

## 2009 Berkshire Hathaway Annual Meeting

*Disclaimer: I attended the BRK annual meeting on May 2<sup>nd</sup>, 2009 and these are my notes taken in real time without the use of a recording device. My goal was to get the gist of some very long questions and then try to capture the most important aspects of the response from Buffett and Munger. When the full transcript is released it will be significantly longer than this so these notes should be a great time saver without losing much of the content. Please forgive any errors or omissions.*

**Moderators: Carol Loomis, Becky Quick, and Andrew Ross Sorkin**

- 1. Loomis: If derivatives are weapons of mass destruction (as Buffett has indicated on many occasions) are they appropriate for a highly rated insurance company?**
  - a. Buffett
    - i. Believe in the long run they will make money on these positions
    - ii. Have very minimal collateral posting requirements
      1. This is why they were willing to write these contracts
      2. As of March 31<sup>st</sup>, 2009 the collateral requirements were less than 1%
    - iii. However, derivatives do pose problems for the world on a macro basis
      1. Will only use them if they believe they are mispriced
    - iv. Believe it is his duty to explain to shareholders the rationale for these transactions/contracts
    - v. Unfortunately, as a result of market to market accounting, the value of these derivatives can swing by billions of dollars on a quarterly basis
    - vi. Odds are very good that the equity puts will end up making money
      1. However, he believes they will likely lose money on some of the CDS contracts
        - a. Those most at risk of loss are CDS on high yield companies
        - b. There are far more Chapter 11's happening now (and will in the future) than previously
    - vii. Will continue to hold and explain these contracts
      1. Have no material impact on BRK as a whole
        - a. Believe their balance sheet strength makes BRK an ideal company to hold these types of contracts
  - b. Munger
    - i. There is a limit to how many of these contracts a company can have and BRK is well under that limit
- 2. Audience Question: How can we teach the world to be more financially literate?**
  - a. Buffett
    - i. A world dependent on credit cards and calculators is hard to teach financial literacy
    - ii. People will continue to do very foolish things
      1. When he first went to Las Vegas he saw a country full of people who will fly from all over just to do something that is mathematically stupid
        - a. Thought that this meant the US was a great country to make money in
- 3. Quick: Can you comment on Wells Fargo (WFC) and their current position with the government? Apparently they did not want to take TARP. Are these government programs and interventions good or bad?**
  - a. Munger
    - i. The government is reacting to the biggest financial crisis in memory in a very hurried fashion
      1. Unreasonable to expect perfection
      2. They are entitled to be judged leniently
        - a. Agreed that some of the reactions appeared to be foolish

3. Stated that the accounting principle that causes earnings to increase as your credit is destroyed (by being able to adjust the value of your debt) is insane
    - a. Thought that the people who made these rules need to be removed
  - b. Buffett
    - i. Government was facing a total meltdown in September
      1. Frozen commercial paper market and huge outflows from money market funds
        - a. When you are getting punched from all sides it is hard to be perfect
          - i. He commended the actions of the government
      2. Nature of the emergency requires people to accept government actions
    - ii. Believes that WFC is a fabulous bank
      1. Has advantages that other banks do not have
      2. Suggested we all read the piece of the JP Morgan (JPM) annual letter written by Jamie Dimon
4. **Audience Question: Do Buffett and Munger employ the use of complex free cash flow calculations with terminal multiples to determine discounted cash flow and ultimate valuation? Does this process fall in the too hard bin? Do they just use simple cash flow calculations?**
  - a. Buffett
    - i. All investing is laying out cash to see how much you can get back
    - ii. If you need a computer or calculator to understand a company then you don't need to buy shares
      1. It should be so cheap that it screams at you
  - b. Munger
    - i. Some of the worst financial decisions ever made were made based on fancy spreadsheets
      1. People started to believe too much in their projections
    - ii. Business schools teach this so that they have something to do
      1. The implication is that business schools are not teaching the right things
  - c. Buffett
    - i. People relied too much on the false precision based on the projection of probabilities of X standard deviation events
      1. People with high IQs are more prone to fall into this trap
      2. There are certain events whose probability cannot be calculated
      3. It is a mistake to think that higher math will take you anywhere in investing
        - a. More likely to take you down the wrong path
5. **Sorkin: When it comes to Moody's (MCO), why do they currently retain such a large holding? Why didn't BRK use its large stake to influence the business model?**
  - a. Buffett
    - i. The conflict of interest (in terms of who paid for ratings) was not the main cause of misunderstanding the CDOs, CMBS, RMBS, etc
      1. The belief that house prices could not fall was the wrong model to rely on
        - a. Congress, bankers and home buyers were all guilty
      2. People levered up their biggest asset
    - ii. Congress would have likely scolded the rating agencies for not rating these securities higher
      1. They would have been seen as limiting home ownership (would have been labeled Un-American) and suppressing financial innovation

