

Notes from the 2011 Berkshire Annual Meeting

About the Author: My name is Ben Claremon and I run the blog site known as The Inoculated Investor. I am currently interning at the value-biased investment firm West Coast Asset Management while I finish the last quarter of my MBA at the Anderson School of Business at UCLA. I graduated from the Wharton School of Business at the University of Pennsylvania in 2003 and have worked for three different buy-side firms since I started my career in investment management. I am currently looking for a full-time equity research position at a buy-side firm that employs a value philosophy. I have posted some examples of my equity research reports on my site (<http://inoculatedinvestor.blogspot.com/>) under the "Equity Research" tab. I am also happy provide a copy of my resume upon request. Thanks in advance for any help.

Note from The Inoculated Investor:

Dear Readers,

The following are my hand-typed notes from the 2011 Berkshire Hathaway Annual Meeting. These were typed in real time without the use of any recording device. As such, it is inevitable that I made some omissions and possibly even some-- but hopefully very few--errors. When I couldn't write down exactly what was being said, my goal was to try to capture the sentiment of the discussion. So, in many cases what is written below constitutes my impressions and interpretations. I apologize if what I took away is not exactly what others did.

In any case, I hope that you enjoy reading the notes. Please feel free to pass them along to anyone and everyone. If you wish to follow me and my career as a securities analyst, please visit my site at www.inoculatedinvestor.blogspot.com. Finally, if you have any questions or comments please feel free to contact me at InoculatedInvestor@gmail.com.

*Sincerely,
Ben Claremon
UCLA Anderson 2011
The Inoculated Investor*

Moderators:

Carol Loomis
Becky Quick
Andrew Ross Sorkin

Comments on 1st quarter results:

Buffett: Comments pertaining to the Lubrizol (hereinafter LZ) matter information will be transcribed and put on the Berkshire (hereinafter BRK) site. They want to be sure that all shareholders hear every word of what has been said about the matter. The following slides for the first quarter of 2011 (Q1) are preliminary. Since the meeting was moved up a week this year, it is early for having slides on the Q1 results. Basically, all of the businesses with the exception of those that are related to residential housing are getting better. You can see the progression quarter by quarter in the 70 companies at BRK and the 100 Marmon businesses that represent a cross section of the US and international economies. In Q1, as has been the case since fall 2009, everything but the residential construction businesses has been getting better each quarter. In Q1, BRK had the 2nd worst quarter in the insurance business in terms of catastrophes around the globe. Usually Q3 is the worst due to hurricanes in the US in September. For example, the 3rd quarter was the record quarter during the Katrina year. In Q1 of this year, we have had some major catastrophes in Asia. These hit the re-insurance business very hard. No one knows how much it will cost in aggregate---probably around \$50B. Based on BRK's market share, the company expects to participate in about 3-5% of those losses.

(Referencing the slides) Overall, the earnings are as they are normally presented. Insurance underwriting

lost \$821M after tax. Warren suggested that normal BRK yearly earnings power is around \$12B after tax, assuming that the insurance underwriting breaks even. For 8 years they have been profitable in insurance, but are unlikely to be so for 2011. If the rest of the year was remarkably catastrophe free in the US in terms of hurricanes, then they could break even or make a profit. But this is unlikely—he expects to have an underwriting loss for the 1st time in 9 years. We should note that BRK has a better record than most insurers and still believes that the underwriting over time will at least break even. If it does, BRK gets the free use of float, a factor that has been an incredibly valuable contributor in the past.

Insurance investment income was down and will go down because of the called (or soon to be called) preferred shares from General Electric (GE), Goldman Sachs (GS) and Swiss Re. They are losing at least 3 very high yield investments that can't be replaced. At the end of the quarter, they had \$38B in cash and that amount does not include the \$5B in cash from the GS preferreds that came in. Unfortunately, that cash is not earning much. But he thinks that will change when he puts the cash to use. They also had full ownership of BNSF in the first quarter of this year. That will account for the gain in railroad/energy segment. Railroads—not just BNSF—will have a good year. Their competitive advantage will grow as fuel prices increase.

Overall the business did well, except for insurance. The 3 major catastrophes cost them an estimated \$1.673 pre-tax. But that projection is early and subject to a lot of change. Nobody knows what the ultimate insured losses will be from the Japan earthquake. About 40% of the loss from Japan comes from a 5 year contract with Swiss Re. Swiss Re has told BRK that they are not going to be renewing the contract. Buffett (joking) said that he wishes they had told him that 3 months ago. BRK has added to the loss estimates because in general they get revised upwards. Just due to the tornadoes (remember that BRK does not serve as a homeowner insurer), 25,000 cars will get auto claims. That's a lot of cars when you think about it. This is going to have an impact on GEICO since GEICO has a share of about 9%. There has been an extraordinary tornado season this year but those losses do not hit the re-insurance business much. The New Zealand quake has caused \$12B in damage. How many people are there in New Zealand, Charlie?

Munger: There are about 5 million people in NZ.

Buffett: Given the population in New Zealand, that quake was the equivalent of about 12 Katrina's. The good news is that there was great growth in policies of GEICO this year versus last year. In the annual report he discussed the fact that the value of GEICO goodwill on the books is about \$1.4B. Given the accounting rules, this value does not grow at all. However, he estimates the true worth to be more than \$14B. Every policyholder at GEICO has an average value of about \$1500. When you add 381K customers (looks like he was referring to the number of new policies every 6 months) it adds goodwill value; similar to the goodwill added to Coke or Mars. A policyholder at GEICO has significant value due to the fact that people have been customers for 10 years more. This value is not on the income statement or balance sheet but there is a lot of value there. If only 66 people sign up for a policy at the meeting, the goodwill value goes up by \$100K. That could pay for the expenses of the meeting.

The last item he wants to discuss regarding the earnings this quarter is the capriciousness of accounting; specifically, regarding how securities are valued and when they have to realize other-than-temporary-impairments (OTTIs). If you own a security for a while and you paid X for it and then it sells at 80% of X for a while, then you have to mark it down. At that point the loss goes through the income statement. It is only when the security gets this OTTI treatment that it goes into the P&L statement. For example, on March 31st, they owned some Wells Fargo (WFC) stock that had a cost of basis of \$8B. Some of the stock had been bought at higher prices than the March 31st figure. But, the rest of the stock had a \$3.7B gain.

Despite that, BRK had to mark down the stock bought at higher amounts by over \$300M and ignore the \$3.7B gain. If they had used an average cost method then they would not have had a markdown. But they chose to use the specific identification method instead because it saves them based the time value of money. In reality, they could use the average cost method and not have this write down. Based on these arbitrary rules, he suggested that we should ignore gains or losses in securities or derivatives on a quarterly or annual basis. Instead we should focus on the operating earnings of the businesses and the gain in book

value. Also, we should make own assessments of intangibles like GEICO's goodwill. Net income bears no connection to how good a quarter the company had. In fact, net income is the most deceptive figure.

Regarding the Sokol situation, the movie (shown at the beginning of the meeting each year) had a clip of the Solomon situation that occurred 20 years ago. He was elected the Chairman on a Sunday and in the early questioning session someone asked him what happened at Solomon. At that point he didn't know that much about it but he said what happened was inexplicable and excusable. Looking back on the situation 20 years later, he still finds it that way. He will never understand why that happened. To some extent, he feels the same way looking at what happened with Sokol not notifying Buffett that he had had contact with Citigroup and had purchased the stock prior to recommending it to BRK. For reasons that are in the audit report—and there is no question that his actions were inexcusable—what Sokol did violated BRK's code of ethics, the rules Buffett lays out to all BRK managers and insider trading laws.

However, it is the inexplicable part that he wants to talk about. One interesting point is that Sokol made no attempt to disguise the fact that he had been buying the stock. He didn't use neighbors or cousins or trusts. Apparently, he wasn't worried about FINRA looking at the trading activity. He was leaving a complete record as to his purchases. Usually BRK is asked to provide details regarding a deal—who knew about it and when. BRK gives the authorities a list of all the people who knew or might have known. Then, a little while later BRK gets a list of names of people that FINRA saw trading the stock and the company is asked if any names ring a bell. Given this process, the odds that insider trading will not get picked up are against you. But Dave did not disguise the trade. If he really felt he was insider trading and understood the penalties, he did it in the open anyway.

Sokol has a net worth in VERY high numbers—made \$24M from BRK last year and Buffett thinks even at that price BRK got its money's worth. There are plenty of activities that are unsavory and the culprits are often people with a lot of money. What makes this puzzling are events that occurred when BRK bought MidAmerican in 1999. At the very beginning, Sokol had options on a piece of MidAmerican. But, Walter Scott came to Warren a year or two later and said he thought they ought to have special compensation for David and Greg Able if they really performed well. When he suggested offering them equity, Warren turned white. But, Warren asked Scott to design something and what they eventually came up with they called The Lollapalooza.

