million in sales and now we’re doing well over $300 million. It took $9 million in tangible assets when we were doing $30 million in sales, it requires $40 now, and it’s made us a billion and half pretax during that period...it’s a much better biz to own than a utility if you’re going to have a lot of inflation.

Munger: We didn't always know this...

Buffett: ...and sometimes we forget it!

Munger: ”It shows that continuous learning is absolutely required to have any significant achievement at all in the world.”

Buffett: The ideal asset is a royalty on someone else’s sales in an inflationary environment. All you do is a get a royalty check every month.

[I’ve thought for a while that you can extend the oft-made Buffett point about the best inflation hedge being a business with pricing power one step further, and look for businesses with a distributor-like business model that have high turns or little inventory. “Demand aggregators” of this sort that are essentially brokers or distributors would benefit from a boost to nominal top

line growth as they take a small cut of inflation-boosted sales. As long as their cost inputs were rising at a slower rate, they'd do pretty well, and Buffett's offhand final comment to the prior question hints at the same thing.]

Question #9 -- Dividends and flying pigs

Q: Only way for a BERKSHIRE shareholder nearing retirement to get income is to sell some Berkshire stock. When would Berkshire consider paying a dividend?

Buffett: We'll pay a dividend when we've lost the ability to invest a buck in a way that creates more than a buck in present value for shareholders. At that point, maybe we should pay out 100%. But now, it's much more intelligent to let it compound and sell off a little once in a while. The logic is unquestionable. Of course, the execution is more difficult -- there will come a time when we do not think we can lay out 15 or 20 billion per year and get something worth more than that for our shareholders. When the time comes that a dollar only buys 90c of value, we'll give the dollar back to the shareholders. I predict that the day Berkshire declares a dividend the stock will go down, and it should go down because it means that the compounding machine has lost its ability to continue on that course.

Munger: There's nothing wrong with selling a little Berkshire stock to buy jewelry as long as you buy it in the right place.

[While I understand Buffett's point – and Berkshire is unique in that its opportunity set of places to invest capital is larger than almost any other corporate entity in the world – I hope that the managers of Microsoft, Cisco, and a slew of other cash-bloated U.S. companies don't take this comment too seriously. Buffett may well be correct that Berkshire's share price will fall if it announces a dividend, but many, many American companies would in my opinion benefit from higher payout ratios, and I would be willing to bet a filet mignon from Omaha Steaks that their share prices would go ***up*** *were they to return more capital to shareholders. Mr. Ballmer, Mr. Chambers – are you listening?]*

Question #10 – Banks and revenue growth

Q: What's your revenue outlook for USB and WFC given all the issues in the economy?

Buffett: These are some of the best banks – if not the best – in the U.S. For banking as a whole, profitability will be significantly less in the years ahead, because leverage will be reduced, which is good for society but bad for smart banks.

Even if ROA is as good as years ago, will be less assets per dollar of common equity, so ROE will be less. Still think USB and WFC are very good operations, very decent businesses, just not at as attractive as they were when leverage ratios could be higher.

If you keep out if trouble on the asset side, banking is a very good business. You get your money so cheap, and because of the implicit federal guarantee, you get to leverage up to a fair extent, and America's been a pretty good place to lend money.

Munger: I'd add that M&T bank is headed by a really sensible fellow, been a wonderful investment for us.

Buffett: If you get the M&T annual report, part of the letter is about the American financial economy, and I'd really recommend you read it. Bob is a very smart guy and he has a lot of good observations. The other one I'd recommend you read is Jamie Dimon's, which is a tour de force...he has some real insights in there, it's a letter everybody could learn a lot from.

Munger: [Bob] Wilmers *[CEO of M&T]* sounds like an Old Testament prophet. He really doesn't like that all the really big banks are making so much money off trading, because they're trying to outsmart their own customers. He'd rather serve them in a culture of deserved trust in both directions.

Buffett: He also expresses quite a dislike for the fact that the market creates a reward system where money sort of disproportionately falls to people who work with money and that tends to attract a lot people who might be better deployed elsewhere.

[I concur wholeheartedly on the Dimon letter – if you haven't read it, you should. I'll be reading the Wilmers letter as soon as I finish editing these notes.]

<u>Question #11 – Why ain't you buying gold, Warren?</u>

Q: My gold investments are up astronomically, but my Berkshire shares are only barely above where they were in 2006. Please explain why you have not invested more heavily in commodities. If Bernanke continue t o print money, won't gold continue to appreciate?

Buffett: I would point out that when we started Berkshire, one share was worth about ¾ of an ounce of gold, when gold was $20, and the shares were $15. Gold even at $1500 has a ways to go. I think he's right about inflation, though.

If you think about it, there are three major categories of investment. Think very hard about which category you want to be in before thinking about the choices in that category. The first category is anything currency denominated, like cash, bonds, and deposits. Dollar bill has on the back of it, In God We Trust....that's really false advertising, should say "In Government We Trust," because God isn't going to do anything about that dollar bill if govt does the wrong thing in terms of keeping it as valuable.

Any currency related investment is a bet on how government now and in the future will behave...almost all currencies have declined in value over time. Built into almost any economic system is that it will be easier to work with a currency that declines in value than a currency that appreciates in value...the Japanese might reaffirm that. As a class, currency related investments do not make much sense.