- a. Rating agencies were in a no win situation
      - iii. BRK is not in the habit of telling the companies that they own what to do when it comes to their business model
        - 1. They are not there to try to change companies and people
          - a. They have had very little luck changing behavior in their history
      - iv. Believe that MCO is still a good business even though it is subject to attack
        - 1. There are not many competitors
        - 2. Doesn't require large amounts of capital
        - 3. Won't do the previous volume but the truth is the capital markets will continue to grow
      - v. He and Charlie personally do not believe in using ratings
        - 1. They never outsource investment decisions
          - a. Disagreements about credit worthiness have made BRK tons of money over the years
    - b. Munger
      - i. Rating agencies are an example people being too smart for their own good
    - c. Buffett
      - i. At BRK they never use the excuse that everyone is doing something so they should as well
        - 1. But it is very hard to stop certain practices when the industry starts to accept them as desirable
        - 2. At Solomon they had enough trouble stopping them from doing business with criminals
- 6. Audience Question: What is your view on US real estate? What do you foresee for California?**
- a. Buffett
    - i. In the last few months we have seen a pick up in real estate activity in the housing market
      - 1. These transactions are at lower prices
        - a. There are more bidders but we have not yet seen a bounce back in prices
    - ii. Foreclosure moratorium caused temporary dislocations
    - iii. Thinks we are seeing something like stability from data provided by their real estate subsidiary in low to mid priced houses in California
    - iv. On average there are about 1.3M households created each year
      - 1. In recessions this number comes down
      - 2. 2M housing starts in recent years has led to a large excess supply of houses
        - a. Now housing starts are trending at like 500K per year
          - i. The excess supply will be absorbed over the next 2-3 years
            - 1. We are eating up like 700K-800K per year
        - b. Once the current excess supply is absorbed we can get back to 1.3M-1.4M households created per year
  - b. Munger
    - i. With interest rates so low people should be buying houses if they have good credit
  - c. Buffett
    - i. Situation is getting corrected
      - 1. We are on the road to recovery
- 7. Loomis: Regarding the 4 managers that are candidates for taking over for Buffett as investment manager, how did they do in 2008?**
- a. Buffett
    - i. Well, all 4 are still on the list

1. There are three candidates for CEO, these are all internal people and are different from the people under consideration to run BRK's portfolio
  2. Could bring in 1 investment manager in or more than 1
    - a. Could even bring in all 4
      - i. These are internal and outside candidates
    - ii. They did not do better than matching the losses in the S&P last year
      1. They did not cover themselves with glory
        - a. But they are tolerant of that given the circumstances in 2008
  - b. Munger
    - i. Most managers got creamed in 2008
  - c. Buffett
    - i. These 4 have been better than average over time
    - ii. If you had asked him in January 2008 whether or not these people would do better than the S&P he would have thought they would for sure
      1. Would have been wrong in retrospect
    - iii. The board knows who the CEO would be if Buffett died
      1. There is an immediate need for a CEO
      2. Portfolio decisions could be more drawn out
        - a. Portfolio can survive without a new investment manager coming in the next day
  - d. Munger
    - i. Don't want a manager who would jump to cash in tough circumstances
      1. They can't do that at BRK so they would actually look down on someone who did that in his/her portfolios
- 8. Audience Question: What is your opinion of the likelihood of the US having nationalized health care? Is this necessarily a bad thing?**
- a. Munger
    - i. Thinks that something like European system will come to the US and be supplemented by a private system
      1. Compared it to the school system that has both public and private schools competing for students
      2. Even though he is a Republican he is not horrified by the idea of nationalized health care
      3. However, he wishes they would wait until the credit crisis was over before they decided to try to fix health care
- 9. Quick: Why not bring in a new CEO now and let him/her learn from Warren and take some of the pressure off of him?**
- a. Buffett
    - i. All of the candidates are currently running a major business and are making capital allocation decisions each day
      1. It would be a waste of talent for the CEO to come in and sit at BRK while Warren reads the Wall Street Journal
    - ii. These people know how to run businesses
      1. They are all ready for the CEO job right now
      2. Will have to develop relationships with potential sellers of businesses, BRK's top managers and shareholders
        - a. It will take some time but it doesn't make sense to start the process now
    - iii. The big challenge will be understanding the different management styles of BRK's managers
      1. Some managers run with virtual independence and some need more input from Warren and Charlie
        - a. The new CEO will have to learn the individual personalities and management styles

- b. Munger
  - i. These people are qualified to be the CEO of a BRK subsidiary and it would be a waste of time for them to come sit in Omaha
    - 1. Thinks that the decentralized CEO building model is better anyway

**10. Audience Question: How do you teach new value investors?**

- a. Buffett
  - i. 49 different schools came to Omaha last year to meet with him
  - ii. Believes that schools only need to teach two courses
    - 1. How to value a business
    - 2. How to think about markets
      - a. The market is there to serve you, not to instruct you
    - 3. No other classes are needed
      - a. Especially those that teach about modern portfolio theory, efficient markets and beta
  - iii. Remind people to always stay in their circle of competence
    - 1. Certain companies do not lend themselves to easy valuation
      - a. It is OK to put these in the too hard bin
  - iv. Accounting can be useful
    - 1. But it is certainly limiting
  - v. One of the most important required traits is emotional stability
    - 1. A state of peace with your decisions
    - 2. Said that this could be innate and admitted that it is not easily learned
      - a. Not the toughest thing to learn but it is not easy
  - vi. If you have a 150 IQ then sell 30 points to someone else
    - 1. You don't need an IQ above 120 to be an investor
      - a. In fact a higher IQ could potentially be harmful
- b. Munger
  - i. There is so much that is false and foolish at business schools, in finance, in banking and in academia
    - 1. If you limit the nonsense then you can eliminate the noise
- c. Buffett
  - i. The fact that business schools still teach the efficient market theory biases him against academia
    - 1. Called it a nutty idea
    - 2. Said that it is a problem that the people who teach it are so entrenched because science only evolves one funeral at a time
    - 3. He can't believe how nutty ideas endure and get perpetuated despite mountain of evidence that the ideas are wrong