This arrangement provided for a large cash payout based on the 5 year compounded gain in earnings, starting for a high base. They set a figure that no other person in the energy business could come close to. But, if the targets were achieved, Sokol would get \$50M and Greg Able would get \$25M. He brought Dave to the office and asked him what he thought of the plan that included 16% compounded earnings growth per year. Sokol looked at it and said it was more than generous. But, he said that there should be one change: he wanted to split it equally between Greg and himself. So, Warren witnessed Dave voluntarily transfer \$12.5M with no fanfare to his junior partner. Back then, Warren thought this act was extraordinary. Therefore, what really makes the recent events so strange is that only \$3M-- 10 years later-- has led to so much trouble. Buffett finds that inexplicable. In 20 years Charlie will be 107 and Buffett thinks he will still not understand what causes a man to voluntarily give \$12.5M without credit and then 10 years later, buy a stock before he talked to Warren about it.

The exact timing of the events—exactly what day Sokol told him about LZ—Buffett doesn't remember. The reason is that he still does not know how to print 10K's and Q's so he had someone else print the reports for him and doesn't remember which day he started looking at LZ. But, when Dave called him he mentioned it might fit what BRK looks for. Specifically, Dave said he had owned it and that it was a BRK-like company. But Warren didn't ask when he had bought it. Based on his trust of Sokol, it never crossed his mind that Sokol had bought it a few weeks earlier.

Munger: It is a mistake to believe that rationality is going to be perfect, even in very capable people. "We prove that all the time." But, in this case, he thinks hubris contributed to it.

Question 1: Carol Loomis- Warren and Charlie have no knowledge of the forthcoming questions. She

wants to start with a Sokol question. A long time shareholder believes that Warren should not have been expected to ask Sokol about when he had bought the stock. But, he wants to know why Buffett was not ruthless and fire Sokol on the spot when he learned of the details. Why was the press release so indirect? Why didn't he express more anger? Why did he handle the matter so inadequately?

Buffett: In between Jan 14th and March 14th, Dave gave no indication that he had had any contact with Citi of any kind. Apparently, Citi had met him in October and talked with Sokol about potential BRK target takeout candidates. Evercore and Citi represented LZ and Buffett never knew about any contact between these firms and Sokol. When the deal was announced, Buffett got a call from John Freund who works for Citi in Chicago and has handled a lot of BRK's equity business for decades. Warren has a direct line with Freund, who called to congratulate Warren on the LZ deal. He then mentioned that Citi's team had worked with Dave on the purchase and said that they were proud to be a part of it. The fact that Citi had been involved was news to Warren and what Freund said immediately set off some yellow lights in Warren's head. Buffett then had BRK's lawyer Mark Hamburg call Dave and Dave readily gave him the information on when he had bought the stock and about how much he owned. Then he was asked about Citi's participation. At that point, Sokol said that he called Citi just to get a phone number. In reality, this was quite an understatement.

However, as a result of the deal, LZ had to issue a proxy statement. BRK was not issuing shares so no proxy was necessary. So, law firm Jones Day went to work with LZ's management on the proxy. Given what Freund had said, Warren eagerly awaited to see the 1st draft. Warren was leaving for Asia and wanted to see what LZ had to say about the Citi matter. In general, the history of the transaction that is included in the proxy is the most interesting blow by blow of a deal. As such, Warren kept urging them to get a draft to him before he took off for Asia. Ultimately, the LZ proxy had a lot of information on Dave's involvement with Citi. It was at that point that law firm Munger Tolles got involved and discussed with the LZ lawyers the discrepancy between what Dave said and what the proxy stated.

Ron Olson (of Munger, Tolles & Olson) was on the trip to Asia as well and all he and Buffett knew at that point was that the partners at Munger Tolles were interviewing Dave and others. They ended up talking to Dave at least 3 times about stock purchases and about the relationship with Citi. Knowing that, Buffett decided that when they got back they would need to have a BRK board meeting on this matter. Specifically, Buffett wanted to know what the lawyers had found out in their interviews. Soon after, a letter was delivered by Dave's assistant (that came out of the blue) in which he said he was retiring at a high point. Buffett doesn't know if the questioning had affected his attitude or this decision. Buffett immediately realized that the resignation could save BRK some money. If they had fired him, there could have been an argument regarding whether he was fired with or without cause. Given that he retired, there was likely to be no litigation and no severance costs.

Buffett thought it was proper to inform shareholders of Sokol's resignation and he drafted up a press release that laid out the good things Sokol had done. He also laid out some actions that he thought were not illegal (based on what he knew then). He then talked to Charlie and Ron Olson about the press release and they had no problems with it. Next, he ran it by Dave to make sure the facts were accurate. But Sokol objected to the idea that one reason he retired was that he had had his hopes of succeeding Warren dashed. Accordingly, Warren was willing to take out that part out after Dave affirmed all the other facts. Finally, even after a second viewing Sokol said it was OK.

But, as Warren would later find out from the LZ proxy, Dave had known that LZ had an interest in being acquired even though the press release said the opposite. Sokol made no attempts to correct the facts on CNBC when he went on. In the meantime, BRK delivered (through its law firm) some information to the head of the enforcement division of the SEC that detailed the facts regarding the stock purchases. In that case, BRK acted very promptly to make sure that the SEC was well versed in what had taken place up to that point. From his standpoint, Buffett thought Dave was gone and that there was little chance of future litigation. He also knew that he had presented some very damaging information to the SEC. But, people are upset about the lack of outrage and Warren pleads guilty on that. His defense is that Sokol had contributed so much to BRK that he decided to focus on the positives instead.

Munger: That press release was not the cleverest press release in the history of the world. The facts were complicated and they did not foresee the reaction from the public and from shareholders. However, you don't want to react with anger. You don't want to be extra ruthless because you are angry. Tom Murphy always told the people at Cap Cities that "you can always tell a man to go to hell tomorrow if it is that important." In this case, it was important to remember a man's virtues and his faults.

Buffett: We should not be surprised that Charlie approved the press release. Warren and Charlie have never had an argument and even though they have worked together for 50 years.

Question 2: Crowd: What do you think of the effect of the Federal Reserve ending the POMO (Permanent Open Market Operations) program will have on the economy and the stock market?

Buffett: (Asked what a POMO is) You are one acronym ahead of me! There is no secret what they are going to do. QE2 is the most advertised open market purchase in history—in terms of the timing and amount purchased. As such, he doesn't think that something that well known can have any effect because the information has already been discounted by the markets at this point in time. If you say you are going to increase tax rates in a year and the hike is locked in stone, the market prices that in immediately. There is no reason why the program end will cause any significant changes in markets at that time. It is true that a huge market force will be withdrawn as \$600B in buying leaves some traces along the way. Specifically, the purchasing of Treasuries will not be there even though the issuance will still be the same. At the end of the day, it will be a different market. But, that truth is already incorporated in the markets.

Munger: I have nothing more to add.

Question 3: Becky Quick- BRK managers have usually been very ethical. But this Sokol event puts a lot of questions in people's minds. How do you know there are not more Sokols at BRK?

Buffett: The potential for there to be more Sokols is a reason why Howard Buffett will be the Chairman when Warren Buffett dies. You can always make a mistake in choosing a CEO. In this case it is very unlikely but it is not impossible. The candidate he and Charlie have in mind is likely a "straight as an arrow." The bible says that the meek will inherit the world. But the question is: will they stay meek? Removing CEOs has become less tough overtime, especially when moral or ethical factors are lacking. But, it is still tough. It is particularly hard to displace a person who is a Chairman and CEO. Accordingly, an independent Chairman and one who owns a large block of stock represents a safety measure to protect against a wrong decision. In any case, the directors will be thinking about the quality of the person as a human as much as they are thinking about the managerial skills. They are likely to find someone who cares more about BRK than he does about himself and they believe they have multiple candidates who embody that.

Munger: The Rockefellers had left Standard Oil's management structure many years before when they did intervene once to displace a CEO due to moral grounds.

Question 4: Crowd: If you were going to live another 50 years, what sector or asset class would you add to your circle of confidence and why?

Buffett: He would have to pick a sector that is large enough that an investment in it would make difference to BRK's huge portfolio. It would have to be something in the technology field. Clearly, this is not going to happen. If he could be an expert—defined as knowing a lot more than other people-- in the tech field, that would be terrific. Tech is going to be a huge field and there are likely to be huge winners and a lot of losers. However, picking winners is going to be very tough, much tougher than picking winners in the integrated oil industry. The disparity in the future is likely to be very dramatic. You could make a lot of money if you could pick winners in the tech field.

Munger: It would either be tech or energy. He thinks they are the wrong people to develop that expertise though. If it was going to happen, it would have already happened. But they want to identify someone else who has the abilities that they lack. That has been hard for them as well but they have gotten better lately

Question 5: Andrew Ross Sorkin- In the original press release regarding the Sokol situation, he said he was initially not enthused about making a deal with LZ. But, in a short period, Warren warmed to the idea. How did that happen? What changed? Did Sokol convince him?