The second category are assets that don't produce anything, but that you hope someone will pay you more for in the future. The classic case is gold. *[At this point, he went into a long example which he has used before about how all the gold ever mined would be a block 67 feet on a side.]* You're betting on not just how scared people are now of paper money, you're betting on how much they think one year from now people will be scared two years from now. Referenced Keynes in *General Theory* when he talked about beauty contest where the goal was not trying to pick out the most beautiful woman in the group, but rather the woman who other people thought was the most beautiful.

The third category of assets is valued based on what it will produce in the future – stocks, farms. You decide how much you pay based on how much you think the asset itself will deliver. Those are the assets that appeal to me and Charlie. If you think about what that asset will produce, you can make a rational calculation in your own mind as to what that asset is worth.

When we look at Berkshire, we're looking at what we think it can deliver from productive assets that we own, and how we can use that capital in acquiring more productive assets. There will be times when cotton doubles in price...but you go back a century, it has not been a very good investment. I would bet on a goods-producing business outperforming something that doesn't do anything over any period of time. But there's no question that rising prices create their own excitement, so when people see gold go up a lot…I mean if your neighbor owns gold and it goes up a lot, and you think you're smarter than he is, and your wife says "how come that jerk next door is making so much money and you're just sitting here…" well, it affects your behavior. People like to get in things that have been rising in price. Over time that has not been the way to get rich.

Munger : Something peculiar to buy an asset which will only really go up if the world really goes to hell. Strikes me as not really a rational thing to do. And there's another class of people who think they can protect themselves by buying paintings of soup cans…I don't recommend that either.

[More on gold which I did not get. My hand needed a break. General point was the same.]

Question #12 – How can I raise money?

Q: How did you attract your first investors and how did you keep them?

Buffett: Sounds like a man who is starting a hedge fund. *[laughter]* Started out selling securities, hated it because if I sold somebody a stock for 20 and it went to ten, I wanted to buy more, but I could not face idea that people were doing it only because they had confidence in me, not because they understood the business. I could not make decisions as well with other people watching me as I can in a room by myself. Started a fund and first years were slow, a few family members and referrals from Ben Graham. Just stumbled along, operated out of my house for six years.

Munger: Took me a long time to leave the family business (?), so any of you who are having a slow time accepting good ideas, be cheered by my example. On raising money, it helps if you've conducted yourself in life so that other people trust you, it helps even more if other people are right to trust you.

Buffett : Unfortunately, with the present fee structure, just attracting money can be enormously lucrative, so the skill of attracting money may be the more important quality in the short run.

<u>Question #13 – Berkshire and conglomerates</u>

Q: Berkshire is like some of the conglomerates from the 1960s. How does Berkshire differ?

Buffett: Some benefits to be a conglomerate, for example tax-efficient transfers between businesses that use capital well and those that don't. Conglomerates from sixties became sort of stock issuance machines where idea was to issue stock at high multiple to buy businesses at low multiples. If EPS went up, and folks said you would do it again, if you had this semi-Ponzi machine, people accepted it and thought you would succeed. Teledyne played that game, but when things blew up, went into reverse and bought its stock like crazy, issued when overpriced, bought it in to an extraordinary degree when it was underpriced, created a sensational record.

Most companies primarily thinking about how they could pump the stock up to a ridiculous level where they could buy big businesses at lower PEs and have this perpetual motion machine going. Not what we're doing at Berkshire.

Munger: Some of those companies get heavily into manipulation of the numbers, one said "I know what I'm gonna report, I just don't know how I'm going to do it."

[A couple of years ago, I saw a great presentation by Leon Cooperman of Omega Advisors about Henry Singleton, the CEO behind much of Teledyne's tremendous record of capital allocation. There's a bio of Singleton called "Distant Force" that's supposed to be quite good.]

<u>Question #14 -- Legacy</u>

Q: A hundred years from now, what would you and Charlie like to be remembered for?

Buffett: Old age!

Munger: I have a saying that came down from one of my great grandfathers, he wanted to be remembered for a fortune fairly won and wisely used. That's a pretty good goal.

Buffett: I'd probably say teacher. I like students coming, I've benefitted from some great teachers in my life.

<u>Question #15 – The not-so-almighty dollar</u>

Q: Dollar is declining and Fed is keeping rates low while other banks are raising rates. A while back Berkshire had a short US dollar position, what is Berkshire doing now to protect against a falling dollar.

Buffett: We have not been really active in currency markets lately. No question that purchasing power of dollar will decline over time, question is at what rate…I also think that purchasing power of almost all currencies will decline, and a short position is a conviction that one currency will decline at a faster rate than another. Don't have a strong conviction, do have some mild views, not enough to bet much money on. Do have some fears of rapid loss of value in dollar. Charlie has pointed out to me that dollar of 1930 when I was born is worth six cents now, yet we've done pretty well. I hate inflation, but we've adapted pretty well to it over the years…we have not had the real runaway type inflation that can be upsetting to a society, but it's something you have to guard against.

Munger: One way or another, I think the world muddles through. Take a really dysfunctional society like modern Greece…one of the main industries is tourist attractions, yet the sites are closed when the tourists show up, yet there it is, the people of Greece are surviving.

Buffett: I think we'll see a lot of inflation, but if I had a choice, I would rather be born in the United States today than in any other place at any other time in history.

