

Notes from 3/25/15 Daily Journal Corporation Shareholder Meeting

By Aznaur Midov

Charlie Munger started the meeting with his introduction of the board of directors. He read three proposals and asked shareholders whether they agree with propositions. He suggested that those who disagreed should disappear, which drew the first serious laugh of the day. The Q&A starts:

Could you please share with us how your vision of Journal Technology has evolved? Also, could you please discuss your milestones for the next 24 months?

Well, that is a very intelligent question. What happened, of course, is that we have a print business, but technology and the culture are changing. Historically, courts and lawyers relied on our printing materials, and for years we were able to raise prices because we had monopoly on legal notices. Now, that source of revenue, just like newspapers, is going away as lawyers want to get their information electronically. Another part of our business that is slowly going away is advertising, which was in the past driven by the law that required certain types of information to be published in newspapers. So, we have a business on the verge of extinction.

A lot of newspapers have the same problem: a lot of them died and a lot will die. In DJCO we decided to try to replace our newspaper business with the business of selling software. Coincidentally, we had a boom of foreclosures at that time that generated a lot of cash helping us with purchasing and developing the software business. It was a very unusual experience. Peter Kaufman mentioned “5.11”, the term used in rock climbing, which means that after thorough inspection, you conclude this move is obviously impossible; however, occasionally someone actually accomplishes it. That is what we tried to do here, and the business looks better today than it has ever looked. This was a venture capital project, which is not the way I used to operate. It wasn’t like shooting-a-fish-in-a-barrel-type thing. By the way, my idea of shooting a fish in a barrel is draining the barrel first. If this transition is successful, we will be much bigger; in all over the country courts. This actually makes the world better. The whole government information system is very inefficient and complicated. People in Microsoft hate this kind of business, because it is too hard. But the fact that it is hard to built also means it would be a hard thing to take away, which is a good thing.

You mentioned that Darwin taught you to question your prior ideas. What did you learn from Einstein?

I didn’t know a lot of things until Einstein taught me them. I learned about the idea of relativity. I wasn’t smart enough to figure that one out by myself. Of course things are relative and should compared to one another. One of our directors said simply: «We should identify everything that annoys customers, and eliminate it one by one». That is, of course, the way to conduct a business. That is why we acquired the software business to give our clients something they needed. Let’s talk about Darwin though. The perfect example of Darwinism is what technology had done to businesses. When someone takes their existing business and tries to transform it into something else – they fail. In technology that is often the case. Look at Kodak: it was the dominant imaging company in the world. They did fabulously during the great depression, but then wiped out the shareholders because of technological change. Look at General Motors, which was the most important company in the

world when I was young. It wiped out its shareholders. How do you start as a dominant auto company in the world with the other two competitors not even close, and end up wiping out your shareholders? It's very Darwinian – it's tough out there. Technological change is one of the toughest things. IBM, on the other hand, dominated the market of «machines», and when business became obsolete, they dominated computers – it was a miracle and rarity.

What is your opinion on activist investors?

I never liked the old system where a board of directors is absolutely permanent. But, like many things, I like the new system even worse. I don't think it is a great thing for civilization when people are getting rich by buying shares and pushing for changes. Carl Icahn is a very able man, but he should not run the world.

How would you change education system?

I know some of the smartest people in the world who tried to improve primary and secondary education. I would say that there is a lot of craziness in liberal arts. I don't know exactly why. I think that technical education is getting better, which is a glory of the world. The other is getting better too, but has some barriers.

How did you balance reading that much and having so many children?

When I want to read something I tune everything else down. I don't know a wise person who doesn't read a lot. I think that people who multitask pay a huge price – they can't think of anything deeply, giving the world an advantage, which they shouldn't give. I wouldn't succeed doing it. I did not succeed in life by intelligence – I succeeded because I have a long attention span.

Is Fed going to return to \$0.9 Trillion of balance sheet the current from \$6 Trillion?

I remember coffee for 5 cents and brand new automobiles for \$600. The value of money will continue to go down. Over the past 50 years we lived through the best time of human history. It is likely to get worse. I recommend you to prepare for worse, because pleasant surprises are easy to handle.

What do you think of societal change due to technology?