Buffett: What he meant is that he didn't know anything about the business. He knew that he would never understand the chemistry of additives. But, all he cares about are the competitive dynamics—moats and competitive advantages. Since he didn't know anything about the company Buffett told Sokol to call Charlie—who knows more about oil. It turned out that Charlie didn't understand it either. But Sokol never even called Charlie. Eventually, Dave passed along information to Warren after having dinner with LZ CEO James Hambrick. With that data, he felt like he got an understanding of industry dynamics, how the business had changed over time and how the oil industry is related to the additives business. He specifically was interested in the ease of entry.

When BRK bought See's Candy in 1982, he wanted to understand whether \$100M in capital would have been enough for a competitor to emerge to take on See's. When he figured out that no one could do so, they bought Sees. It is the same thing with Coke. He knew that \$100B would not be enough to take on Coke. Richard Branson tried to with Virgin Cola and lost. It is not impossible for people to enter LZ's business, but in terms of low cost service and people breaking into a market and taking the company on (in a \$10B market), he thought there was a large moat. LZ has lots of patents and a great connection with customers. In fact they work with customers about how to create new additives for engines.

This situation was similar to when the Iscar people came to talk to him and he realized that there was a durable competitive advantage present. LZ has the #1 market share in this business and this position is sustainable—they are helping engines run longer. Lubricants will always be around and this was a company that will be there for a long time. Warren didn't understand all of this until Sokol explained that to him. He hadn't paid any attention to the company and he understands it now that it has been explained to him. He thinks it will be a great addition to BRK and LZ is enthused about being a part of BRK—the people see BRK as an ideal home.

Munger: Iscar and LZ are like sisters. They operate in very small markets where other companies have the sense that they should not enter. If you can find other companies like that, please give Charlie a call.

Question 6: Crowd- Using estimates of the values of the investment portfolio and the operating businesses, he calculated that shares of BRK are worth about \$185K. Given that the shares trade for only \$124,750 (as of 4/29/11) does this mean the empire is a value trap?

Buffett: They give data on operating earnings per share and investment portfolio value per share to give shareholders guidance and because they think these figures are important. In general, operating earnings are going to increase over time. Investments are about the same as they were at year end but can go up or down based on whether or not they can buy more businesses. However, their primary goal is to grow operating earnings. In terms of the value of BRK shares, they only have a range in mind since a single number is impossible to calculate. If you asked him and Charlie, the ranges would likely differ as well.

They do not regard the BRK shares to be overpriced and said that they very recently had a large international company that might be interested in doing a deal with BRK. But, this company is bigger than they could handle unless they are willing to use a lot of stock in the deal. They won't do that because they think the shareholders would be poorer, as they would be using a cheap currency to buy a company. They did use stock in the BNSF deal but there was also a lot of cash used. In the LZ deal they knew for sure that they would have never use stock because they would be giving away the businesses they own at too cheap a price. Obviously, this would not have been good for their shareholders.

Munger: The right factors to look at when valuing BRK shares are operating earnings per share and investments per share. Their enormous wealth means that they have lost the ability to do certain things (because of their size) but they will not always be as inactive as they are now.

Buffett: Charlie, could you see us using stock for a deal in the next few years?

Munger If this business was good enough—of course.

Question 7: Carol Loomis- Buffett often has very glowing remarks about the future of the US economy, despite the tremendous problems in the US. How can a lousy long term US economy make him happy? How does he see gold nuggets when others see salt?

Buffett: He doesn't see how anyone could be anything but enthused about this country. When you go back to 1789, the country has been through the most extraordinary economic period in the history of the world. He was born in 1930 and if he had been told in the womb what would happen during the Great Depression—unemployment would increase to 25%, the Dow would go to 42, grasshoppers would take over, the Dust Bowl would devastate Midwest, and 4000 banks would close—it would have been like a Woody Allen movie where he said “go back, go back!” But the standard of living for the average America has increased 6 to 1 since then. There were centuries where nothing happened for the average person. It is a great system that just gets gummed up a lot.

His father was anti-New Deal and at a young age Buffett heard a lot about how things would go to hell. Also, his future father-in-law wanted to have a talk with Warren before he got married. At that point, Doc Thompson said that he wanted to tell Warren that he was going to fail—but that it would not be his fault. He said, if you and Suzy starve, she would have starved anyway. According to him, it was because the Democrats were going to take the country on the road to communism. Similarly, when he got out of school in 1951 the two people he admired the most in the world—Ben Graham and his father—told him not to work in stocks because the Dow Jones average was way too high (selling above 200).

There always have been negatives and problems. This country even went through a civil war. Of course there are a few lousy years from time to time. In fact there have been 15 recessions in the US's history and there is always a list of 10-15 reasons that the country will not do well. The growth may not be a straight line, but the power of capitalism is incredible. This is what is getting us out of this recession. Monetary and fiscal policy can help and were needed in 2008 for sure. At that point the government was the only entity that could do what was needed. In comparison, in the early 19th Century people didn't even know what monetary and fiscal policy were.

Recessions come and go when excesses come and go and capitalism corrects for this. The game is not over. The potential for the US has not been used up. The rest of the world has caught up. For example, the state capitalists in China are opening up new economies that have been dormant for centuries. They are not growing faster because they are smarter or work harder; they are just tapping a system poised for growth. We may have 20 lousy years ahead of us but we will be so far ahead at that point that it won't be recognizable.

Munger: The world will go on. In Europe, a huge population died due to the Black Death. (Warren chides him for being so upbeat). He understands the point of the question, but he wants to add a twist to the sentiment. He said that you can be cheerful even when things are deteriorating. He has a personal saying that “the politicians are never so bad that you want to live to have them back.”

Question 8: Crowd- Aside from not needing to put huge amounts of capital to work, are Coke and See's still great business to own in an inflationary situation? Are they better than companies with irreplaceable hard assets and pricing power -- like the railroad—in protecting against inflation?

Buffett: The first businesses are superior. If you have a great consumer product that requires very little capital to grow and support that growth—and you do more volume as inflation grows—that is a wonderful asset to protect against inflation. The ultimate example of that is your own earning ability. People who have made investments in themselves—outstanding teachers and doctors—see their wages increase with inflation. They also don't have to make an additional investment in themselves. People should think about a long term real estate asset like a farm where additional capital is not required to finance inflationary growth.

The worst businesses are the ones with huge receivables and inventories. Their volume stays flat and they have to come up with more money to finance that volume. Normally BRK does not like businesses that require a lot of capital—railroads and utilities. But, he and Charlie believe that they should be able to generate a good return in the railroad because of the value it provides to the economy. The ideal business is one like See's. See's Candy was doing \$25M-\$30M in revenue when they bought it and they were selling 60M pounds of candy. Now they are doing over \$300M in revenue. It took \$9M of capital then and the business only needs \$40M in tangible capital now. If the price of candy doubles they don't have any receivables or inventory. Fixed assets don't have to increase either.

Munger: What's interesting is that they didn't always know that. (Buffett: Sometimes we forget!) Continuous learning is always required.

Buffett: He has said in the past that he is a better businessman because he is an investor and a better investor because he is a businessman. There is nothing like actually experiencing the necessity—specifically in the 1970s when inflation was gathering strength-- of capital investment in a big scale that didn't actually help to increase earnings. He wrote an article in Fortune in 1977 called "How Inflation Swindles the Equity Investor." Ideally, to protect against inflation, you want a royalty on someone else's sales so you don't have to invest any more capital—you license it to them and you make money as their volume grows. You have no receivables or fixed assets and have to make no capital investments. This represents great inflation protection as long as the product remains viable.

The fact that they are investing in capital intensive business means that they unfortunately can't buy more See's Candies. They would love to find them, they just can't. They have to invest so much that they can't buy little businesses anymore and, as such, they are not doing as well in buying investments or operating businesses because they have to put billions to work. There is a real disadvantage to size but they like having a size problem.

Question 9: Becky Quick- The only option for a shareholder nearing retirement to get income is to sell shares of BRK stock. This is because BRK does not pay a dividend, even though Buffett likes to collect dividends. So, when would BRK consider paying a dividend?

Buffett: He and Charlie will pay a dividend when they have lost the ability to invest a \$1 in a way that creates more than \$1 in present value for the shareholders. At that point, they would likely pay out 100% as a dividend. If you had a savings account that paid 5% and you had a choice between (a) taking \$50 out and (b) leaving \$50 in and later being able to sell it for 120% of its value (when you wanted to sell), wouldn't you rather leave that money in the bank and let it grow? Every dollar that has stayed with BRK has grown much more than it would have if it had been paid in a dividend. As such, it is much more intelligent to leave a dollar in.

Of course, the execution of it can be a problem. Can they keep investing \$1 and create more than a dollar of present market value? There is an end to that at some point but the logic is not refutable. By leaving money with BRK people have a lot of money and they can cash out by selling shares. There will come a time—and it may come soon-- when they can't lay out \$15B a year and get something back that is worth more than that for their shareholders. When a dollar only buys \$.90 of value, then they will pay a dollar back to shareholders. The stock will go down that day and it should because paying a dividend means that the compounding machine is dead.

Munger: "There is nothing wrong with selling BRK stock to buy jewelry if you do it in the right place."

Question 10: Crowd: BRK has large positions in Wells Fargo (WFC) and US Bancorp (USB). What is the outlook for these banks in the event of a tough economy and potential deflation?