<u>Question #16 – Berkshire vs a fund</u>

Q: Should I invest in Berkshire or a good no-load mutual fund?

Buffett: Index funds are better if you're not actively investing. Given a choice between an index fund and Berkshire at present prices, I would take Berkshire.

Munger: I don't think the average return for a skilled investor over the next fifty years is going to be a good as it was over the last fifty years. Given those lowered expectations, I would choose Berkshire.

Buffett: Charlie's big on lowering expectations

Munger: Absolutely. That's the way I got married -- my wife lowered her expectations. *[laughter]*

Buffett: And he lived up to them!

<u>Question #17 – The Last Sokol Question</u> *[pasted from Berkshire's transcript]*

ANDREW ROSS SORKIN: The question is, can you explain the company's policy for your own personal investing outside of Berkshire and that of your other managers, and why aren't all trades in investments first cleared through a compliance department like that of most other companies?

WARREN BUFFETT: Well, I don't think it is true of most other companies. We have 260,000 employees, and we have one company that's a subsidiary of General Re called New England Asset Management but that's the only company that advises people on investment or operates in the investment field.

At Berkshire, there are presently three people that can execute trades and then there are a few other clerical people that would see what was done. But we are not a investment advisory firm. We're not a mutual fund or anything of the sort. So if we -- we have some, I think, pretty clear rules that are going to be looked at, again, I can assure you by the audit committee. But in terms of the code of conduct, code of ethics, and insider trading rules, which go to the managers, I don't think there's anything ambiguous in those.

Now, to extend those beyond -- I don't know, Marc, how many people those go to but -- whether 60 or 70 or something, I'm not sure of the number -- but the problem with rules, you know, is, I mean, you've got to have them and we emphasize not only the letter of them but the spirit. That's why I write that letter every couple years.

I was on the audit committee, for example, of Coca-Cola, and Coca-Cola has about one-fifth as many employees -- or did then, had about 50,000 -- had about one-fifth as many employees as Berkshire, and each time the audit committee met we had eight or ten code violations. I mean, people -- if you take Berkshire at 260,000 people, you know, that's about the number of households in the greater metropolitan Omaha. And as perfect as we like to think we are in Omaha, I will tell you there's a lot of things going on in Omaha right as we sit here that, you know, do not match the rules.

So it's a -- it's a real problem. The problem, obviously, with the Sokol thing is it hit very, very high up, you know.

But we had a case sometime back where a fellow that was a friend of mine, vice president of one of our subsidiaries, and, like I say, a personal friend, and we supplied the evidence that sent him to jail. You know, it -- it has happened. We had a -- as I remember some years ago I think it was in Woodbury, New York, we may have had a woman arrested in the offices just because we want to make very clear, you know, what -- that we mean business and as the -- as the audit committee said that this is not public relations, this is reality.

Here's a letter that went out from Johns Manville. I didn't know anything about it until Todd Raba gave it to me the other day, but it describes what -- dated April 27, and it said, The audit committee clearly found that Mr. Sokol compromised the integrity related values of both Berkshire and JM have worked so hard to ingrain in the fabric of both companies. This should serve as a tragic lesson learned for every employee in JM. And then in boldface, There are no gray areas when it comes to integrity. And it goes on.

So we hope to get some value out of this experience that will help us reinforce with not only the 60 or 70 managers but with 260,000 people that we do mean business on this, and we've shown them we mean business when we -- we have sent more than one person to jail.

But there will be -- you know, if we -- we can have all the records in the world and if somebody wants to trade outside them or something, you know, I -- they're not going to tell us they're trading in their cousin's name. You know, it just doesn't work that way. And then it -- we will have occasions in the future when people do wrong things. Usually they get handled at the subsidiary level. I mean, it's somebody doing something, whether it's getting a kickback from a vendor or stealing out of a cash register, whatever it may be, and then, you know, we get the occasional mega one, which is very painful, but we will -- if there's anything we can do in the rules that will make it even more explicit or get across further the idea that rules are not made to be danced around but rather the spirit of them extends beyond them, we want to be sure we do it. Charlie?

CHARLIE MUNGER: Yeah, all that said, if you look at the greatest institutions in the world, they select very trustworthy people, and they trust them a lot, and it's so much fun to be trusted, and there's so much self-respect you get from it when you are trusted and are worthy of the trust that I think your best compliance cultures are the ones which have this attitude of trust and some of the ones with the biggest compliance departments, like Wall Street, have the most scandals.

So it's not so simple that you can make your behavior better automatically just by making the compliance department bigger and bigger and bigger. This general culture of trust is what works.

And, you know, Berkshire hasn't had that many scandals of consequence, and I don't think we're going to get huge numbers either.

<u>Question #18 – Giddyup, Ben</u>

Q: Are there any changes to U.S. econ policy or Fed policy that are needed to get the economy going again?

Buffett: Not much more we can do in terms of policy. Hard to imagine we can push much harder on the monetary front. When residential construction comes back, you'll see much more of a pickup than you would think just looking at the construction job numbers. Refers to Shaw Carpets, NFM, etc. Pace coming out of this has been slow, but given how bad got it, the recovery in economy is good. Peak in railcar loadings was 219k, bottom was 150k, now we're at 190k or thereabouts . It's come back in a significant way… we have companies in basic industries that are setting records, look at TTI, which distributes electronic components all over the world, it's setting records, look at ISCAR which supplies basic industry, business is going up and up and up month by month.