**11. Sorkin: Is there a succession plan for Ajit in place? Considering the size of the re-insurance business, is it risky not to have a plan in place?**

- a. Buffett
  - i. It is impossible to replace Ajit
    - 1. If something happened to Ajit they would have to limit the amount of capital, risk and authority of who ever came in after
      - a. The authority comes with the person, not with the position
  - ii. Enormous damage can be done in the insurance business with a pen so you have to be careful who you give that pen to
  - iii. Buffett talks to Ajit every day because he likes to hear about what Ajit is up to
    - 1. Not because Ajit needs him
- b. Munger
  - i. The fact that it is true that a fool may eventually run a business (referring to the idea that you should find a business that a fool can run because eventually a fool will run it) does not take away the importance of finding a company that is managed by incredibly capable people

**12. Audience Question: How do you look at the market's valuation of BRK's shares?**

- a. Buffett
  - i. There are two components of BRK's valuation: earnings and investments
    - 1. Both of these should rise in value over time
    - 2. Thinks that the investments are worth more than they are being carried for
    - 3. Earnings power (excluding underwriting profit/loss) of businesses was not as good in 2008 (and most likely in 2009 as well)
      - a. Most of the businesses will do well and some will do sensationally
        - i. Some obviously have problems
    - 4. If you add the 2 components of value then you conclude that BRK was undervalued at the end of 2008 versus the end of 2007
      - a. But that was true for a lot of stocks
- b. Munger
  - i. In 2008 the float business was tough
    - 1. But over the long run they will have a negative float
  - ii. Believes their casualty business is the best in the world
  - iii. If there is a better utility business in the world he doesn't know of it
  - iv. Thinks that the quality of BRK's businesses is going to matter over time
    - 1. If you think it is easy to find such good businesses then you are crazy
- c. Buffett
  - i. In September 2008 people started acting differently
    - 1. It was like a bell went off and many businesses got hurt as consumers and other businesses changed their behaviors
    - 2. Despite this GEICO actually saw a huge uptick in interest
      - a. Competitive advantage is reaping rewards
        - i. Being the low cost producer is a huge advantage in this environment
      - b. Fundamentals are in place for greater growth in the future

**13. Loomis: Since it is tough to reinvest retained earnings at the same rates as before, does it make sense to consider a dividend policy now, especially since Buffett has readily criticized others for not paying dividends?**

- a. Buffett
  - i. They are not going to start paying a dividend
  - ii. Security values were depressed in 2008
    - 1. Reinvested earnings did not match return on the stock dollar for dollar in 2008
    - 2. But they have never underperformed over a 5 year period
    - 3. Implied that 2008 was an understandably aberrational year
      - a. If these results continued then there would be a case to be made that they had not reached their return goals
  - iii. Identified WFC as a company that will be better off in 2 years a result of the credit crisis as competitors have pulled back or disappeared
    - 1. Implied that BRK may be in the same position based on the ability to buy assets at attractive prices
  - iv. You never want to be in the position in which someone can force you to sell your business
    - 1. You can't rely on daily quotes or returns to help you decide on an investment

**14. Audience Question: Would we be better off investing in hard assets as the US and world take on so much debt, a fact that could lead to inflation?**

- a. Munger
  - i. YES!!!
- b. Buffett

- i. In the 1980s a lot of wonderful things were done to help build this country through infrastructure development
  - 1. This should be the model now as well
  - 2. However big organizations (both governments and companies) are prone to be slow and wasteful
    - a. The intent should be to get money into action quickly and intelligently
- ii. On the day after Pearl Harbor if they had added earmarks to the declaration of war it would have been a disaster
  - 1. He is often very distressed by all the earmarks attached to bills
- iii. We are doing things on a scale that will have consequences in the future
  - 1. There is no free ride
  - 2. Implied that inflation was a real possibility
- iv. One no brainer that we should be spending on is an improved electricity grid
  - 1. This has nothing to do with the fact that they own an electricity subsidiary

**15. Quick: Despite the strong balance sheet, is BRK at a cost of capital disadvantage based on not having the government guarantees that more troubled institutions have enjoyed?**

- a. Buffett
  - i. BRK is at a huge disadvantage
    - 1. Its raw material cost is higher than that of the troubled banks
  - ii. Have to find other sources of funding
    - 1. Especially for Clayton Homes
  - iii. They can't become a bank holding company
    - 1. Only use borrowed money in the utility business
      - a. Borrowings are well under the other utilities
  - iv. Have \$58B of float that they can use but right now they can't go head to head with a government subsidized business
- b. Munger
  - i. Have a disadvantage but they would rather be in their position than that of the more distressed companies