The world has changed. If you are going to have a free trade and better communication, then people who once dominated will face these new complications. Free trade and technology also hurt hard working people, which is very hard to fix. They tried to do it in Greece, they tried to vote themselves into riches. I think that Greek solution is idiocy. Their reality is that if they want to prosper, they have to work. Their whole system doesn't work because they only use carrots and not sticks. Look what happened to Japan. They used to be an export power of Asia, but all of the sudden, China and Korea displaced them. Japanese were better at quality control and the others wanted to get into the game. Then Korea came with nothing into auto business. They worked 84 hours a week with no overtime pay. At the same time everyone in Korea was going to great schools, was having tutors, were raised by Tiger moms, etc. Are you surprised when you see a result like that? Only if you are a total idiot.

What is DJCO's money allocation strategy? Are you going to buy another technology company or operate as BRK?

We bought Wells Fargo stock when it was at \$8, and I don't think we will have another opportunity like that. As of technology business, it was a tough experience and I don't really think we want to try doing it again. Of course, we might buy something that can complement existing business, but we are not looking into venture capital opportunities any more. I don't even know how we did it in the first place – it was mostly Guerin's idea (Vice Chairman).

Do you have comments on Lee Kuan Yew?

Lee Kuan Yew («LKY») is the most important nation builder that ever existed in the history of the World. He turned mosquito squad into the first world country. Then, using that example, utterly changed and transformed China and Vietnam. There was only one person in LKY's high school who was smarter than he was. It was a female a one year older, so he married her. He just was very rational. Peter Kaufman loves this story: initially LKY was surrounded by Muslims and Hindu, with no army, in a very dangerous position. He realized that the new nation has to have an army and he asked the world to help him. Everyone declined except of Israel. How did he pull this off when most of his population were Muslims who hated Israel? He solved the problem – he accepted help from Israel by telling everyone they were Mexicans. He eliminated corruption by not compromising even when his close friend was accused of bribery. The friend committed suicide and surviving wife asked Lee to cover it up due to low regards for suicide in Chinese culture. Lee declined. He was very tough about getting done what had to be done.

What is your advice for people who try to achieve financial freedom through investing?

In my life lime success in investing was easier. If you were rational and disciplined you had a tailwind of 10% per annum. Now, I doubt that the world will be able to get 10%, so it will be more difficult; and it is impossible if you are staying in big stocks.

Could you comment on Posco position that DJCO holds?

Posco is the most efficient steel company in the world. It had a pretty close to a local monopoly position in its country for a long time. It is very hard to avoid being commoditized in the modern world. In the places like Dow Chemical with complex chemical process, with 1000 PhDs, it is still hard to not be commoditized. Posco was able to do so.

You have said in the past that the private mortgage insurance is wrong. Could you please elaborate on that?

Private insurance caused the financial crisis. Finance in the US went crazy; crazy and immoral, which is not a good combination. The people who caused the crisis had one thing in common – not one has any shame at all. In fact, they blame others. At the time, they were giving unlimited credit to people who didn't deserve credit. It is really a dumb idea. You would think that people would know it by now, but I don't think they really do.

Do you think American Express' moat has narrowed recently?

Amex had a long period of achievement and prosperity. It doesn't look quite so easy going forward as it once did. This is another example of how tough capitalism is. Citi and Visa made a better deal.

You have told Elon Musk many reasons why Tesla would fail. Could you please share those reasons with us?

I think that the auto industry is very difficult and competitive. Everyone is making affordable cars and everyone has an enormous size and wealth. Elon Musk is a genius, and if anyone can do it right he probably is the one. But as we say at Berkshire, when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact. I just think it is going to be that tough. To get electric cars off the ground is really hard.

What are your reading habits? How do you retain information?

I don't take notes. I just read when I feel like reading and I think when I feel like thinking.

What do you think of Robo-advisors and Robo-funds?

Well, Robofunds and Index Funds are beating 98% or something of managed money over long period. If I had to manage \$200 billion and were expected to beat the index I would not welcome the job. I think people who have a good chance of performing well are those who are willing to work in less efficient markets. But it is very hard to be a value investor with \$200 billion, and one of the reason is that people will start copying you.

How did you get an idea of investing in good quality companies instead of cigar butts?