Munger: The one place where we're making a huge mistake is not learning enough from the big mess that came from wretched excess in our financial system, I don't think we've throttled the sin and folly out of that aspect of the economy nearly enough. All of our crashes have come from financial crises that were preceded by perfectly asinine and greedy behavior. Lot to be said for taking an axe to our financial sector and whittling it down to a more constructive size. I would have tax system discourage trading, I would have various types of Tobin taxes. Making heroes out of the people who succeed at it is not good for the fiber of the country either. I hate the idea that 25% of our best engineers are going into the financial sector. It's crazy what's going on. And I think the lack of contrition in our fin sector after the disgraceful stuff they got us into is perfectly awesome. It makes David Sokol look like a hero.

Buffett: Sideline, how many of you know that if you trade an S&P 500 futures contract, and hold it for ten seconds and have a profit, that sixty percent of profit is long term gain. Essentially, our congress has said that this activity should be more lightly taxed than cleaning washrooms. Extraordinary that we have decided that this activity should get sixty percent taxed at a fifteen percent max rate even though it may take ten twenty seconds and be just a flicker on a screen

Munger: And the hedge fund guys get a much lower tax rate than the professors of physics or the drivers of taxis. This is demented.

[There's some great stuff in that section worth pondering, especially with regard to the lack of lessons learned – and changes made – post financial crisis. Makes you wonder whether the next one will come sooner than it might have otherwise. I think the tax code points are excellent as well, but that's just me.]

[LUNCH]

<u>Question #19 -- Build Your Dreams</u>

Q: What do you think of BYD these days?

MUNGER: Price still much higher than when Berkshire bought, so not as cheap as it was then. I'm encouraged by what's going on.

<u>Question #20 – Oil Bubble</u>

Q: Is there an oil bubble? What's your view on oil? *[Questioner prefaced question by unnecessarily describing her profitable investments in oil stocks since 2007. Once of those cringe worthy moments that can occur at BERKSHIRE meetings, of which there were remarkably few this year.]*

Buffett: Well, you've done a whole lot better than we have.

Munger: I think the crowd would rather hear from her than from you!

Buffett: We really don't know. Dealing with finite resource…you stick a lot of straws into the earth. I can almost promise you that oil will sell for a lot more some day. Smaller countries where oil is being found now are smarter about concessions being offered than were 50-70 years ago, they drive much more intelligent deals. Traditionally, BNSF has hedged some portion of oil, I suggested to them…I didn't think we could guess the price of oil, if we could, we wouldn't need to run the railroad, we could just sit in a room trading oil and avoid all the hassle of running a railroad.

I am quite convinced that the dollar will be less valuable over time, so the dollar price of most things will go up over time. An intelligent person can make more money over time by thinking about productive assets rather than speculating in commodities.

Munger: What we have done is much easier than what you are trying to do.

Buffett: We like easy. I don't know any way to have an edge in that sort of activity.

<u>Question # 21 – What have you learned lately?</u>

Q: Could you please let us know some of the most important things you learned in the past year?

Munger: Read *In the Plex* about Google and found it very interesting.

Buffett: What I learned is that I'm going to have Charlie write the next press release. *[laughter]*

Munger: I approved that damned press release with no objections. We're in a lot of trouble if you're relying on me to find Warren's errors.

<u>Question #22 – TBTF</u>

Q: Are taxpayers going to again be at risk of bailing out big banks?

Buffett: There are institutions that government should properly support, but that does not mean saving managers or shareholders. I was on the fence with regard to bailing out the automakers, but my hat is off to the administration for doing so. Problem of TBTF will always be with us, for that reason you have to reduce the propensity to fail, and among those is you have to make it so that CEO and to some extent the board…Any institution that requires society to come bail it out for society's sake should have a system in place that leaves the CEO dead broke. Board of directors should suffer severe penalties – should give back the last five years of director's fees or whatever. Need incentive practices in place that make it very, very painful to fail.

Munger : Past panics and depressions started by and large on Wall Street, tended to involve an excess of speculation and bad behavior. This last mess which created so much danger should have created something like what happened in the thirties, which prevented a new mess for a long long time, but of course …you can confidently expect a new mess before your career is over. It's really stupid for our country to have allowed this. Partly the failure is not one of evil but one of stupidity. Finance and economics are not hard sciences. Finance really attracts people who should have gone into snake charming.

Buffett: if there's anybody we forgot to insult, don't worry, we'll get to you.

Question #23 – WPO Board

Q: Why did you and Melinda Gates resign from WPO Board?

Buffett: I won't be selling stock, if they want my advice, I'm a phone call away, they'll just be getting the advice a lot cheaper. At age 80, I'd rather spend a few more days at Berkshire and less on the road. I don't think Melinda did it on the basis of age, but you'll have to ask her.

Munger: Enjoy being on Costco board, it's one of the pleasures of my life. But serving on a lot of different boards is for the birds.