**16. Audience Question: What would Graham have said about derivatives?**

- a. Buffett
  - i. He would not have liked them
  - ii. They cause leverage to go wild, lead to counterparty risk, make unexpected problems emerge, and can lead to financial devastation
    - 1. Having said that, if Graham had seen mispricings he might have bought them in moderation
      - a. Would not have done it in a way that another person's (counterparty's) problem could affect him
  - iii. Believe that derivatives are used as a way around regulations on leverage
  - iv. As settlement dates get stretched out (as they are on CDS) there is more likely to be a default
    - 1. There is a reason why security markets have 3 day settlement periods
- b. Munger
  - i. Derivative dealers are playing games with its clients because they are privy to some of their clients positions
    - 1. Leads to an unfair advantage
    - 2. This is a dirty business
    - 3. We need less of this in the US

**17. Sorkin: Why have we seen no concessions on preferred shares and debt from banks like we have seen from GM and Chrysler?**

- a. US Bancorp (USB) and WFC are making lots of money
  - i. There is not reason to go to the senior holders as ask them to make concessions when there is a ton of equity below them

1. No reason for senior debt to give up anything
  2. Companies with strong earnings power are very different from the car manufacturers
    - a. Chrysler obviously does not fit in the strong earnings category
- 18. Audience Question: If BRK had a smaller asset base and was more nimble, how would they act differently with all of the volatility?**
- a. Buffett
    - i. They own stocks they like regardless of what the price has done
    - ii. Cost basis has nothing to do with how you should run the fund/portfolio
      1. You still look at intrinsic value not the selling price
- 19. Loomis: If it is true that Charlie and Warren are BRK's competitive advantage and are now running a business that is tough to understand, why should someone buy BRK for the long run?**
- a. Buffett
    - i. BRK has a sustainable advantage that is not Warren and Charlie
      1. They have a cultural advantage based on the business model
    - ii. They have a different shareholder base than other companies and that is a huge advantage
    - iii. They have a model that allows businesses that they buy to keep running their businesses without a lot of input from BRK
    - iv. It is very tough to copy BRK
      1. But this is not just about Warren and Charlie
    - v. People will always want to join up with BRK (as a result of the culture) no matter who is in charge
  - b. Munger
    - i. Many subsidiaries of companies are run terribly by the centralized headquarters of corporate America
      1. This will remain ample enough to give BRK an advantage in the future
- 20. Audience Question: How do you justify buying and holding when the fundamentals of a company change?**
- a. Buffett
    - i. You sell when you lose faith in the management or they make a mistake from the beginning
      1. Sell when the competitive advantage disappears
    - ii. They buy a business for keeps
      1. This is unless they promise to lose money indefinitely or have prolonged labor issues
    - iii. When in doubt buy and hold
      1. If you find something much more attractive then you can sell
      2. BRK does sell stocks periodically
    - iv. They ask the CEOs the interview what they would do differently if they owned 100% of the company?
      1. They often hear a lot of things people would do
        - a. There are no examples at BRK
          - i. They run it as if they own 100%
- 21. Quick: Since BRK does not buy back shares, would it make sense for an investor to sell his/her BRK shares and just buy what Buffett is buying?**
- a. Buffett
    - i. First off, an investor can't buy the free float, which is BRK's advantage
    - ii. They also can't buy the businesses they own or make private investments
  - b. Munger
    - i. It is not a bad idea to do what the question suggests
- 22. Audience Question: How will inflation affect younger generations? What is BRK doing to protect against it?**
- a. Buffett:

- i. Inflation will affect younger generations
    - 1. Even a couple points of inflation can lead to a slippery slope
  - ii. Policies stimulating the business world will lead to inflation and the government will have the incentive to inflate our debt so we pay it off with less powerful dollars
    - 1. In essence, the Chinese by funding our debt are paying AIG's bonuses
      - a. Our taxes have not been raised yet
  - iii. Fixed dollar investments will be hurt the most
  - iv. Best protection versus inflation is your own earnings power
    - 1. 2<sup>nd</sup> best protection: a wonderful business
      - a. A business that people will patronize regardless
      - b. A business that does not include high capital investment costs
- 23. Sorkin: Since the newspaper/publishing business is struggling what should BRK do with The Washington Post (WPO) shares? Are there better opportunities out there? Would they buy another newspaper?**
- a. Buffett
    - i. Current environment has accentuated the problem with newspapers (erosion has been accelerated)
    - ii. Would not buy most newspapers at ANY price
      - 1. Used to be the ultimate business, now they face unending losses
      - 2. Essential nature is gone
        - a. No pricing power
        - b. Not essential for advertisers
      - 3. There is nothing on the horizon that changes that
    - iii. Could have sold the Buffalo News years ago but refused to do it
      - 1. It is worth less now
      - 2. As long as they don't see unending losses then they will keep it
    - iv. WPO has no answers for the slump in the newspaper business
      - 1. Do have good education and cable businesses though
  - b. Munger
    - i. The decline in newspapers has been a national tragedy
      - 1. Has been an important part of our history
        - a. Used to keep the government and companies more honest
      - 2. Whatever replaces newspapers will not be as good
- 24. Audience Question: Will consumer spending changes be permanent and impact the discretionary businesses at BRK for years?**
- a. Buffett
    - i. When it comes to housing, in a few years you could see an equilibrium based on a return to normalized housing starts
      - 1. This will eventually help the BRK businesses that are tied to housing
    - ii. When it comes to retail, the high end has been the hardest hit
      - 1. Thinks this will last a while
        - a. People will save more
        - b. The experience of the last 2 years will last a long time
    - iii. Retail real estate industry
      - 1. Tough period to be in for a long time
      - 2. Shopping center business will not be the same
        - a. Centers bought with 5% capital rates will look silly
    - iv. In the service industry, these companies require less capital and are better businesses
    - v. Don't expect a quick rebound
- 25. Loomis: Since BRK has endorsed share buybacks for other companies but refuses to buy back BRK shares, should BRK shares be discounted because of that?**
- a. Buffett
    - i. Has not written about stock buybacks in years

