



Notes from the Meeting Dr. George Athanassakos and Ivey MBA and HBA students had with Mr. Warren Buffett

Omaha, NB, February 26, 2010, 10:00 am - 12:00 pm

1. On Emerging Markets investing:

- Fundamentally, investing in emerging market is very similar to investing in developed markets: you still need to understand the business you're investing in and their prospects over the next 2, 5, 10 years.
- In addition, these businesses need to be largely immune to big changes, and have a lot of upside (e.g., that purchasing power per person will increase going forward)
- A good way to get exposure to emerging markets is by investing in businesses that invest and operate in emerging markets (e.g., Coca-Cola) .
- Emerging markets becoming own net exporters not a threat because ultimately what is important is unleashing human potential. This allows the human race as a whole to progress (this is not a zero-sum game, everyone benefits from progress).
- Generally, foreign marketable securities are of less interest to Berkshire (smaller, shallower capital markets) – Berkshire would be interested more in buying whole businesses (or large pieces of them).
- In the mid-2000's, he sat down and leafed through a manual of Korean stocks, finding a large number of bargains (good companies, trading at 3x earnings or less).
- He bought a basket of 20, to reduce the overall risk (and because Berkshire positions need to be large to make any impact on their results).

2. On doing anything different if he was starting the Buffett Partnership today:

- Mr. Buffett explained the Buffett Partnership: he started with a series of partnerships with friends and family, generally Omaha locals, and a total of \$105,000 to manage across the partnerships (which were eventually consolidated).
- He didn't want to waste time explaining things to people so he took the "psychological pressure" of investing off them by updating them once yearly.

- Mr. Buffett started working as a stockbroker, but admitted he wasn't the best salesman and wanted to do the real analytical work of investing for himself and investors.
- His only regret is that he did not start young enough (his first stock purchase occurred at the age of 11).

3. *On his "Inner Scorecard":*

- Mr. Buffett's first advice was to "marry up"; you can't choose your parents, but you can choose your spouse (he also said to marry someone with "low expectations")
- He also talked about making sure to have the right heroes in life (he mentioned some of his, including Howard Buffett and Ben Graham).
- He discussed an elderly Polish Holocaust survivor in Omaha who had passed away within the past year.
- Mr. Buffett said he believed being really successful in life meant that, at the age of 60 or 70, there were plenty of people willing to "hide you" (that is, if they were in a situation like his Holocaust analogy, would they be willing to put their life on the line to save yours?).

4. *On Berkshire Hathaway's (BRK-A, BRK-B) acquisition of Burlington Northern Santa Fe:*

- Buffett talked about railroads and their synchronization with the overall long-term goals of the US economy, as well as some of their underlying fundamentals: 40% of goods move through the US via rail, low CO₂ emissions (can move 480 miles on 1 gallon of diesel), as well as the capital intensity (multi-billion dollar gap exists between BNSF's capex and D&A).
- Buffett mentioned that although BNSF's performance is down 16% from 2008 levels, he thinks that more goods will be moving around the country by rail 10-20 years from now and that BNSF will be earning "decent returns on capital".
- In addition to Berkshire's previous ownership in BNSF, he mentioned that he viewed the west, where BNSF operates, is more attractive than the east.
- The idea came about in a meeting he had with Matt Rose, BNSF's CEO, when he was in Fort Worth visiting DTI, Justin Boot and ACME Bricks.
- He contrasted BNSF with See's Candies, which have very low turnover using very little capital (pre-tax \$70m on \$40m in capital), while rail businesses are capital intensive and low-return businesses.
- He talked about See's pricing power: every Dec 26th, the price increases by 1 cent (at Christmas and Valentine's Day, when they do most of their business, no one is willing to "low-ball" on such a product); the problem with See's, unlike BNSF, is that it offers little scale or opportunity to re-deploy capital.
- BNSF is a good investment largely because of the opportunities it offers to re-deploy capital at fairly high rates of return (e.g., tracks, bridges, tunnels, locomotives, etc.).

5. *On the US Federal Debt and its implications for future generations:*

- With respect to the deficit level, Mr. Buffett says it is actually 60% of GDP due to trust funds (not 80%).
- Mr. Buffett mentioned that the deficit was at 120% at the end of WW2, and we had a far brighter period post-WW2 versus pre-WW2.