Question #24 – I come from the Land Down Under

Q: Concerned that weaker dollar will erode value of Berkshire stock, despite pricing power of Berkshire businesses. Can I be confident that in the long term, any fall in the dollar will be offset by a rise in the value of my Berkshire stock? *[Questioner is from Australia, for context.]*

Munger: The answer is no. *[laughter]*

Buffett: Would be a lot easier to just have the Aussie dollar go down. Aussie dollar was one of two currencies we bet on last year. I think movement could be dramatic, and could be dramatic in either direction, that's why I don't know what to do.

Question # 25 – Berkshire equity portfolio

Q: Has equity portfolio become an afterthought?

Buffett: I prefer large acquisitions, but equity portfolio is not an afterthought at all. It's impossible to have a big edge in the kinds of stocks we're buying. A small edge, maybe.

Munger: In the days when we were doing so well in marketable securities, nobody called us and said "you're the only place in the world that I would want to sell my business," now it happens a few times a year. I prefer in some ways this part of the game to the earlier game, because it's more fun to create permanent partners doing constructive things than just outsmart other people in shuffling little pieces of paper around.

Buffett: It's fun to do both, actually.

Question #26 – Sandbagging?

Q: Are you perhaps undervaluing the insurance companies by assuming only a breakeven in underwriting? *[Refers to Buffett's projections in 2010 AR of normalized Berkshire earnings given insurance ops at breakeven.]*

Buffett: Would not be inappropriate to include some normalized underwriting profit.

Munger: Is there any other large P/C insurance operation in world that you would trade for ours?

Buffett: No, nothing close. Geico had underwriting profit of 8 points in the first quarter. It's a marvelous business. Ajit has built from scratch a great business, if somebody wants huge amounts of insurance and a quick answer, there's nobody else to call except Ajit.

Munger: P/C insurance is a tough business, like banking – there are temptations to be stupid. If you're in it, we have the best one.

Question #27 -- More on inflation

Q: In period of high inflation, which BERKSHIRE businesses will do best and worst?

Buffett: Any business with pricing power and low capital intensity.

[Buffett makes the same Sees-vs-utilities comparison made earlier in the meeting, so I stopped taking notes for a little while. Only new nugget was a point about the replacement value of hard assets – like BNSF's tracks and rolling stock – increasing by a lot during inflation.]

Question #28 – Don't hold your breath

Q: Has Berkshire been considering splitting the A shares?

Buffett: Have been split, effectively, bc B shares are available.

Munger: Warren used to say, "May you live until the A shares split."

Question #29 – Ajit

Q: Since Ajit may be in line as next CEO, can you give us more insight into how he thinks, and a concrete example of a policy he has written that has impressed you?

Buffett : can't think of any decision he's ever made that I could have made better. He's as rational a thinker as Charlie, he loves what he does, he's very creative and has moved into lots of different insurance areas that others have copies, then Ajit has found new niches. His mind works like a machine, day after day. To an extraordinary degree, Ajit thinks of Berkshire first, he could leave and make a lot more money, maybe hundreds of millions. You won't find anything like it in the insurance world or the business world.

[I found this answer disappointingly general, since Buffett has been fulsome in his praise for Ajit many times in the past. As the questioner asked, a specific example would have been very helpful in giving a fuller picture of someone who – in Buffett's words – "is not exactly a publicity hound."]

Question #29a --

[There was a back and forth bt Buffett and Munger, and then Munger said, "You didn't answer the question, or maybe you avoided it on purpose, he said "What are our worst businesses?" I must have missed the context for this.]

Buffett: Generally speaking, we made certain mistakes in going into smaller business that never had the potential to be big, but overall probably retailing…NFM is a terrific operation…we have not made…despite being in quite a few retailing businesses for quite a while, we have not created major earnings power there.

Munger. luckily it's a small part…you're right, that's been the hardest game for us…if we were a little smarter, we could have figured that out sooner.

[I was glad to hear him say this. Some years ago, I was in Omaha with an equity analyst we had recently hired at Morningstar, and the analyst asked: "Borsheim's is a nice store, but what's the moat?" I couldn't figure it out either.]

<u>Question # 30 – ROIC and goodwill</u>

Q: What's the proper way to think about goodwill and return on capital? Berkshire's manufacturing, service businesses have pretax returns on tangible capital over 20 pct, which suggests either skilled mgrs or fantastic businesses. But the return on allocated equity is in the single digits, which looks drab. Accountants treat intangibles similarly because they have different economics. For an indestructible brand like Sees or Coke, I can see why the brand should not be amortized, as its value grows with time. But all the tobacco companies have billions in goodwill, and unit sales of cigs declining every year in developed countries, so perhaps those should be amortized. And then there's AOL/TW.

Buffett: Good will should have been written off with AOL/TW, because it was just a mistake in the purchase price. Goodwill should not be used in evaluating the fundamental attractiveness of a business…there you need to look at return on tangible assets. Basically, in evaluating the businesses we own, in terms of what the management are doing and what the underlying economics of the business are, forget about goodwill. In terms of evaluating the job we're doing of allocating capital, you have to include goodwill, because we paid for it.

If you were to buy whole of KO today, goodwill would be worth a lot and you shouldn't amortize that or look at it to evaluate the economics of the underlying business, but in terms of evaluating the economics of the business that purchased it, then you have to allow for goodwill, because buyer is allocating capital and paying for it.