1. Sees recent purchases as foolish
  - a. Companies spent too much
- ii. In the 1970s and 1980s this was attractive for other companies
  1. In 2000 they thought BRK's shares were too low and they said so
    - a. It was self defeating because the stock went up and then they could not buy any shares
    - b. Would say so again if they thought shares were that compelling

**26. Audience Questioner: Based on the macro economic picture, how has opportunity cost decision making changed?**

- a. Buffett
  - i. These decisions are much more in front of mind recently
    1. When intrinsic value is changing fast then opportunity cost calculations are more challenging but also can be more rewarding
      - a. Saw this in September and October 2008
        - i. Needed a lot of cash around and had to sell Johnson & Johnson (JNJ) shares to get in on really attractive deals
        - ii. Would do this again but it is hard to sell in huge quantities in falling markets

**27. Quick: What are the deciding factors when it comes to GEICO ad spending and how do they measure return?**

- a. Buffett
  - i. Measuring return is the problem of advertising in general
    1. Will continue to spend money on ads with GEICO
      - a. Want everyone in the US to have in their minds that they can save real money by switching to GEICO
    2. People have to buy car insurance
      - a. They don't like to but in order to drive they have to
    3. Value of GEICO (by adding subscribers) goes up more than the costs of ads
      - a. Would spend \$2B on ads if they could

**28. Audience Question: How do you know when it comes to financials/banks if the model is still intact?**

- a. Buffett
  - i. WFC has the best competitive advantage of all of the big banks
    1. Big 4 banks have different models but WFC's is the most unique
  - ii. Was very wrong on the Irish banks
    1. Did not understand their construction exposure
  - iii. With WAMU (WM) and the other banks and institutions that have failed there were many signs that they were doing things that highly levered businesses should not be doing
    1. They simply believed that house values could not go down
  - iv. If you read the 10-K's and 10-Q's of these companies you could tell that their models were different from that of good banks like WFC
    1. Has to do with a different cost of capital
    2. The information is there
      - a. You just have to find it
        - i. This is a very tough assessment for people who are not familiar with the banking industry
          1. Hard to distinguish between two banks so these are companies better left to people with experience
          2. Black boxes are not suitable for passive investors

- a. Produce numbers, not cash
  - b. Munger
    - i. GAAP allows companies to improve their earnings by changing their accounting treatment of certain items
    - ii. A lot of the new regulation that is coming would not be needed if accounting had done its job
      - 1. Accountants should be ashamed of their profession
- 29. Buffett Preliminary Comments on Q1 2009**
- a. Q1 earnings of \$1.7B versus \$1.9B in Q1 2008
  - b. Underwriting profit was up
  - c. Float was up \$2B as a result of a March transaction with Swiss Re (this is long duration float)
  - d. Utilities' earnings were down
    - i. Constellation Energy (CEG) stock was down during the quarter and there was a payment to buy Mid American options that hurt earnings
  - e. All of the other businesses were down as well
    - i. Insurance and utilities should be better the rest of the year
      - 1. He is not expecting the others to do well
  - f. \$22.7B in cash
    - i. They then spent \$3B on the Dow Chemical (DOW) deal the day after the quarter ended so cash was just about \$20B as of 4/1/2009
  - g. BV/Share was down \$6
    - i. CDS contracts were down even more from Q4 as a result of the market turmoil
- 30. Sorkin: At first glance BYD looks like a speculative venture capital investment. Is this really a value investment?**
- a. Buffett
    - i. Does not believe there is an investment that is not a value investment
  - b. Munger
    - i. BYD is not an early stage venture capital company
      - 1. Not unproven and speculative
        - a. Called what they achieved have a "damn miracle"
    - ii. Achieved a leading position in lithium batteries off of a base of zero
      - 1. Then they decided to go into the auto business with no experience
        - a. Now have the single best selling car in China
    - iii. CEO Wang-Chuan Fu is hiring the smartest engineers in China
      - 1. Charlie is not going to bet against 17,000 Chinese engineers
        - a. Would be amazed if something great did not happen
      - 2. Believes this is a talented group of people who may carry the future of the world
    - iv. The car we are going to see is made basically from scratch by BYD
      - 1. Everything but the glass and the rubber
        - a. This is unheard of in the car industry
- 31. Audience Question: How do you view the US Dollar (USD) versus other currencies? Is inflation going to hurt the USD?**
- a. Buffett
    - i. This is unpredictable but the dollar will buy less 5-10 years from now
      - 1. But this is true in the rest of the world with other currencies as well
        - a. Hard to compare the USD to other currencies
          - i. Governments around the world are running large national deficits to offset demand contraction
  - b. Munger
    - i. There has been a lot of inflation in our history
      - 1. A little bit of inflation is not going to hurt us
        - a. But you want to avoid runaway inflation
- 32. Loomis: How do we quantify the impact of the AAA downgrade?**