Everyone has the idea of owning good companies. The problem is that they have high prices in relations to assets and earnings, and that takes all fun out of the game. If all you needed to do is to figure out what company is better than others, everyone would make a lot of money. But that is not the case. They keep raising the prices to the point when the odds change. I always knew that, but they were teaching my colleagues that the market are so efficient that no one can beat it. I knew people in Omaha who beat parimutuel system. I never went near a business school, so my mind wasn't polluted by this craziness. People are trying to be smart - all I am trying to do is not to be idiotic, but it's harder than most people think.

As a chairman of a major hospital, could you speak to us about Obamacare?

It's one of the most complex subjects on the Earth. It is amazing what had been done in medicine from vaccine for children to whatsoever. A lot of people now take many benefits for granted, but I lived in the world where many children died, where every city had a tuberculosis sanatorium, and half of the people who had tuberculosis died. It is amazing how well medicine works. On the other hand, comparing to some other systems American system is peculiar. It is very hard to fix because on one hand you create incentives saying we will pay you so much amount for taking care of people and everything that is saved is yours. On the other hand we could be dealing with convalescent homes. Convalescent homes is a great name – you convalesce at home. This creates a huge incentive to provide care and keep

money. If we didn't have that system, all people would pay for themselves fixed cost which is the only feasible solution. The rest of the world is going that direction because the cost is raising. If Government is going to pay «A» anything it wants for selling services to «B» who doesn't have to pay anything, of course the system is going to create a lot of unnecessary tests and procedures. I think it will get addressed more and we will probably end up with the system of convalescent homes. If incentives are wrong the behavior will be wrong.

I am curious why despite a large Asian population in the US only few end up at the top?

Arithmetic plays against you. 99% of the population is going to end up in the bottom 99%, and 1% of the population will end up at the top 1%.

What do you think of 3G Capital?

3G through enormous discipline, enormous will and intelligence, adopted zero based budgeting system which is far more extreme than anyone else's, and yet they have been able to do it time after time. During financial crisis companies were firing 8-10% of people, and I know no example when they didn't work better after such cuts. You need someone tough enough and shrewd enough to make right decisions. Of course you need someone who is smart enough to cut something that is not needed and 3G is great at doing that. I actually think that they would probably even increase the sales. 3G is teaching us something about reality. Jerry would you comment on that?

Jerry Salzman (CEO): I don't think we ever had extra costs. We used to have about 300 employees and now we have about 150. We have taken direction of the company and sized it accordingly. During the period significant growth in revenue through the crisis (due to advertising required by law), we added 1.5 people. When we moved the other direction we eliminated 1.5 and actually a little bit more. We try to be ahead of the game by anticipating what could happen and by using technology, and that is the only way we would be able to handle a particular sequence of events.

You mentioned in the past that if everyone is indexing it is not going to work.

Of course. It is far away from happening, so I don't spend time thinking about it. Indexing has gained a lot, and rightfully so, because it is quite rational way to invest. If you think about it there are only about 5% of rational people and 95% shamans and faith healers.

What are the chances that the Singapore's culture would sustain itself without Lee Kwan Yew?

Chances are great. LKY left the base. He eliminated the corruption, made it hard to get in, and paid government people very well. But of course when he was doing all great things, China wasn't. Now it has changed and Singapore has strong competition.

What about Singapore's decision to allow casinos to come to their country?

I wouldn't allow that. But if you think about it you make so much money running the casino, with no inventory and headaches. It is like a license to print money. People just can't stand the temptation. But LKY was no longer in power when that happened. He wouldn't allow it. I do not think it is desirable in the USA to have casinos everywhere. But damn politicians

solved that way their short term problems by bringing in this poison – they deserve to be on a lower circle of hell. I can hardly see any place in the country where you don't have a casino. And the advertising on TV with all these happy people is ridiculous.

How do you deal with failures?

I have only a few of them.

There is a lot of talks about importance of trust. How do you asses people's trustworthiness?

Trust is so useful. Having to deal with the people you trust is the right way of living. You asses trustworthiness by experiments. The simplest way to be trusted is to keep deserving it. Not like those happy people on TV advertising casinos. By the way a lot of our major financial institutions are just casinos. If you think of what derivative desk is it is a casino in drag. People who work there make witch doctors look good.

Endowments following David Swensen's approach putting more money in Private Equity and Hedge Funds. Didn't you comment that if you ran endowment you would hold stocks?