I don't think amortization of goodwill makes any sense, writeoffs make sense if you determine that the business' performance does not support the purchase price. But in terms of looking at whether a business is good, mediocre, or poor, look at return on net tangible assets

Munger: Well, I think that's right. As the gentleman said, when we buy a whole business, we never get a huge bargain, we may get down toward 10% on pretax earnings on what we pay, but that isn't so awful as you think when a lot of the money comes from insurance float that costs us nothing. In other words, if you have 60b of float, and that give 6b year in earnings, that's not all bad.

Buffett: For Lubrizol, we're paying close to 9b for equity, for about 1b pretax earnings. Lubrizol itself is employing 2.5b in equity to earn that 1b pretax. It's a very good business in terms of the assets that are employed, but when we end up paying the premium we pay to buy into it, then it becomes a billion pretax on 9b. You have to judge us based on close to a 9b investment, you have to judge James Hambrick in running this business based on the much lower capital that's employed… it could turn out to be a very good business and we could turn out to have made at least a minor mistake if it isn't as good a biz as we think it is now.

[From an investor/analyst's perspective, this was one of the gems of the meeting. Whether ROIC should be assessed with or without goodwill is one of those "how-many-angels-on-the-head-of-a-pin" arguments that crop up frequently, and my opinion has always been exactly what Buffett said – it all depends on the question you're asking. Are you assessing the core economics, or the prices paid to acquire them? Plenty of companies have collections of good businesses which were acquired at stupid prices. But just because they were purchased at a high price does not make them bad – low ROIC -- businesses. As a side note, this question was asked by Joel Tillinghast, the manager of Fidelity Low-Priced Stock FLPSX. I note this because of a few interesting facts. Tillinghast manages a $31 billion fund with almost 900 positions—average market cap of about $3b – which should be a recipe for complete mediocrity. Yet this fund has beaten two-thirds of its peers over the trailing three and five year periods, and more than 95% of its peers over the past 10 and fifteen years. Remarkable – it's like outracing a mini cooper with a dump truck. I met Mr. Tillinghast briefly once, and was thoroughly impressed, but don't take my word for it – look at the record.]

Question # 31 – Professor Munger

Q: In *Damn Right, [a good but not great bio of Munger]* Charlie says he would teach finance based on the histories of a hundred or so companies that had done well and done poorly. What would some examples be?

Buffett: I predict Charlie will talk about Costco. *[laughter]*

Munger: Costco is a business that became the best in the world in its category...extreme self-imposed ethical duty to take all of its cost advantages and pass them along to its customers. Generated fanatical loyalty. Costco has one store in Korea that will do over $400mm in sales this year. These are figures that can't exist in retail. This is quite rare. If once or twice in your lifetime you're associated with such a business, you're a very lucky person.

The more normal business is one like say GM, which became the most successful business of its kind in the world, and then wiped out its common shareholders a couple years ago. That's a very interesting story. Heavily unionized business combined with great success and very tough competitors...success turning into a disadvantage is a big problem in business. So, there are all these wonderful lessons.

I don't know why people don't do it. That's the way it should be taught. Harvard Business School once taught it this way, and then they stopped. I'd like to make a case study as to why they stopped. I think I can successfully guess, which is that the course of history of business trampled on the territory of the barons of other disciplines. IBM is an interesting case...there's just one after another that are utterly fascinating, and I don't think they're properly taught at all because nobody wants to do the full sweep.

Buffett: Charlie and I were once on a plane that was hijacked, the hijackers picked us out as the two dirty capitalists, they said that each of us would be given one request before they shot us. They turned to Charlie and said what is your request? Charlie said I would like to give once more my speech on the virtues of Costco, with illustrations. Hijacker said that sounded reasonable, turned to me and asked me what my request was, and I said "Shoot me first!"

[Humor aside, I think there's an incredibly valuable point here. Having hired well over 150 analysts during my time at Morningstar, I was always struck by two things about most newly-minted MBAs .One, how few successful investors they could knowledgeably discuss—I mean, if you wanted to play in the Major Leagues, wouldn't you know more baseball players than Babe Ruth and Hank Aaron? – and two, how little they knew about business history. Perhaps the Munger Curriculum would change at least one of those deficiencies.]

[Missed the next question. Bathroom break.]

Question #32 –The $100,000 question

Q: What kind of compensation structure would be best for next Berkshire CEO?

Buffett: will make a lot of money and should make a lot of money...big responsibility, should pay well. Base salary should be supplemented by an option system that incorporates a couple of unusual features...option price should not be less than the price the assets would bring if the company were for sale. The idea of giving options at some depressed market price is crazy because why, you wouldn't sell your business at that price.

Because of compounding feature of leaving money there, should be an increase in the base price annually at some rate...with that kind of a structure, could give a very large option...if someone is creating excess value above a given rate in a very large sum, then they deserve something quite significant. The present comp system has no relevance on what my successor should earn. The main thing is getting the right person with the right values, who interacts well with the managers and knows how to allocate capital. You just heard how our managers who accomplish a lot, can make a lot of money with Berkshire. People make well into eight figures sometimes at Berkshire, but they earn it.

Munger: I hope it will be a long time in the future...Also, I think somebody in America has to be the exemplar for not grabbing all that you can.

[lots of applause]

Question # 33 – Hungry and Thirsty

Q: How do depleting water supplies and food stocks affect your investment strategy?

Buffett: An important subject, but doesn't affect our investment strategy.