- a. Buffett
  - i. BRK won't regain the AAA soon because the agencies won't turn around that quickly even if they should
    - 1. CDS cost actually went down when Moody's downgraded BRK
      - a. AAA spread versus AA spread is not material
        - i. Impact on borrowing cost is immaterial
    - 2. They lost some bragging rights in terms of their insurance business
      - a. But no one has a better rating than they do
      - b. In Buffett's mind BRK is a AAA
        - i. They run the company in a way that no one could be a better credit
    - 3. Credit agencies can't quantify (in the ratings) management's opinions and views about obligations
      - a. They can't actually quantify the fact that no one ever has to worry about BRK being willing and able to meet its obligations
- b. Munger
  - i. Next change from Moody's will be an upgrade
    - 1. He thinks they deserve a higher rating and he knows that MCO is smart
- c. Buffett
  - i. If they hypothetically write a \$1B equity put they get \$150M in cash (the premium) and this creates a liability on the balance sheet
    - 1. The guy on the other side of the trade sets up a receivable
      - a. On a mark to market basis the asset goes up and the liability goes up if the market falls
        - i. But BRK has the cash and the other guy then has to buy CDS on BRK to protect against the company not living up the contract
        - ii. The more the asset goes up the more CDS they have to buy and then the CDS on BRK goes up
          - 1. This is a senseless self-reinforcing process

**33. Audience Question: Can you talk about the potential for building wind farms at Mid American?**

- a. Buffett
  - i. Mid American is the largest wind farmer in the US
    - 1. Wind only blows about 35% of the time in Iowa
    - 2. Iowa has been receptive and is the biggest wind using state
  - ii. Wind cannot be your base load because of the unpredictability
  - iii. Mid American has not raised rates in a decade in Iowa
    - 1. They have been able to keep rates down through a wind tax credit and by exploiting other efficiencies
      - a. They charge a rate that leads to a good return and is fair to consumers
  - iv. Company is putting in more wind farms through Pacific Corp. as well
    - 1. Coming online soon in California
- b. Munger
  - i. In anything that makes sense when it comes to the utilities BRK is going to be a leader
- c. Buffett
  - i. Constellation was close to Chapter 11
    - 1. Were about to receive a ratings downgrade that would have forced them to post collateral and would have forced them into bankruptcy
      - a. Buffett and Mid American were there that day with a firm cash offer

- i. This is BRK's competitive advantage: the ability to write a check the day they see an attractive deal
- ii. Also have managers that can deliver

**34. Quick: In regards to the Bank of America (BAC) and Merrill Lynch deal, does protection of the banking system justify a lack of disclosure? What would BRK if they were put in a similar position?**

- a. Buffett
  - i. This was a very fragile situation
    - 1. Merrill would likely have gone under without the deal
      - a. Can see why the government did not want the deal to blow up
- b. Munger
  - i. You can criticize original contract legitimately
    - 1. But, once signed, the Treasury acted properly as well as BAC
- c. Buffett
  - i. The deal was done over a weekend
    - 1. Between Saturday and Sunday BAC got 2 separate fairness opinions on the deal
      - a. Paid \$10M for each
        - i. Those turned out to be pretty worthless

**35. Audience Question: What has the net effect (or future effect) of the government interventions on BRK? Have the companies been helped or hurt?**

- a. Munger
  - i. New rules are going to come out and it is not clear what those rules will entail
    - 1. The lobbying pressure from the financial institutions has been quite strong and effective
      - a. But the climate of disdain for financial institutions will limit some of the lobbyists' impact
    - 2. BRK will have to adapt as needed
- ii. Buffett
  - 1. Wall Street is thrashing around
    - a. People do not like Wall Street right now
    - b. People have had to worry about things such as money market funds that they have never had to before
  - 2. It is hard to satisfy the fury without high profile people going to jail or being punished
    - a. Anger right now is sort of amorphous and without a specific group of villains it is aimed broadly at Wall Street and the banks
    - b. Believes this will eventually result in legislation
      - i. Some of which could affect BRK

**36. Sorkin: Due to BRK's size the returns are not likely to be as strong going forward as they have been in the past. Do they target a specific return or acceptable rate?**

- a. Buffett
  - i. Impossible for BRK to average 20% a year again
    - 1. He would be satisfied beating the S&P 500 by a few percentage points each year
    - 2. 10% better than the S&P just can't be achieved now because of their size
  - ii. Book value will continue to be a good proxy for and barometer of intrinsic value
- b. Munger
  - i. Understand that they can't multiple book value per share at the same rate they used to
    - 1. But believes that the best days of BRK are still ahead
      - a. BRK will make a large and positive contribution to society in the future

**37. Audience Question: How do you look at investments in China? How do the Chinese keep the purchasing power of their reserves?**

- a. Buffett
  - i. Will evaluate Chinese opportunities as they see them
    - 1. They can't own more than 24.9% of an insurance company in China
      - a. GEICO faces a limitation on ownership
    - 2. BRK does a lot of things that are exportable
      - a. Should see opportunities in buying companies in the future
  - ii. China can't get rid of their dollar denominated assets
    - 1. The US trade deficit requires that China at least hold some dollars
      - a. Going to build their dollar reserves as long as they have a trade surplus
      - b. Have focused on bonds and are now not to happy about the prospects for the purchasing power of those bonds
        - i. They have a right to be concerned in his eyes
- b. Munger
  - i. If he was the Chinese finance minister he would be doing and saying the same things
    - 1. But they are advancing so fast that some loss of purchasing power will only hurt them trivially
  - ii. US and China should be close friends because they are tied at the hip
    - 1. China will be very hard to compete with in the future