I don't manage endowment funds and of course it is very difficult to manage multibillion fund. David Swensen is very successful at Yale, and of course that system has spread. Any successful system would spread by example. The other system that has spread is leveraged buyout. Those people actually have an advantage in the world that we have. Your common stock is yielding 10% average over time pretax. But here you have a different way investing in common stocks using leverage, and you also eliminate some unnecessary costs like 3G does. Of course you have a wonderful experience. I guess hedge funds, where Warren was famously skeptical, manage billions and billions. I think he is right and there will be a lot of very bad experiences. There are also going to be good experiences. Some of them used leverage and of course they had high returns. I wouldn't do it because I don't like balance sheet swelling with leverage.

What is your advice for young tech entrepreneur?

I don't know much about Internet and the new world with networks. The only thing I can say is that the desire to get rich fast is pretty dangerous.

As an operator of a business I am curious to hear what system you use to identify great investments.

We tend to look for easy decisions, but we find it very hard to find "easy decisions". We found just barely enough and they had their own problems. So, I don't have a system.

In the past you mentioned that you don't want to use US hydrocarbon. I wonder if you could share your updated thoughts given the world is awash with oil, and there have been a lot of geopolitical developments as a result of it.

You will be surprised, but I haven't changed my mind. I think that hydrocarbon reserves are one of the most precious assets that we have in the US. It is as precious as the soil in

Iowa. Just because we can export that soil for pay doesn't mean we should do it. I like the fact that we have hydrocarbon that we have in the ground. The fashion now, is to be independent and to use them up as fast as we can – I think it is insanity as a national policy. I am probably in 1% of those who think that way, but of course I am right. We are just lucky that we didn't know about fracking earlier, otherwise we would be in trouble. It sounds like it makes sense to export extra oil we have, but it is not right thing to do. If we were like Japan, importing all the oil without having our own, we would feel exposed and in danger, and rightfully so. We would not have leverage against other countries because we would be dependent. The fact that my idea about the subject is unconventional doesn't mean it is wrong – it just means that other people don't think very well.

You mentioned the devastating effect technological change had on newspapers. Going forward, do you see any under-appreciated trends that might have same consequences for other industries?

One that affects young people – it is likely that they will face major catastrophes. I think we had a very favorable period. I don't see how we bring back that age when an uneducated man could march ahead rapidly as long as we have free trade and worldwide competition. And I don't want to stop a free trade with a big nuclear power of China. China and US have to get along – they would each be out of their minds not to get along with each other. I think trade helps us. Of course it will hurt some people, but that is what manhood is – taking life as it is instead of whining all the time.

One of the peculiar things that we see is the existence of negative yield on certain government bonds. What are your thoughts on that?

It has never happened before in my life. I remember 1.5% rates after World War II. It certainly surprised all the economists. It surprised people who created life insurance industry in Japan as they all went broke because they guaranteed 3% interest. It surprised everyone, including economists who pretend they knew it all along. I was flabbergasted when they became low, but when they get negative I became really flabbergasted.

You mentioned that getting into software business was difficult and solving problems of your customers is not easy. Can you talk about those challenges?

Every government department needs all kind of information. Their complicated systems interact with other systems, which is a very complex activity. This makes software more and more important. The government set its own way of doing business. The company like Microsoft was in a business somewhat similar to ours and even they find it difficult. But it is a huge market and the right idea is to serve the customer correctly.

Do you see any parallels between what is happening today with television and what happened to the newspaper industry?

With the newspaper it is easy – a revolutionary change in technology. Newspapers were power houses and very constructive parts of the local systems of the country. We lost all of that due to technology. Television is different. I am surprised how well television has survived in the world of internet and cable, but I am not sure I understand the situation well enough to predict what is going to happen next 25 years. Something puzzled me recently: our anniversary report came out recently and it created some buzz in China. Chinese people like

elderly rich men. We are trying to be wise and that's a Chinese system. But all of the sudden the buzz stopped. Here is what happened: one woman in China took \$150K of her own money and created a documentary film. She streamed the film over the Internet, and it had 200 million viewers in a week. The documentary was about smog in China. This one woman whom no one ever heard of is changing the policy of China. That is a new world. That is a new source of power, which I can't understand, but I know that it is different. What important is that in this case it was very constructive. China was dead wrong for allowing people to die 10 years early in Beijing because the air is so lousy. This is how I feel about the new media. I understood it better when people were buying newspapers. Murphy liked it when they all were black and white, there were only 3 of them, and he had a strong position. He didn't welcome new competition. I don't understand how they got so damn much information through the space at the same time. It's too complicated and I don't understand it. But at least I understand peanut butter (reaches out to a peanut butter candy).