Munger: if there's enough energy, you can get enough clean water...Main reason for being restrained in the use of hydrocarbons is that modern agriculture wont' work without them... great believer in being conservative in terms of blowing all the hydro on heating houses and running cars.

Question #34 – Lubrizol

Q: Purchase of Lubrizol done in negotiated transaction, Board of LZ did not run a sale or auction. According to proxy, you did not permit a "go shop" process despite their request that you allow them to do so. Did Board breach its fiduciary duty by not running a more competitive process?

Munger: *[leans over to Buffett and says, "I can do this."]* The answer is no, the Board did not breach its duty because we were not going to participate in the transaction if they did not do it our way. *[laughter, since this was the first time in memory that Charlie took the lead in answering a question not addressed specifically to him.]*

Buffett: We basically don't participate in auctions. Very very recently , we were asked to participate in one, and we're just not interested. If they had said we want to conduct an auction, we would have said good luck, and then looked for something else.

Munger: Anybody else got an easy question?

Question # 35 – How good are you?

Q: How can we determine how good of a job you have done in allocating capital?

Buffett: The real test will be whether the earning progress at a rate that's commensurate with the amount of capital that's being retained...over time if we keep your money, then we have to earn a better than average return on that money...has to translate into the stock trading at a premium...we've done okay, but the job just gets tougher.

Question # 36 – Please sir, state the obvious

Q: Five recent Berkshire deals – GE, Swiss Re, Goldman, Dow, and Wrigley were all very different in terms of structure and terms – why?

Buffett: In terms of comparing those five deals, every one of those deals was done at a different time, and market conditions were different and opportunity costs were different. When I did Swiss Re, not thinking about Dow Chemical deal, thinking about what else I could do with 2.7b dollars, that's the way all the decisions are made. Past deals we've made don't make any difference. One of the errors people make in business is that they try and measure every deal against the best deal they have ever made. The goal is not make a better deal than you've ever made before, the goal is to make a satisfactory deal that's the best deal you can make at the time

Munger: Of course we're going to make different deals at different times based on different opportunity costs. There is no other rational way to make deals.

[I was a little surprised Loomis used a question "slot" with this one. Very specific, so I doubt she had received a dozen like it, and kinda obvious. Sort of like asking why Buffett buys different stocks at different times.]

Question # 37 – Speed reading

Q: What advice would you have to people who want to learn to read faster?

Buffett: Although I read five newspapers and Ks and Qs every day, I am not a fast reader, and I'm slower than I used to be.

Munger: The value of speed is overestimated.

Question # 38 – Debt ceiling

Q: Are you worried about Congress playing politics with the raising of the debt ceiling? What would be the effect on economy and Berkshire?

Buffett: If didn't raise ceiling would be one of the most asinine acts that congress has ever performed. *[Tells well-worn story about Indiana legislature in 1890s introducing a bill to change value of pi to 3 so it would be easier to work with for kids.]* That's the only bill I can think that would give competition to not raising debt ceiling.... *[laughter]*

The U.S. is not going to have a debt crisis of any kind as long as we can issue debt in our own currency. The difference between being able to borrow in your own currency and having to borrow in another is night and day. The thing we need to worry about is inflation. On the other hand, if you're a member of the euro, you have to worry about ...you can't print money...you can go and get your co-member s to try and help you out....giving up the right to issue debt in your own currency is a huge step, and the U.S. has not done it.

MUNGER: Reference to bipartisan things like the Marshall Plan, but now both parties are trying to compete to see who can be most stupid, and they keep topping each other.

Question #39 – Glowing corn.

Q: Can bond-like returns of building a proposed nuke plant by Mid-American in Iowa offset mega-catastrophe risk posed to Berkshire?

Buffett: Nothing like the exposure that you referred to. Nuke power is an important part of the world's equation in dealing with energy. Important, safe, not going anyplace in U.S. for a while because of reaction to what happened in Japan.

Munger: Can't be so risk averse that things having very tiny chance of making big dent in one subsidiary are unendurable for us...have to have a certain amount of courage in running this company.

Buffett: We are not bearing any risk at any time that could threaten the enterprise.

MUNGER: And if a tsunami gets to Iowa, it'll be a hell of a tsunami. *[laughter]*

Question #40 – Charitable contribution program

Q: Would Berkshire ever re-instate the charitable contribution program that it had for 20 years?

[Long answer rehashing history of program, protests about donations made by BERKSHIRE shareholders – not Berkshire itself – to pro-choice groups through program, boycotts of Pampered Chef folks in some communities as a result, and Buffett did not think it was fair to harm the economic well-being of those Pampered Chef folks.]

Question #41 – Growth, certainty, and forecasting

Q: When you think about LT cashflows, do you try to forecast growth or just think about certainty? If you have an indestructible company like Coke or BNSF, do you try to estimate growth?

Buffett: Obviously we love profitable growth, we would love to find a way to take a Sees candy and move it geographically, make it grow more. If we see growth in the future, and it produces a high return on incremental capital, we love it. But we do not rule out companies where there will be low or no growth.

Munger: Interesting thing is that in our country the business schools teach people to make these projections way into the future, and then they use them in their business decision making. I've always regarded those projections as doing more harm than good. An enormous false precision gets into things when making projections over long periods of time.