- He said that you can't really promise medical equipment 20 years in the future: the output / capital might increase, but they can promise anything away they want and it may not necessarily happen; things will have to adjust.
 - Ambition and innovation have not died; Mr. Buffett doesn't know where the next good things will come from, but he believes they are coming.
 - Mr. Buffett does worry about nuclear, chemical or biological warfare.
 - Megalomaniacs couldn't harm people on the scale that they can now – they have always existed and will continue to exist (“in fact nuts grow in proportion to the population”); the big difference is that only now there are exponential growths in the possibility of ways to inflict harm on other people.
 - We must consider: intent, knowledge, materials and deliverability in the consideration of large-scale attacks.
 - Only material is a choke point now – Mr. Buffett thinks this must be continued to be emphasized and it is what worries him most.
 - Mr. Buffett talked about how we all live better than John D. Rockefeller, who controlled the largest proportion of GDP of any person who ever lived in the US.
 - We are warm or cold depending on preference, we can watch the World Series on TV without actually having to take a train there, etc.
 - Mr. Buffett vs. us: we generally consume the same things on a day-to-day basis (his suits are more expensive, but they look cheap on him, and he uses a private jet); wealth brings some slight improvements in living, but overall it's just toys.
 - “Success is getting what you want; happiness is wanting what you get.”
6. *On whether or not there is a bubble in the Chinese economy:*
- Mr. Buffett declined to comment directly on Jim Chanos's comments about the Chinese real estate situation.
 - Mr. Buffett described the US economy as having a structure that unleashed the potential of the Gates' and Fords of the world.
 - China has taken elements of our system and naturally adapted them to unleash the potential of 200 million people.
 - Mr. Buffett went out of his way to say that we will not suffer if China does well – “did the rest of the world suffer from our prospering?”
 - Mr. Buffett spoke about the success of BYD, which was founded in 1995 by a man who is now 43 years old and who has 130,000 employees and 13,000 engineers working for him with the best-selling car in China (the world's biggest car market).
 - He gets his suits made-to-fit in China.
 - “Nice for the home team to win every game, but it's just not going to happen”: Mr. Buffett talked about the Lewis-Schmeling fight in 1938 (the whole world cared, but the fight made no money and only 25,000 people in Madison Square Garden could watch)
 - Now hundreds of millions of dollars are made watching middleweight fighters on Pay-per-View, and the individual who invented the TV didn't make anything – it's the people who use the TV to make money who made the money (“it would be great if China is inventing lots of stuff”).

7. *On financial innovation over the last 30 years:*

- Financial innovation is no different from innovation elsewhere – “then why is it bad?”
- First, Mr. Buffett said that CDO-squared are not the most important issue at hand and that extremes will always exist within the context of money.
- Mr. Buffett discussed an allegory whereby everyone in the room was shipwrecked on a deserted island, with everyone making rice to survive (where we can all survive off the rice by working in rice fields for 8 hours per day and would be satisfied). But what if 20% of the people started trading rice futures and options, necessitating everyone else to work 9 hours a day? We are all worst off – like any “casino” type activity, what is the net benefit to society?
- Mr. Buffett said that although life may not be equitable, there is a lot of money “on Wall Street” and there needs to be restraints.
- “The invisible hand sometimes gets out of hand”.
- “Derivatives are financial weapons of mass destruction”.
- It’s not all bad though: per point of IQ and energy, the most money is to be made on Wall Street, so how do we address the problems without “throwing the baby out with the bathwater?”
- Mr. Buffett believes that if things become extreme enough, the US will “do the right thing” (e.g., the stimulus package).
- “It remains to be seen if we can have an enlightened market system without restraints – but when you have the privilege of the backing of the US government, you need to operate within some rules. If you want to go it alone – fine”.

8. *On his most difficult challenge and how he overcame the adversity:*

- Mr. Buffett doesn’t feel he has faced much adversity in his life. He believes he has been exceptionally lucky.
- “I won what I like to call the ovarian lottery. I have nothing to complain about.”
- At the time I was born, there was about one in 50 chance I would be born in the US. I had good parents and a good education.
- I am white. I am male – my sisters are just as smart as I am, but even though we had parents who didn’t tell them what to do, they got the message from society on what they were supposed to do.
- I am wired in a way that enables me to be good at capital allocation.
- I wasn’t accepted to Harvard, and this at the time seemed unlucky, but it was the best thing that ever happened to me. I ended up at Columbia instead with Graham and Dodd
- “I have no muscles. I’m a poor physical specimen, but nothing seems to go wrong.” Doctors have said he is healthy!
- “It’s mentally destructive to think about what you don’t have.”
- If you had the opportunity to trade your life in and pick from 100 lives, randomly drawn from the six billion in the world, would you do it? If you wouldn’t, and I don’t think anyone would, it is because you are lucky to be living in North America, to be intelligent and have the resources to get a good education. You are the luckiest 1% of humanity.