Buffett: These are among the best large banks—if not the best-- in the US. They are different from some other money center banks even though they are very large. In terms of banking as a whole, profitability will be considerably lower (in his view) in the period ahead in comparison to the early 2000s. This is because

the leverage will be reduced—which is a good thing for society. It may be a bad thing for smart banks and good for the US as a whole. Dumb banks did dumb things with leverage and it cost the rest of us. Even if future ROA is as good as it has been, there will be fewer assets per dollar of tangible assets so ROE will go down. He thinks that these two banks are great businesses even though they won't be as profitable when leverage is down.

Banking is a fundamental business. Losses are going down and the worst is likely past. As John Stumpf from WFC said a few years ago, "I don't know why we are trying to find new ways to lose money when the old ways were still working." The banks always go crazy on the asset side but the federal government is behind the banks. The FDIC has handled the failure of around 3900 banks—250 in the past few years-- and the taxpayers have never paid a dime. All the money comes from FDIC assessments on other banks. If banks are just smart on the asset side—especially since money is so cheap and because of the implicit government guarantee —America should be a great place to lend money. BRK has added to its position in WFC and both companies are great institutions. But they will not earn 25% on tangible capital—and they shouldn't either.

Munger: M&T Bank (MTB) is headed by a very sensible fellow and also has been a great company for BRK to own.

Buffett: The M&T annual letter—written by CEO Bob Wilmers-- has a lot to say about the US financial economy and is worth reading. He highly recommends reading it because Wilmers is a very smart guy. Jamie Dimon's letter from JPMorgan is very good as well. It has a lot of great insight on the banking and economic scene. They don't own the stock but people can learn a lot from the letter.

Munger: Because he talked about morality and business, Bob Wilmer sounds like an Old Testament prophet. He doesn't like that banks make so much money in trading. He thinks these banks are just trying to outsmart their own clients. It is one of the best annual reports ever.

Buffett: Wilmers also discussed the fact that he doesn't like that money flows to people who work with money. Sadly, this attracts people with a lot of ability to banking when they should be doing something else.

Question 11: Andrew Ross Sorkin- Why have they not invested in commodities? BRK's stock has barely kept up with inflation. Please explain why they have not invested more heavily in commodities. If Bernanke continues to print money—and there is no indication he will stop—won't commodities like gold continue to appreciate?

Buffett: When they started BRK, one share was worth about $\frac{3}{4}$ of an ounce of gold—when gold was \$20 and the shares were \$15. So, even with gold at \$1,500, BRK has done a lot better. He thinks the questioner is right about the risks of inflation. But people have to consider which of the three major categories of investments offer the best protection against inflation. You have to think very hard about which one you want to be in before you think about the specific choices within the category.

The 1st category is anything currency denominated (cash, bonds, and money market accounts). If you reach into your pocket and pull out your wallet—this is an historic event by the way-- the dollar says "In God We Trust." Unfortunately, this is false advertising. If Elizabeth Warren were here, she would say that it should say "In Governments We Trust". This is because God won't do anything about those dollars if the government does the wrong thing. Any currency-related investment is a bet on what the government will do in the future. If you lived in Zimbabwe and invested in currencies, your family would have left you by now because that was not a good decision. Almost all currencies have lost in value over time. It is built into any economic system that the economy will be easier to work with when the currency is depreciating as opposed to appreciating. The Japanese can reaffirm that with their experience (of the appreciating yen). As a class, currency-related investing in the UK or US or anywhere else--unless you are getting paid really well--does not make sense.

The second category of investments is items that you buy that don't produce anything but you hope that

someone will pay you more for later. The classic case is gold. If you take all of the gold in the world and put it into a cube, it would be 165K tons and would be about 67 feet on one side. If you had it you could put a ladder up, climb on top, and think you are king of the world. You can fondle it and polish it but it isn't going to do anything. All you are doing when you buy gold is hoping that someone else will pay-- a year from now or 5 years from now--you more to own something that doesn't do anything. You are betting not only how scared people are about paper money now but also on how much people will be scared years from now. Keynes described all of this in Chapter 12 of *The General Theory of Employment, Interest and Money* when he talked about the famous beauty contest. In this case, the game was not trying to pick out the most beautiful woman among the group, but the woman who other people thought was the most beautiful. When you buy these assets you are just betting on a beauty contest. As an aside, he bought silver 13 years ago because of the industrial use. But, given that silver has moved a lot recently his timing was clearly 13 years off.

The third category of assets is producing assets. You buy a farm because you expect a certain amount of cotton or soybeans. You decide how much you will pay based on how much the asset will deliver over time. These are the assets that appeal to Warren and Charlie. The logical follow-up to that is if you buy a farm you have to calculate how much corn or soybeans it will produce and how much you have to pay the tenant farmer. The outcome out of it and the ultimate success will be dependent on the expectations. You should not care if you get a quote on the price of the farm each day. They bought Iscar and LZ and they don't go around getting a quote on them each day—they look at the results of the underlying businesses. This is the same for securities. They don't care if the stock exchange is closed for a few years. They look at the productive assets at BRK that generate capital that can be used to buy more productive assets.

There will be times when cotton doubles in price and it will hurt Fruit of the Loom. But if you go back centuries, buying cotton was not a very good investment. Whether it is gold, oil, silver—(remember that gold doesn't have much utility), he would bet on good producing businesses to outperform something that doesn't do anything, over a period of time. Rising prices create their own excitement, especially when it comes to gold. If your neighbor owns gold and he is making money and you are not, it can affect your behavior. People like to get in on things that are rising in price. But, over time, that is not a good way to get rich.

Munger: He finds it peculiar that people buy asset that work only if the world really goes to hell. That is not really a rational thing to do. People who want to leave a country because they think the country is going to hell should buy some gold. Most other people are better off buying BRK's stock. Also, it is not a great way to make money buying paintings of soup cans (reference to paintings by Warhol).

Buffett: You have to remember that more gold is being produced each year so all of the \$100B in added gold has to be absorbed this year. But the truth is that there not much utility in gold. People take it out of the ground in South Africa and then send it to New York and it goes back into the ground at the Federal Reserve. This process would seem very strange if you were watching from Mars. He also wanted to mention that all the gold in the world is worth \$8 trillion (T). There are roughly 1B acres of farmland in the US and all the farmland is worth a little over \$2T. And if you take 10 ExxonMobiles, they would be worth around \$4T. So you could have all the gold in the world or you could buy all the farmland in the US, 10 ExxonMobiles and still have more than \$1T to walk around with.

Munger: You would need an army to protect that gold as well.

Question 12: Crowd- How did you attract investors in your first funds? How did you keep them?

Buffett: Sounds like a man who is starting a hedge fund. When he moved backed from New York, he knew he didn't like selling securities because he didn't like selling stock for \$20 and it going down to \$10. He didn't want people to watch every decision he was making. He told his family that he was starting a fund and the first years were very slow. Ben Graham referred some people to Buffett when Graham's fund was winding down, but it was very slow. For 6 years he worked in his home. When Charlie came along, Buffett told him that he had too much intellect to work in law.

Munger: He said it took him a long time to leave the family business. It took years for Buffett to pound into Charlie the point that he should not be in law.

To keep and attract investors, it helps to if you conduct yourself in way that allows other people to trust you. It helps more if other people are RIGHT to trust you. It is a really a simple formula—the first one and then the second.

Buffett: With the fee structure these days, attracting money may be more lucrative than actually managing it (with skill).

Munger- He and Warren understood at a very young age that they should never take large fees from people. He wishes their example were more popular, but is it spreading—they buy a new company every 5 years.

Question 13: Carol Loomis- The BRK model is like those of some of the conglomerates from the 1960's? How does BRK differ from these companies?

Buffett: BRK is a conglomerate and there are some benefits to being one. For example: tax efficient transfers of money between businesses that use capital well and those that don't. The conglomerates from the 1960s became sort of stock issuance machines in which the idea was to get the stock and the multiple to be very high so they can buy something that trades at a lower multiple for cheap. If successful, EPS went up and this Ponzi scheme was accepted and supported by Wall Street. Everyone thought the game would continue forever. But, there was an unspoken conspiracy that this was a perpetual motion machine that could have failed if people realized the emperor had no clothes.

As such, most of these companies have very little relationship to BRK, which is very decentralized in general. Managers of these conglomerates were only thinking about how they could pump the stock up to a level where they could buy big, established businesses that were selling at low P/E multiples. BRK is not in that game even though he and Charlie do want to buy cheap businesses. BRK is a conglomerate but the way they operate it represents a rational way of running the businesses

Munger: Some of these companies got into manipulation of the numbers: "I know what numbers I am going to report, I just don't know how we are going to do it." That's not how things work around here (at BRK).

Question 14: Crowd: What would Warren and Charlie like to be remembered for in 100 years?

Buffett: Old age!

Munger: Warren wants to be the oldest looking corpse anyone ever saw. Charlie wants to be known for fortune fairly won and wisely used.