**38. Loomis: Can you give us a post mortem on the General Re deal?**

- a. Buffett
  - i. Post mortems are good to do internally but they should not always be public
    - 1. This is not done at enough companies
    - 2. Should not blame the company you bought because your projections were wrong
  - ii. So far this deal has worked out well after some initial trouble
    - 1. BRK has made some dumb decisions
      - a. Did not realize that the General Re they bought was not the General Re of 15 year prior
        - i. Reserve and underwriting policies had changed
    - 2. Now it has been resurrected by BRK's management
      - a. Now it is the company that Buffett thought it was
      - b. Believe is has a great future
- b. Munger
  - i. It is important to turn lemons into lemonade
    - 1. It is not pleasant, pretty or easy
    - 2. Ordinary managers could not have turned General Re around

**39. Audience Question: How does BRK view union workers versus managers and workers with set contracts (where they are not unionized)?**

- a. Buffett
  - i. Do not believe in contracts
    - 1. Don't want relationships that are based on contracts
      - a. They want managers who will be passionate about the business no matter who the owner is
- b. Munger
  - i. The BRK model is based on a seamless web of trust
  - ii. The Hollywood model based on no trust and specific contracts is not their model

**40. Quick: Why not spin off some BRK companies to unlock more value?**

- a. Buffett
  - i. They won't be spinning off any companies
  - ii. They don't care about increased trading multiples
    - 1. If they have great businesses they want to keep them for the long

- iii. Their structure allows them to move cash within the company with no tax consequences
    - 1. Can move money from See's Candy for example to other businesses that have a higher return on invested capital
  - iv. BRK buys to keep and people know they can trust BRK
  - b. Munger
    - i. So many spinoffs are just used to produce Wall Street fees
      - 1. Are not really good for shareholders
      - 2. Short of some sort of crazy regulation BRK would not split off any divisions
- 41. Audience Question: Do you have any comments on the troubles in the student loan industry?**
- a. Munger
    - i. There has been a lot of scandal based on certain sales methods
      - 1. Companies got real cozy with school administrators
    - ii. In all honesty he does not know much about the business
  - b. Buffett
    - i. Was approached about a deal concerning Sallie Mae (SLM) and he passed
- 42. Sorkin: Are GE and Goldman Sachs (GS) attractive businesses or were the available securities attractive? Does the fact that these companies have a history of managing earnings worry them?**
- a. Buffett
    - i. Lots of companies have been managing earnings recently
      - 1. This is not unique to GS and GE
    - ii. Liked the terms of the deal and the quality of management
      - 1. Markets were in chaos and it was a really extraordinary period
    - iii. There was not another alternative for these companies
      - 1. So BRK jumped in and made attractive deals during this period
  - b. Munger
    - i. Have done a lots of business with GS and have been very happy with the service they have received over the years
  - c. Buffett
    - i. BRK does a lot of business with GE
      - 1. Have bought many wind turbines
      - 2. In general he is happy with this deal as well
- 43. Audience Question: What happens to BRK's businesses if the world economy continues to be bad or gets worse?**
- a. Buffett
    - i. The world system works well
      - 1. We will live better in the future
      - 2. The system brings out human potential
        - a. Capitalism will have some bad years
        - b. But we have not reached our potential
          - i. We will continue to move forward at a rapid rate
    - ii. There are always problems in the world
      - 1. But this is the only world we have
    - iii. China used to have a model that took away from people's potential
      - 1. Now they have a model that works
    - iv. We will find more ways to innovate and move forward
  - b. Munger
    - i. He is cheerful about the economic future
      - 1. We will harness the energy of the sun
      - 2. We will turn sea water in fresh water
      - 3. We will preserve carbon resources
      - 4. He believes that technological breakthroughs will change energy production

- a. If you have enough energy then you have fewer problems
- b. Solving the energy problem solves mankind's biggest problem

**44. Loomis: Now that BRK is in control of Swiss Re, should we be worried about the underwriting standards at Swiss Re? Shouldn't we be wary based on the General Re deal?**

- a. They have a convertible security that pays 12% and is callable at 120% of par
  - i. Convertible at 25 Francs
  - ii. Expect it to be called
- b. This company's problems have not come from underwriting
  - i. BRK is fine with the 20% quota share they own
    - 1. Believe it will provide an attractive float
- c. BRK also has a reserve-loss sharing deal in which they would pay out \$5B over a certain loss threshold in 10-15 years
  - i. In the meantime they have \$2B to invest