Are there specific unintended consequences of the current interest rate environment?

I think something that strange and that important is likely to have consequences. I think it is highly likely that people comfortably think they know the consequences down to the economic progression – none of them predicted this. Now they are going to know what will happen next? Again, the witch doctors. I regarded all that as very weird: interest rates are going to zero, all the governments are printing money like crazy, and prices are going down. Of course I am confused. Anybody who is not confused doesn't understand the situation very well.

What is the least talked about or most misunderstood moat?

You basically want me to explain you a difficult subject of identifying moats. It reminds me a story. One man came to Mozart and asked him how to write a symphony. Mozart replied: «You are too young to write a symphony». The man said: «You were writing symphonies when you were 10 years of age, and I am 21». Mozart said: «Yes, but I didn't run around asking people how to do it».

What surprised you the most about human nature?

The one thing that surprise me all my life is how many people with high IQs do massively stupid things. This makes a world a very dangerous place, because your doctor or your investment manager can go crazy. Here is an example: there was a doctor in California who was giving people an open heart surgery. He was thinking that everybody needs open heart surgery and he did a massive amounts of them. Well, I expect worst in human nature, but how can anyone be like that putting people at such risk? And why was it allowed to continue year after year? By the way, surgeries went wonderful, because nobody survives open heart surgeries better than a person who doesn't need it at all. So, those are kinds of things that surprise me.

When do you think software would get to a point that it would reduce lawyers billable hours?

A: I wouldn't hold my breath. I do think there is some trend to billings, and not only lawyers but also consultants, and accountants. But I think in law it is most obvious as I see clients insisting on a different system of compensation, because it has gone too far.

There is debate in China whether they should follow Singapore's model given that Singapore is a much smaller country that had British legal system, which is very different from Chinese situation. What's your opinion on it?

China adopted some parts of Singapore's economic system. But the anti corruption part of China are right from Lee Kuan Yew's book.

How would you quantify the appropriate amount of debt used in different types of investments (Real Estate, Private Equity)?

I think it varies based on circumstances. The idea that companies take a lot of debt to buyback shares is not very compelling. Leveraging yourself too much is like taking all the safety margin out of the bridges.

What relationship do you think indexes will have with the companies they have big positions in?

The rise of indexes created a situation where public companies ended up with large owners who can't sell. They will likely execute the power over the companies they have the stake in, but I doubt it is going to be intelligent execution.

What is your view on moats in technology industry? Do you think Google and Apple have long-lasting moats?

I am not an expert in moats of technology companies, because I don't understand them. I do think that Google is a remarkable company, and if you put a gun to my head and force me to buy one big technology company I might choose Google. But do I understand value of their moat versus anybody else's moat? The answer is no. By the way, anyone who will give you an answer is probably wrong.

Denmark is considered to be the happiest country in the world. Any thoughts on that?

It maybe true. It's a safety net, it's monolithic, it's surrounded by advanced countries. If you are in a small group of people who you are closely identified with, you enjoy it better. That's just the way human mind works.

Buffett's part of shareholder's letter was much more pessimistic. What did you think about it?

I liked it. It was very useful. CEOs don't criticize themselves or their accountants, so someone had to do it. They all were awful, and everyone, including investment managers, went along with that. Valeant Pharmaceutical Company is ITT of the modern day, except that the guy is much worse than Harold Geneen.

20 years ago you mentioned that the most important invention is air conditioner. Has anything changed?

Internet, in my opinion, is more important. You saw what that woman in China was able to accomplish with the video she streamed online.

What separated Henry Singleton from other CEOs of conglomerate era?

He was a genius. Every time he took aptitude test he would score 800 and leave early. He was a very successful mathematician and played blindfold chess. He made a lot of money buying companies like anyone else was doing, and bought back stocks when they went out of favor. He was totally rational human being. What I found interesting about Henry Singleton is despite his educational profile and intellectual ability, Warren was much smarter at investing. Warren thought about investing all the time and because of that he ran rings around Singleton, who was a genius...and Warren is almost a genius.

We conclude the meeting on this note.