Buffett: Said he enjoys teaching a lot. He really likes to meet students. He had some fabulous teachers in his father, Ben Graham and Tom Murphy. Mentioned that on Wilt Chamberlain's tombstone it says: "At last I sleep alone"

Question 15: Becky Quick- The US dollar is depreciating and the Federal Reserve is keeping rates low while other central banks are raising rates. What is BRK doing to protect against that?

Buffett: BRK had a small short position in two currencies last year and made about \$100M. However, they have not been that active in the currency market. Buffett thinks that the purchasing power of the dollar and all currencies will decline. He and Charlie have a mild perception of which ones might do worse but not enough to invest. They don't know which one will decline the faster. Through the Coke (KO) stock BRK owns, it has a lot of non-dollar exposure. But, he and Charlie are unlikely to make a large currency bet even though Buffet has had (so far) unwarranted fears of the dollar losing value rapidly. A dollar from 1930 is worth \$.06 today and, despite that, Warren, Charlie and BRK have done very well so far. So, inflation is

not a killer. Overall, they have done well even though they would have been discouraged if they had known in 1930 what would eventually happen to the dollar. Having said all of that, he hates inflation and knows they have to worry about high inflation.

Munger: Modern Greece is a god awful modern culture when it comes to paying taxes and managing money. The country has a dysfunctional government and people don't want to do work. But people are still surviving. Adam Smith said that a great civilization has a lot of ruin in—it takes a long time to ruin it and there is a lot left even after the ruin.

Buffett: We will see inflation but he would rather be born in the US today than in any place in any time in history.

Question 16: Crowd: Why should people invest in BRK rather than in a no-load mutual fund?

Buffett: He advises people to buy index funds if they are not actively investing. If they have a day job and want to put money to work over time, they will do well buying index funds consistently overtime. If he had to choose right now between investing in BRK and an index, he would choose BRK. But, he would not be unhappy buying an index.

Munger: On the other hand, Charlie would be very unhappy if he had to own an index fund. He does not think that the average return for the investor will be the same over the next 50 years as it was over the last 50 years. He thinks that an investment in BRK will be good, after understanding these lower expectations. That's how he got married—his wife lowered her expectations.

Buffett: And he met them!

Question 17: Andrew Ross Sorkin- Can you explain the company's policy regarding employees outside investing activities? Why aren't all trades cleared through compliance?

Buffett: BRK has hundreds of thousands of employees. There are only 3 people at BRK who can exercise trades for the company. BRK also has very clear rules in terms of the code of ethics. These rules will get looked at again because of the Sokol thing. The problem with rules is that you have to have them but understanding the spirit of them is important too. Coke had about 1/5th the number of employees that BRK has when he was on the Board and they had lots of violations each time the compliance committee met.

At BRK, they cannot be perfect. The problem with the Sokol thing is that it went very high up. A vice president of a subsidiary who was a friend of Buffett's was sent to jail due to evidence that BRK provided. He got a women arrested in her office to make it clear that they mean business. The audit committee said that its recent report was not merely public relations, it was based on the facts. The members found that Sokol broke the integrity of the values held at BRK. There are no grey areas when it comes to integrity. In any case, Buffett hopes to get some value out of this experience. They do mean business on this, but there will be bad things happening no matter how many records they keep. There will be occasions in the future when people do wrong things. Usually violations get handled at the subsidiary level—kickbacks and stealing, for example—but they get an occasional mega-one. If there is anything they can do in the rules that make it more explicit that the spirit extends beyond the rules themselves, they will do it.

Munger: The greatest institutions in the world select people they can trust—it is a great feeling to be trusted. Wall Street has huge compliance departments and yet has plenty of scandals. Culture is much more important than rules in preventing scandals.

Question 18: Crowd- Are there any significant changes to US economic policy, tax laws or Federal Reserve policy that need to be instituted to help boost the economy?

Buffett: The Fed has had its foot to the floor in terms of monetary policy. The Chairman reaffirmed just the other day that this policy will continue for an extended period. However, we can't push much harder on the monetary front. We have had a stimulus bill but people need to realize that deficits by definition are

essentially stimuli. We have a huge stimulus no matter what we call it—taking in 15% of GDP and spending 25% of GDP. We have used levers in a way that was unprecedented. It was wise to use these policies, especially in 2008. But, they are less important than people think they are. The natural powers of capitalism will be what take us out of this.

Also, residential construction has flat lined. When it comes back--and it will even though it will take the absorbing of a lot of excess supply-- we will see a pickup of employment that you won't necessarily see in construction job numbers. At Shaw and Furniture Mart there are thousands of indirect workers who lost their jobs when the residential construction market died. When it comes back, those jobs will come back as well. He just doesn't know when, although he thinks we may see it by the end of the year. We are creating households faster than we are creating houses and we are losing houses due to tornadoes. We are progressing more slowly than are Asia and Brazil for sure. Our pace of recovery has been slow, but when you consider the paralysis and the huge hit the US took, the recovery has been significant. BRK has companies that are setting records. For example, BRK subsidiary TTI is setting records right now. Iscar is doing really well, mainly because its products are not used in building houses. The economy is coming back and when the housing market overhang dissipates, the economy will come back even more.

Munger: The one place where we are making a mistake is not learning enough from the problems caused by having wretched excess in our financial system. All crashes come from financial crises, which of course come from asinine behavior. He thinks we should take an ax to our financial system to cut it down. He also believes we need to create tax systems to discourage trading (Tobin taxes, for example). Stocks should trade at the frequency of real estate and society doesn't need computers trying to outwit one another. Also, we need to stop making heroes of people who succeed in this business. The lack of contrition is utterly awesome. It makes Sokol look like a hero. It is just terrible that 25% of best engineers are going into finance.

Buffett: He is just getting warmed up! This is just a sidebar: if you buy an S&P future, hold it for one second and then sell it, you get a 60% long term gain and a 40% short term gain. Congress has basically subsidized this type of trading. This activity gets 60% taxed at a 15% rate although it is a flicker on the screen.

Munger: Hedge fund managers get a lower tax rate than people who drive taxis and teach. That is just demented.

Question 19: Carol Loomis- Both of you expressed a positive view on BYD when the stake was bought. Is it still as attractive now? Are the delays affecting your confidence?

Buffett: Charlie is the BYD expert.

Munger: The price is still way higher than the price BRK paid so it is not as cheap as it was then. Any company moving as fast as BYD is will have delays. He is encouraged by what is going on. They are having trouble in auto distribution because they have been try to double their sales each year for the last 6 years and it worked for the last 5 yrs.

Question 20: Crowd- Given that state of the world today, is there an oil bubble? What are their sentiments regarding oil?

Buffett: They actually did take a position in oil a long time ago (Charlie: When it was \$10/barrel). It was in the 1990s. They really don't know where oil prices will go in the short run. Obviously, you are dealing with a finite resource. He doesn't know if the world is up to 88 or 89 million barrels a day, but that is a lot of oil to take out each year. You put a lot of straws in the earth. Oil will sell for a lot more one day. Do you know how many producing oil well are there in the US? There are like 500K. There are wells near Charlie that have been going for 100 years. What has happened is that people are looking for oil all around the world.

Traditionally, BNSF has hedged a lot of oil—due to its diesel usage—and Warren suggested that they should not try to guess the direction of the price of oil. If they could do that, they should not run the

railroad—which is a lot of hassle—they should just trade oil. The BRK parent company does not hedge oil, although some subsidiaries do. The dollar will become less valuable over time so the dollar price of things will go up, maybe substantially. The question of whether oil will go up enough to maintain purchasing power given the taxes on any gains is another matter. Accordingly, he still thinks productive assets will generate better returns over time.

Munger: If they had invested in nothing but oil since the beginning, they would not have done as well as they have. What they have done is much easier than what the questioner was trying to do (making money predicting what was going to happen with oil prices).

Buffett: We like easy. We don't know how to have edge in betting on oil. He has no idea how to have an edge investing in commodities in general. But he does know people who have an edge investing in stocks and distressed debt.

Question 21: Becky Quick: Could you please let us know the some of the most important things learned in the last year?

Munger: Charlie read the book *In the Plex* about Google and found it very interesting. He finds it interesting that firms have created different and peculiar kinds of engineering cultures. Will he ever make any use of it? Probably not. But he enjoys learning. That is why we are here.

Buffett: What I learned is to have Charlie write the next press release.

Munger: I approved that damned release with no objections. BRK shareholders will be in a lot of trouble if they are depending on Charlie to find Warrens errors.

Question 22: Crowd- Are the taxpayers once again at risk to having to bail out too big to fail banks?

Buffett: There are institutions around the world that governments should probably “bail out.” But, if that happens, stockholders and managers should not be saved. Maybe some of the institutions should not be either. Fannie and Freddie have not reconstituted themselves while firms like Chrysler have. He was on the fence about the government saving the auto companies but the government looks like it made the right decision in retrospect. Right now in Europe they are thinking about whether countries are too big to fail. The problem of too big to fail will always be with us. We just have to reduce the propensity to fail. The board and the CEO should be at risk to being left broke. This is especially true for the CEO but the Board should suffer huge penalties—maybe they should have to repay the last 5 years of directors fees. If you run a firm that needs to be saved, then the person running that institution should be aware that it is very painful to fail.