**45. Audience Question: How do you develop the right compensation structure in capital intensive subsidiaries?**

- a. Buffett
  - i. You have to include a factor in compensation that includes capital cost
    - 1. Can't just be based on earnings
      - a. Would lead to earnings manipulation
  - ii. Unfortunately boards have had little effect on compensation
    - 1. CEO becomes a large determiner of his/her own compensation
      - a. Often selects the compensation committee
      - b. Of the 19 boards Buffett has been on he has been on 1 compensation committee
        - i. No one wants a tough guy like Buffett on the compensation committee
    - 2. Boards do not do enough to monitor and affect compensation
      - a. Not every CEO wants a rational compensation structure
    - 3. Believe that there should not even be a separate compensation committee
      - a. The whole board should be involved
    - 4. The board rarely acts enough like owners
      - a. Has gotten better though over the last few years
        - i. But off a really low base
- b. Munger
  - i. There is often a club-like atmosphere
    - 1. Directors are liberally paid and they have the incentive to keep CEO pay high as well
      - a. Creates a mutual pay raising climate
- c. Buffett
  - i. Thinks 100 page proxy statement are absurd
    - 1. If it takes that many pages then something is very wrong
    - 2. When his/her personal compensation is important (financially) to an individual director then he/she is not likely to argue with the CEO
- d. Munger
  - i. A man/woman who has a lot to lose if he/she loses his/her office or position is not likely to be independent

**46. Quick: What is the worst case scenario for BRK's insurance business?**

- a. Munger
  - i. A catastrophe loss that costs \$2-\$3B pretax
    - 1. But he wouldn't trade their insurance business for any one else's
    - 2. Even that big a loss would not impair the company over the long run
- b. Buffett
  - i. Would pay 3-4% of a \$100B catastrophe based on their current share

1. The kind of scenario in which this could occur would be a situation in which there was so much inflation that people became unhappy about their daily purchases and the government was forced to nationalize businesses

- a. This is a very low probability event but it is not impossible

**47. Audience Question: How should BRK shareholders outside the US hedge against a slide in the USD?**

a. Buffett

- i. Euro Dollar is an easy thing to hedge if you want
  1. Not as easy with other currencies though
- ii. BRK will continue to do things that make sense
  1. They will own companies that make money outside the US through direct and indirect means
- iii. They don't have a goal about a certain percentage of earnings coming from abroad
  1. They don't wake up and think they should put more money in a specific country
    - a. They look at deals as they present themselves

b. Munger

- i. Modern capitalism is messy and has defects
  1. There is plenty right and wrong with all models

**48. Sorkin: How do you look at temporary or permanent layoffs based on short term changes in the economy?**

a. Buffett

- i. Things can change very fast in the economy
  1. BRK's brick plants are closed now
    - a. But won't permanently contract
  2. But the Buffalo News business may never come back as the textile business never did
- ii. If business changes are material then you must change the model
  1. Have to lay off as you see fit when your competitors are
    - a. Firms usually err on the side of waiting too long and you never like doing it

b. Munger

- i. Some businesses have a shared hardship model in which layoffs get delayed
  1. But you can't operate each plant at 50% to avoid closing the weakest one

**49. Audience Question: How can shareholders work to help curb compensation?**

a. Buffett

- i. The AIG bonus scandal has had a huge impact on the government and the public
  1. People are enraged
  2. No statute will be able to make constituents 100% happy
    - a. Clinton era compensation bill was terribly counterproductive
      - i. In the end the shareholders paid when companies could not deduct more than \$1M of compensation for executives and this reduced earnings
      - ii. Led to a lot of people hiring lawyers to try to get around the tax laws
        1. Led to longer proxy statements as well
      - iii. Suggested repealing this Clinton era bill
- ii. If the money management companies spoke out on just the most egregious cases then they could embarrass people and behavior would likely change
  1. Restraining factor is not present now though
- iii. Consultants inflate compensation even more
  1. No one wants to be in the bottom quartile of pay

- b. Munger
  - i. He is not optimistic about money managers changing their ways
    - 1. A money manager who is making \$20M a year managing a fund is not likely to try to curb other executives' pay
      - a. It would be like throwing stones in a glass house
  - ii. Pension funds are also dominated by liberals that will not allow the values to change

**50. Loomis: How does BRK evaluate potential managers?**

- a. Buffett
  - i. Usually buy companies that have great management teams in place
    - 1. You have to ask yourself whether or not these people will feel the same way about the company the day after the deal
  - ii. What do they do when managers get too old and lose their edge?
    - 1. BRK has no mandated retirement age (probably because it would force Munger out)
    - 2. Decisions to remove older managers are tough on Warren and Charlie
      - a. Have been really slow on these in the past
      - b. This is the only part of the job they do not like
  - iii. Want to find people who love their businesses
    - 1. Believe they can spot that in people

**51. Audience Question: What is Buffett doing in his own portfolio?**

- a. Buffett
  - i. Not buying as aggressively as he was in 1974
    - 1. That was the best period ever
      - a. There was a different interest rate situation then
      - b. Country is not in as much trouble as it was in 1974
  - ii. Has recently bought some equities and bonds
    - 1. Likes when things get cheaper
    - 2. Buy things on sale when you can get a lot for your money
  - iii. Said he spends 99% of his time thinking about BRK and only 1% on his portfolio
- b. Munger
  - i. In general when stocks go down by 40% they are more attractive
    - 1. Plus, interest rates are low now as well
  - ii. This is not as bad as 1974
    - 1. In 1974 he knew it was his time to buy
      - a. Too bad he didn't have enough money

**52. Quick: How do they identify capital intensive businesses that overstate earnings because they understate actual depreciation?**

- a. Buffett
  - i. Utility earnings come from regulated ROE
    - 1. They are more afraid of non-utility companies
      - a. You don't get rich or poor on utilities
      - b. But inflation could end up affecting the utility business
  - ii. A lot of moats have been filling up with sand recently
    - 1. Newspapers and TV stations have lost their moats