Buffett: Lubrizol had already made projections out to 2015, asked did I want to see them, and I told them no. I've never seen a projection from an investment banker that didn't show the earnings going up over time. It's like asking the barber if you need a haircut.

[The false precision point is a great one. Someone – I dunno if it was Buffett or Sam Zell – once said, "If it takes you until line 137 of your spreadsheet to decide whether something is a good value or not, you've already lost the game."]

<u>Question #42 – Huh?</u>

Q: Three stocks are listed in the most recent Berkshire 13f as being owned by Warren Buffett directly. What are they?

[Marc Hamburg gets up and explains that these are part of retirement plans in Berkshire, but Buffett's name shows up on them because he is the controlling shareholder.]

<u>Question #43 – Furriners</u>

Q: When looking at investments in China, and business culture is different, successful business practices are different, what are characteristics you are looking for?

Buffett: Follow same principles, but recognize that we know less. We weigh in that uncertainty. Looking at Petrochina in 2003, very cheap, looked at Yukos around the same time, no geopolitical expert, but I decided that I was more comfortable buying Petrochina than I was buying Yukos. We do make allowances for our lack of understanding...but basic principles of trying to value business and finding managements that have competence and integrity, attractive purchase price, don't change.

<u>Question # 44 -- Cash</u>

Q: What does Berkshire do with its cash?

Buffett: Choices are all lousy. We don't play around with short-term money. The last thing in the world we want to do is try to get 10 extra basis points. It's a parking place, just a parking place, but one where we know that we'll get our car back when we want it.

Munger: Really stupid to try and maximize returns in ST money if you're in an opportunistic game like we are.

Buffett*: [lengthy answer about importance of being able to deliver lots of cash quickly for a deal if need be]*

<u>Question #45 – Charlie and Wind</u>

Q: Will you host another meeting?

Munger: Yes, we'll call it "An afternoon with Charlie." It will be only for hard core addicts.

Q: Mid-Am investing a billion in wind. How do you feel about it, what will returns be?

Buffett: Can't count on wind for base load, that's a real limitation. Economics only make sense with an incentive tax credit from federal government. One of asset of Berkshire is that it pays a lot of taxes, so wind makes sense for us, enabled us to keep rates unchanged for more than decade.

<u>Question # 45 – NetJets</u>

Q: Said that Sokol resurrected NJ from verge of bk, struck me bc did not remember you having said that NJ was in such bad shape. Was it in worse shape that we knew?

Buffett: Said it was destined for bk absent fact that Berkshire owns it. If it had been a standalone, that's what would have happened. Conditioned statement on it not being owned by Berkshire.

<u>Question # 46 – Advice for youth</u>

Q: Youth unemployment is high but lots of bright young folks out there willing to learn. What advice would you have?

Buffett: Main thing you can do, lots of reading, improve your own skills, I have one diploma hanging in my office, from Dale Carnegie course. It's incalculable how much value I got from that course...nothing like improving your own skills, and communication skills are the first area I would work on to enhance my value throughout life.

<u>Question # 47 – Insurance</u>

Q: Does Berkshire equity ownership in Swiss re limit amount of cat business that you are willing to write directly?

Buffett: Investment in Swiss Re is 4b, less than 2% of net worth, not of magnitude that would cause me to change what I'm willing to do, the risk we're willing to bear. Those investments are no constraint at all.

Munger: Insurance, especially reinsurance, is not an easy business...taken a long time to do as well as we have.

Buffett: Didn't do much at all for first fifteen years. Business that looks easy, but it's not. Better have factored infrequent events into your pricing.

<u>Question # 48 – Todd Combs</u>

Q: How did you meet Todd Combs, and how can we as shareholders assess his progress?

Munger: He sent me a letter, we had a meal, I called Warren and said this is a guy you should talk to. We have a very complicated business, with very elaborate procedures, as you can tell. *[laughter]*

Buffett: And his results will be known over a five year period. More likely than not than we will have more than one investment manager.

<u>Question # 49 – JNJ and Synthes</u>

Q: JNJ one of BERKSHIRE's largest holdings...thoughts on purchase of Synthes?

Buffett : I would like the deal a whole lot better if it was all for cash. When they trade away their present businesses for some other business, they're either saying that their own businesses are fully valued or that the other guy is making a hell of a mistake in selling to them. By using a lot of stock, you could draw the inference that JNJ is not valuing its own businesses as attractively as you might think they should be evaluated.

<u>Question #50 – Elephants</u>

Q: Commented recently on an elephant that you thought was too big. What size is too big, has phone been ringing, etc.?

Buffett: I got through college answering fewer questions than that. Hard to name a precise figure. Appetite is always there, not going to borrow money, not going to issue shares except in a minor way. Looking at a couple of Lubrizol's size, would be comfortable doing those. Can't do a really big elephant now.

Munger: Very reluctant to issue shares.

Buffett: We hate issuing shares.

<u>Question # 50 – real estate and cyclical businesses</u>

Q: Insight into current state of real estate, given Berkshire's involvement in these areas?

Buffett: Terrible – no bounce at all. *[Some more here, nothing new. I was getting pretty tired.]*

Munger: One advantage of buying these very cyclical business is a lot of people don’t like them. In the big scheme of things, what do we care if it’s lumpy?

Buffett: See’s candy loses money 8 months of the year...why look at a cyclical business any different than a seasonal one?

[And that’s all she wrote.]