We should also reduce leverage in the system and we have made progress on that front. Fannie and Freddie are too big to figure out but it is more important to figure out the right solution than a quick solution. In Europe there are banks and countries that may be too big to fail. But this will always be the case.

Munger: Past depressions and panics started on Wall Street and there was always a lot of bad behavior from people who were profiting from waves of excesses. This new mess should have triggered changes that made another mess less likely to occur. Partly the failure is based on stupidity. The academic institutions believe a lot of things that are not true. Finance and economics are not hard sciences and the so-called experts believe things are not true. Finance attracts people who should be snake charmers.

Question 23: Andrew Ross Sorkin- Why did Melinda Gates and Warren resign from the Board of the Washington Post (WPO)? Does this mean Buffett will sell the stock?

Buffett: He has made the statement that BRK would not be selling stock. He remains a phone call away from anyone at the Post and they could save fees and he could save travel if he were not a director. He will not sell shares of the Post and his enthusiasm is as high as it has ever been. He is available for advice much cheaper than he was before. Melinda didn't do it for age. But he is 80 and it is easier this way.

Charlie, do you have any advice on being on board in general? Charlie is on the Costco Board.

Munger: Serving in a lot of board is for the birds. He really likes the people at Costco though. He said that one of the best things in his life is interacting with those people.

Question 23: Crowd- The questioner is worried that the fact that the dollar falling is going to hurt the value of his shares. Is BRK doing anything with currency hedges?

Munger: The answer is no!

Buffett: Said that they did own the Aussie dollar last year and it helped them make \$100M. In general, they can't say what the movements in that currency-- versus the dollar-- are going to be. Instead, they try to think about increasing intrinsic value and earnings power of the company every day. The shareholders will share in the gains in BRK's stock with him and Charlie, who will make or lose money through their stock ownership. Luck may determine how well they do but they know they will do nowhere near as well as they did in the past. Smaller amounts of capital lead to much better compounding.

Munger: Australia has open pit mines at a time when Asia is booming and needs a lot of metal. He can't say how well BRK will do in terms of Australian mines, but does think the shares of the company will do better than most US stocks.

Question 24: Carol Loomis- Where do you see the equity portfolio going over the next few years?

Buffett: In general, they prefer large acquisitions but the equity portfolio is not an afterthought. They are equally interested in both aspects of BRK's operations. They are hoping to get lucky and make significant additions to their portfolio of companies—some subsidiaries are even making bolt-on acquisitions. Most companies are likely to earn much more in 5 years than they are now. They have not lost focus on the portfolio. They have \$150B in cash and marketable securities on the balance sheet so the returns are obviously significant to BRK as a whole.

Munger: Said that they will always have lots of securities due to the insurance operations. But they will do worse than before in terms of returns because the universe has shrunk due to their size.

Buffett: They have to put billions to work in most cases and thus it is impossible to have a big edge.

Munger: In the days when they were doing well in securities, nobody used to call them and say that BRK was the only company they would ever want to be bought by. Now this happens a few times a year. This is much more fun than shuffling a few pieces of paper around (referring to shares of stock).

Question 25: Whitney Tilson- T2 Partners: Are they undervaluing the insurance companies in their disclosures by only taking into account a breakeven in underwriting?

Buffett: Yes, but it is really hard to predict underwriting profit. They are being conservative in valuing the company with the assumption of breakeven underwriting. But if there was another Katrina, they could lose a lot of money in underwriting this year and every 5th year or 10th year. As such, it would not be appropriate to include a normalized underwriting profit for the insurance company

Munger: Would Warren trade any large P&C insurer for theirs?

Buffett: No way. There is no other one in the world like theirs. If you look at GEICO, it is now the 3rd largest in the US and has a very low combined ratio. In fact GEICO realized an underwriting profit of 8 points in the first quarter of 2011. Also, Ajit has built a business that he operates all alone. Buffett may not see his transactions all the time, but if people want a lot of insurance and a quick answer there is no one else to call. This did not exist when Ajit got there. Montross has a great business at General RE and there also is a group of smaller companies with unusual and attractive franchises. The managers have done a

great job building a unique insurance company.

Munger: People invested with an Omaha boy and ended up owning one of the best insurance companies in the world. P&C insurance is a tough game. There are temptations to be stupid like there are in banking. But among the insurance companies, he thinks BRK has the best one.

Question 26: Becky Quick- Which businesses will do well and which will do badly in high inflation?

Buffett: The ones that will do the best require little capital to facilitate inflationary growth and can raise prices. The value of the dollar has fallen 80-85% since they bought the See's Candy business and the company sells multiples of the initial amount of candy without much more capital. However, businesses like utilities that get bond-like returns and require a lot of capital would do badly in the case of high inflation. In these businesses, you get a fixed return and if yields on bonds go up, they are not going to do that well in an inflationary environment. Just like bonds in general, these businesses will not do well.

Munger: Their capital intensive railroad business and utility operations are some of the best in the world, just like the insurance operations. It is not all bad to be world-class in your main businesses.

Buffett: The California government is talking about building high speed rail for \$43B and Buffett knows the cost would go up a lot before all was said and done. In contrast, BRK paid for \$43B for 22,000 miles of track, 6K+ locomotives and 13K bridges. The replacement value of those assets is huge already and would grow dramatically under inflation. The country will always need rail transportation and thus BRK is control of tremendous assets to own.

Question 27: Crowd- Has BRK been considering splitting the A shares? What are the pros and cons and potential effects?

Buffett: In effect, they have been split 1500 for 1 by having the B's available. If any transaction involves the A stock, the B shares would be treated the same (meaning, if the company were sold). There is no real disadvantage to owning the B's, except for slightly less voting power. Accordingly, they are not likely to split the A shares.

Munger: Warren used to say: may you live until the A stock splits.

Question 28: Andrew Ross Sorkin- Can you tell us how Ajit thinks about insurance and give us some examples of some policies he has written?

Buffett: Said he can't think of any decision Ajit has ever made that Warren thinks Ajit could have made better. Buffett is not privy to all transactions these days, but Ajit tells him about the big and interesting ones. You would be better off voting with Ajit than with Warren. Ajit is as rational a thinker as Charlie or anyone he as met. Ajit loves what he does and is very creative. Through Ajit, BRK has moved into areas of reinsurance that others have not. As other companies have copied BRK, Ajit has moved into new niches. Who know what tomorrow brings? If there happens to be a huge catastrophe in the 3rd quarter, then there could be a lot of opportunities in writing coverage.

Ajit's mind works like a machine and Buffett really doesn't know what his best deal was. However, the best deal Warren made was hiring him. Ajit is invaluable and he thinks of BRK first. After insurance became popular, at many points he could have monetized himself—he still could— immediately and create 100s of millions of dollars of wealth. Other firms could give him 20% of \$1B and Ajit knows it. But, it doesn't cross his mind to do that. He always thanks Warren for his salary each year and Warren thinks he has left off a zero (meaning that he is getting a bargain no matter what he pays Ajit). Ajit has 30 people who work close to him and you won't find anything like it in the insurance world or in the business world.

Munger: The secret to being successful in any field is getting very interested in it. This is true with Ajit. Every Thanksgiving he flies to London because they don't have Thanksgiving there. He loves what he does.

Munger: (After some back and forth) What are the worst businesses?

Buffett: In general, small businesses that do not have the potential to become big. For example, they have not made a lot of money in retailing even though they have been in it for a long time. See's is a great business. When they bought it they were like the duck on the pond when it is raining, thinking that they were rising because they were on top of the world. But, they have trouble being very successful with companies like Dexter.

Munger: If they had been a little smarter, they could have figured this out earlier.

Question 29: Crowd- Questioner asked a question about goodwill, including goodwill when you calculate return on equity and write offs of goodwill.

Buffett: The AOL-Time Warner goodwill should have been written off. In general, goodwill should be not amortized, but should be written off when necessary. Goodwill should also not be used in evaluating a business. What the management is doing and how the operating businesses are doing are what the most important factors. In this case, the focus should be on returns on tangible assets. But when you are assessing how well he and Charlie are doing in calculating return on equity, you need to include goodwill.

Munger: Even though they only make big acquisitions these days, they make still 10% and that is not all bad.

Buffett: In the case of LZ, they are paying about \$9B for about \$1B in pretax earnings. LZ itself is employing \$2.5B of equity to earn that \$1B in pretax equity. When you include the premium BRK paid to buy the entire thing, you should judge Warren on the returns generated on a \$9B investment. But, you can judge CEO Hambrick on the returns on the much smaller capital base.

Munger- They not going to be able to buy decent operations for low prices anymore. They are just too big.

Question 30: Carol Loomis: If Charlie could teach finance, would he teach it based on companies that had done well and those that had done poorly? Would he give some examples?