9. *On the importance of his character (specifically humility, patience and discipline):*

- Pick one classmate who you would want to go long on, or receive 10% of their earnings for life. Think about people you like, admire, and who are productive. This person may not have the highest IQ, but they are high functioning. And you are betting they will be very successful. Now pick another classmate who you would short. List the positive qualities of the successful students and the negative qualities of the unsuccessful student. The goal is to become the successful person by working to achieve their positive qualities and by eliminating the negative qualities and habits of the unsuccessful student. Develop the qualities you like in people, eliminate the qualities you don't.
- Change the negative qualities while you're young: "The chains of habit are too light to be felt until they are too heavy to break."
- Attracting good people to you will lead to success, more so than industry knowledge.

10. *On the transition of the US economy to a service-based economy (from a manufacturing-driven economy):*

- Currently, we [the U.S.] send them [the Chinese] pieces of paper and they send us \$225 billion in things that we want to buy. Why don't they just keep the money they have and the goods they produce? People just don't think that way.
- The China-US dynamic cannot go on forever, and things that cannot go on forever... well... they end. The advantage currently is that the US can denominate debts in its own currency. Other countries can't. The dynamic does not necessarily need to reverse. It is possible for a steady state to exist. It is thought to be in the interest of the countries involved to maintain the current system, and it will probably exist for a while. If and when it does end, it won't be the end of the world. The money doesn't disappear, it just goes into other pockets.
- China's current arrangement is to import goods and receive cash. This will likely not change for some time.

11. *On judging management at Berkshire holdings and potential investments:*

- Buy a business so good that an idiot could run it, because sooner or later, one will.
- I always ask myself, "Does the owner love the business, or do they love the money?" There needs to be passion. Otherwise the contract will not keep them mentally there, or there for the long-term.
- To ensure they don't lose their passion for the business, and promise them they will get to "paint their own painting," and I won't take it away from them by giving too much direction.
- Mr. Buffett loves his job because he gets to paint his own painting, and he gets applause. Good managers are someone with a similar equation. Mr. Buffett will give his managers applause and he let's them paint their own painting. Managers at Berkshire don't have contracts.
- Berkshire has never purchased from a private equity company, because they are in love with the money, not the business. That's not a bad thing, but it's just not for Warren Buffett.
- It's not a healthy environment when everyone is vying for the top job. For example, at GE there will be 40 executives who want the top job. When the new CEO position is announced, those who weren't picked leave their jobs right away. Like that, you lose 39

of your best people and keep one. At Berkshire, people love their own jobs. No one wants my spot because they are all passionate about their own job.

- Take the job that turns you on and the money will follow. The goal is to be smarter at the end of the day, every day that you go to work. This is what kept Rose Blumkin (founder of Nebraska Furniture Mart) working until she was 103.
- When you have a choice, always feel excited about what you do. This is not always possible. Mr. Buffett once sold shirts at Penny's, and he didn't like that.

12. *On his "all-in bet" on the US economy:*

- How can you not bet on the US?
- 40 years after the invention of the telephone, it took the average person 53 hours to make enough money to pay for a long-distance phone call that lasted 3 minutes. Look what you can do for free now. This kind in development is fostered by the American system.

13. *On Coca-Cola's acquisition of its leading North American bottler:*

- The dumbest contracts in Coke's history were the long-term licensing agreements with large bottlers with a fixed price on syrup. This is an inefficient bottling situation. Every bottler held on to these licenses tightly. No one could touch them, and Pepsi and Coke eventually became like commodities. 80-90 of these contracts still exist today, and Coke bought this large bottler in an attempt to reorganize the distribution channels and rationalize the distribution of the product.
- Coke is a good product. It's one of the only products with zero taste memory. The fifth coke of the day tastes as fresh as the first. You don't get sick of the taste. (Mr. Buffett drinks 5 or 6 cokes each day, equal to 750 calories from Coke each day. Mr. Buffet jokes he owes half his life to Coke!)
- Coke is associated with happiness and sponsors these types of events, like the Olympics. You want a brand to be associated with emotion. This extends to See's Candy (a Berkshire subsidiary): If a guy buys his sweetheart chocolate on Valentine's Day and gets a kiss from her, this gives him a positive association with the brand!

14. *On his role as a public figure:*

- Mr. Buffett won't support anything he doesn't believe in, regardless of whether it would help or harm Berkshire. He says he will speak his mind as he sees things.
- Mr. Buffett thinks he and Berkshire are under taxed compared to others living in the US. He pays 16.6% tax on an income of \$66 million. He doesn't think this is fair, and says there should be a dramatic change made to the system.
- He attributes the low tax rate to policies enacted under George Bush. "George Bush is my tax planner! He seems to think people like me are a dying breed and need to be protected."

15. *On Ethics ...*

- When something goes wrong, some people think you need better PR. The problem is you're doing something wrong.
- Some people want to play close to the lines, but there is still lots of money to be made playing in the centre of the court
- Never trade reputation for money