Munger: Costco has taken all of its cost advantages and passed them onto its customers. This act has generated a lot of customer loyalty, especially when you do it consistently over a long time-- strange things happen. The company has a store in Korea that will do \$400M in revenue this year. Those numbers are just not possible in retailing. Such success also requires the right ethics and the right diligence—these are very rare. Normal businesses are like General Motors (GM), which became the most successful business in the world and then wiped out its shareholders in the last few years.

If he were teaching he would go through the Value Line on GM over a number of years and look at the how the how a highly unionized business and tough competitors from Asia and Europe impacted the company. Its success turned into a disadvantage. The types of graphs don't exist that he would use to teach. Business schools don't even have the graphs he would use. He knows that these graphs would step on the toes of professors and the fancy cases they have written. IBM is an interesting case and is just another great company that is not properly understood because the schools do not teach correctly.

Buffett: (Telling a joke) Charlie and Buffett were on a plane that was hijacked and soon were picked to die because they were dirty capitalists. Each got one final request and Charlie said he wanted to give once more his speech on the virtues of Costco, with illustrations. When they then asked Buffett about his last request, he said he wanted to be shot first.

Question 31: Crowd- If Warren and Charlie decided to have a kid in the next 5 years, how would they incentivize him or her to compete against the highly motivated and hungry kids from the rest of the world?

Buffett: If you are very rich and you bring up your kids to think that they are privileged because they came out of the right womb; that is a terrible mistake. Charlie has raised 8 children and not one of them has that sense. If you are going to raise your kids to think that other people should do all the work for them, you will not get a good result. Charlie has been rich most of the time his kids were growing up. Buffett was rich when his kids were in high school and college. He knew he didn't want to give them the idea that they were special because their parents were rich. You don't have to have a bad result because kids grow up rich. But, you have to be careful to not give them an incentive to do better than their parents in their parents' domain. If you are rich and your kids turn out to have no incentives to succeed, don't blame them; blame yourself.

Munger: You can't raise children in a rich family and have them enjoy working 60 hours in the hot sun. Just by being rich, you are definitely destroying their incentives. Accordingly, Charlie's advice is to try to lose this battle as well as you can. Get kids interested in something and they will do well on their own.

Question 32: Becky Quick- What compensation structure will be appropriate for the next generation of BRK leaders?

Buffett: It will be higher and it should be higher. The Board will decide that salaries should be supplemented with an options system. But the option strike price should not be less than the price the firm could achieve in a sale. Since you would not sell your business at that price, the option strike price should not be set at the market price. In reality, given BRK's structure, with no management at all the earnings could increase. So, the base price should include some compounding, minus the dividend paid. With that kind of a structure you can give large option. If you are creating excess value with a very large sum of capital then that person deserves a nice compensation. The current salary structure (Buffett's \$100K salary) has no bearing on what the next guy will make. People make well into 8 figures at BRK and they earn it. They don't get it from phony targets; they get it because they create excess value for BRK.

Munger: He hopes the time that Warren is replaced is a long, long way away and believes that Warren's positions may be taken over by someone who takes Warren's pay. He thinks that someone needs to be the exemplar in this society. He or she should set an example that people should not take all they can get.

Question 33: Crowd- Could you share your thoughts on depleting water supplies and food stocks and discuss how that affects your investment strategy?

Buffett: It is an important subject but does not affect the strategy. He would love to buy another MidAmerican or GEICO. He is looking at earnings 5, 10, and 15 years down the road but does not worry so much about a number of societal issues that may affect the global economy.

Munger: They don't pay too much attention to the water issue. If there is enough energy, you can find enough clean water. Israel makes a lot of clean water from sea water. Regarding agriculture, one of the main reasons we need to be restrained in the use of hydrocarbons is because agriculture doesn't work without them. We need to think about putting hydrocarbons into agriculture and not cars and homes. That being said, people who say drill, drill, drill are nuts.

Question 34: Andrew Ross Sorkin- Regarding the purchase of LZ, why was the company not allowed market itself after engaging BRK? According to the proxy, the company was not allowed to look for other buyers. Did the LZ board breach its fiduciary duty?

Munger: No, the Board did not because BRK would not have done the deal if LZ had wanted to do it any other way.

Buffett: They do not participate in auctions. In fact they were actually asked to recently. In the end, if the company decides to go through the auction process, the company may actually not even get as much and BRK would have paid it. And, if they come back to BRK after an auction process, BRK will not pay as much as it originally would have.

Question 35: Crowd- Going forward, how can we determine how good a job Warren does in

allocating capital?

Buffett: The question to ask is the following: are earnings going up commensurately with the amount of capital being retained? Over time, the market test—how well the stock does-- will be the barometer. But that measure can be very volatile. It is not a perfect measurement—return on capital— but they know that they have to always try to earn a better return on capital. The stock should trade at a premium if they are doing a good job.

Munger: They have continued to beat the market but can't top their past performance. But, he guarantees that some outperformance will occur in the future.

Question 36: Carol Loomis- 5 recent BRK—GE, GS, Swiss Re, Dow Chemical and Wrigley--deals were very different in terms of returns. What were the differences in those deals? Why would the Mars family make such a deal at the time they did?

Buffett: The Mars family can speak for itself. But in terms of the 5 deals listed in the question, the important thing to remember is that each one was done at a different time (Although GE and GS were close in timing). Market conditions were different and the opportunity costs of capital were different. They could have done a better job allocating the money post-panic. They were a little early with the GE and GS deals. But, they don't have perfect foresight—sometimes it is bad. When he did the Swiss Re deal, he was not thinking about the Dow Chemical deal. He was thinking about what he could do with \$2.7B. These deals are not related. Each one has to do with what was available that day. Past deals made don't make a difference. People try to measure each deal against the best deal they have ever made. This is a big mistake as some people subsequently take themselves out of the game. The goal is to make the best deal you can at the time.

Munger: Of course different deals will happen at different times. There is no other rational ways to make deals.

Question 37: Crowd- What advice would you give to people who want to learn to read faster?

Buffett: That is an interesting question. Although he reads 5 papers and K's and Q's each day, he is not a fast reader and is not as fast as he used to be. He doesn't know how effective speed reading classes are. But, if they are effective, then he suggests people try to learn to read faster. Being able to do so is a huge advantage. Charlie reads faster than Warren. Woody Allen claimed he took a speed reading class and claimed to have read *War and Peace* in 20 minutes. Unfortunately, all he knew was that it was about Russia. That's how he feels when he tries to read fast. Kids should start young though because reading is very pleasurable.

Munger: The value of speed is overestimated. He had a roommate who was very smart and took more time to do problems. But, he never made mistakes and Charlie often did. So, going slow is not all that bad.

Question 38: Becky Quick- Are you worried about Congress playing politics with raising the debt ceiling? Would it affect the BRK stock price if it wasn't increased?

Buffett: If they did not raise the ceiling it would be one of the more asinine things that Congress ever did. They once passed a bill in Indiana that pi should be equal to 3 so that school children could use it easier. That would be the only bill ever that was more asinine. With such a large deficit, it doesn't make sense to have a debt ceiling. Also, the ceiling should change with inflation and growth—as debt capacity grows. Maybe it should not grow as a percentage of GDP though. Arguing about the debt ceiling wastes a lot of time playing games and leads to silly statements. We have better things to do. In the end there is no chance that they won't increase the debt ceiling and the idea should be eliminated because it just results in stalemates.

The US is not going to have a debt crisis as long as we keep issuing notes in our own currency. When you can borrow in your own currency, all you have to worry about is the printing press and inflation. On the

other hand, if you are a member of the Euro, you cannot print money and giving up that right is a huge step. The US has certainly not made a habit of denominating bonds in another currency. The Japanese have followed the same policy and even though they have a high debt to GDP, they have a better ability to pay back that debt. He wanted to buy a bank in the 1950 and the only place they could borrow money was in Kuwait--in Dinars--but he had no idea what they would say the value of the Dinar was when they went to pay it back. So they didn't buy the bank.

Munger: Said he liked bipartisan times when things got done—like the Marshal plan. Both parties are trying to compete to see who is the most stupid and they keep topping one another.

Question 39: Crowd- Today MidAmerican wants to build a nuclear power plant in Iowa. But, because of the nuclear disaster in Japan, TEPCO may have liability of \$140B. Can the bond like return justify the mega catastrophe risk?

Buffett: He doesn't believe the type of exposure is the same. Nuclear power is an important part of the world energy equation. France has a high percentage of nuclear power and 20% of the US power comes from nuclear energy. Nuclear power is important, safe and he knows that it is not going to go away in the US because of the reaction to what happened with TEPCO. We should continue to develop it in the US and around the world. Some people didn't understand what he said when he said that nuclear power would have a major setback due to what happened in Japan. He was suggesting the setback would be temporary and that he still thinks it is an important source of energy.

Munger: Said that they have to have courage in running this company. Any new plant built in Iowa will be a hell of a lot more sophisticated than the one in Japan—we are learning as we go. He said that they can't be so conservative that they don't run the business the right way.

Buffett: BRK has to carry toxic materials on the railroads and has gas pipelines. Even so they are not taking any risks that could destroy the franchise. He is the Chief Risk Officer and believes that this role cannot be outsourced to a committee.

Question 40: Andrew Ross Sorkin- Would BRK ever re-instate the shareholder charitable contribution program it had for 20 years?

Buffett: Both he and Charlie loved the program and the shareholders loved it as well. It was a tax efficient way for people to give away money. Some families used it as a learning device and talked about to philanthropy with their kids. Nobody else copied it—corporate America was not interested in letting the shareholders direct contributions. There was always small backlash against some of the charities that were being helped. They got letters when people were upset. Some people didn't buy See's candy because BRK supported Planned Parenthood in California. But, they didn't worry much about that.

However, when they bought the Pampered Chef, the company operated through 50K+ independent contractors. These were largely women who wanted to supplement their incomes by selling products. Unfortunately, a campaign developed where people said that because BRK gave money to pro-choice organizations (which primarily reflected the views of shareholders), they were going to boycott these women. The women were being hurt by this boycott—there were effective radio campaigns and other disruptions. So, they decided to kill the program because these were not high income individuals. It soon became apparent that it was unfair to continue.

Munger: They did not want to parent company distracted by social issues of the times. Plus, it is not like BRK and its shareholders are not charitable. A lot of BRK stock is given away each year.

Buffett: They didn't want these bystanders to be hurt. A large amount of BRK stock gets given away. For example, the partnerships were started in the 50s and 60s and long term shareholders continue to give away give back 90% of the money they have made in BRK.

Question 41: Crowd- When you think about the long term cash flows of a company, do you try to

estimate growth?

Buffett: Growth is part of the equation. They love profitable growth and would love to find a way to move a company like See's into new areas because it would likely to be very profitable. But they can't really do that. On the other hand, Coke has traveled well to 200+ countries for 100 years. If they see growth in the future and the company produces a higher return in incremental capital, they love it. But these days they don't rule out low/no growth companies. There will be some growth at LZ but that is not why they like it so much. They think plenty about whether businesses will grow profitably but don't rule out slow/no growth companies.

Munger: Business schools teach people to make projections way into the future, using their computers. Then, people use these projections in their business decisions. But projections do more harm than good. Warren does no projections like those. False precision gets into analyses when programs make projections. People falsely think projections are significant because they came out of a computer.

Buffett: When they bought Fetzner, it had been shopped by First Boston to a number of companies. Buffett sent the owner a letter saying that he would pay \$60 a share and they made a deal even though they had never spoken before. The guy from First Boston was there the day of the closing and had a contract that gave him a commission even though he had never called BRK. The guy then mentioned to Charlie that his team had prepared a book for this deal and asked if he would like to see this book. And Charlie said that he would pay the guy \$2M if he didn't show him the book.

In terms of LZ, the company had made projections already to 2013 and 2015 and Buffett said he didn't want to see them. He has never seen a projection from an investment banker that showed that earnings were going to go down. It's like asking a barber if you need a haircut. Instead, Buffett and Munger are doing projections in their heads. They have a model in their minds of what the company will look like in a few years and have an idea where they could be wrong or off.

Munger: Recommended to students that we learn to analyze companies the Buffett and Munger way, but pretend to do it the MBA way while we are in school.

Question 42: Carol Loomis- 3 stocks are listed in the recent BRK 13F as being owned by Warren Buffett directly. What are they?

Mark Hamburg- They are not owned by Warren. But, because he is a controlling shareholder, his name shows up in the filings. In reality, they are part of a retirement plan.

Buffett: Said he owns very few securities outside of BRK and spends most of his time on BRK investments. He does own some government bonds even though he has been telling people not to buy them. These bonds just represent a place to put his money and forget about it so he can focus on BRK.

Question 43: Crowd- How do they think about investing outside of the US?

Buffett: They follow the same principles but realize they know less about taxes and customs whenever they invest outside of the US. They weigh that uncertainty when they are making decisions. PetroChina's stock was really cheap in 2003 compared to its cash flows. Yukos in Russia was cheap as well. They knew they were not experts but he felt more comfortable buying PetroChina than buying Yukos. He was impressed by PetroChina's reports. The company was planning to pay 45% of earnings out as dividends—a ratio higher than that of any US company. In general, they do make allowances for lack of understanding of key factors outside of the US. But the principles are the same across the world.

Munger: They make so few investments in China that it is hard to draw general lessons.

Buffett: But, they are willing to look at China investments tomorrow. They want a large investment and will look outside the US. He loves the idea of looking at various ideas outside of the US that are new to him. The universe has gotten much smaller though because of BRK's size. Some countries are just too

small.

Munger: China has at least one private company that makes \$3B in pretax earnings each year.

Buffett: Charlie, tell me the name of that company after the meeting.

Question 44: Becky Quick- What does BRK do with its cash?

Buffett: Short term money choices are lousy. They do not and did not own commercial paper or money market funds. Their money is held in Treasuries and they are getting paid nothing for it. It is irritating but they would never try to earn 30-50 extra basis points by going into something else that is more risky. Treasuries are an unattractive parking place, but are ones in which they know they can get their car back. During the crisis they needed money to facilitate the Wrigley deal and they couldn't show up on the day of the deal with a money market fund. They needed cash and that is why they keep it in Treasuries.

Munger: Said he has seen people struggle because they want to earn an extra 10 basis points on their short term money. But he and Warren don't want to fool around with a dubious instrument when they need money.

Buffett: They bought one pipeline in which the owner thought he might go bankrupt in the next few weeks if he didn't get the money fast. Their ability to come up with cash when people need it or when others are scared has allowed them to do a number of great deals. Even if Ben Bernanke runs off to South America with Paris Hilton, Warren needs to make sure his check is going to clear. He needs to have cash to do a big deal.

Question 45: Crowd- Asked Charlie to host a meeting of his own since the WESCO annual meeting is no longer going to be held. Then, he asked about wind power.

Buffett: Wind power is terrific, but only when the wind blows—which is about 35% of the time in Iowa. This is a limitation and means that wind can't be relied on for a base load. The economics of wind only make sense with a tax credit from the government. Standing on its own, the investment will not return a desirable return on capital. Iowa is a good wind state. In fact the whole Central US is good for wind. It made sense to locate a large number of megawatts of capacity in Iowa and they have more in construction now. They will be doing more wind in the future but it will be dependent on the price you can get and on the tax credits.

One of the major assets of BRK is that it pays a lot of taxes. A lot of utilities get 100% depreciation and even though they get tax credits on wind, some companies don't have the ability to use those credits. BRK pays a lot of taxes so it can benefit from these credits. BRK has paid somewhere around 2% of total corporate taxes in the US over the last 5 years. So, these credits allow BRK to invest in wind and have allowed the company to keep rates unchanged for more than a decade.

Munger: Charlie said that there would be an event. It would just not be called the WESCO annual meeting. It will be called an "Afternoon with Charlie" and is only for hardcore shareholders.

Munger: Said he had nothing to add to the wind commentary.

Question 46: Andrew Ross Sorkin- Buffett had said at one point that Net Jets was on the verge of Chapter 11? However, the questioner thought the problems were more short term. Was it close to bankruptcy? Should he have told the shareholders?

Buffett: Net Jets was destined for Chapter 11 if it had been a standalone company. In its history, BRK has had 2 insurance companies that would have been on the brink if they had been standalone companies. But, it never crossed his mind to actually let them fail—BRK made them whole. BRK did the same thing with Net Jets. If BRK had not done that, in his opinion, Net Jets would have gone into Chapter 11. BRK has a lot of different companies but is one entity. Moody's and S&P look at individual companies but BRK will

always make its companies whole.

Munger: (No Comment)

Question 47: Crowd- Youth unemployment is very high but there are a lot of bright students out there who are willing to learn. What advice--from an investment perspective--would you give to today's youth?

Buffett: Warren said he did a lot of reading when he was young. In fact, he said that he lived at the library for 4 years. Anything you can do to improve your own skills is very beneficial. He has one diploma up in his office, although he received a few others. The one hanging is from a Dale Carnegie course that cost him \$100 and he took in 1951. He thinks that the communication skills he learned in that course were invaluable. If he hadn't learned how to communicate, he would not have gotten where he got. You want to find what you are passionate about early on and then do things to improve your skills.

Munger: Economics is a tough subject. It is easy to teach microeconomics and basic ideas, but once it gets much more complex, it gets very tough. Don't hurry to jump into learning something in areas where the experts cannot agree with each other—economics for example. Start with other stuff.

Buffett: He agreed that students should not take a lot of courses in economics. He doesn't remember his economics classes at Wharton being the most useful.

Question 48: Carol Loomis- Does the equity ownership in Munich Re and Swiss Re limit the amount of other insurance business BRK is willing to write? In other words, does the ownership increase BRK's exposure too much?

Buffett: He said he has invested less than \$4B in those companies or 2.5% of BRK's net worth. That is not a large enough amount to change the risks they are willing to bear in the re-insurance field. He believes that BRK is away below even tolerable risk levels in the reinsurance business. BRK went through the worst quarter since the Katrina quarter in Q1 of 2011 and still made lots of money in its insurance businesses. They would love to have more reinsurance business on their books. They just can't find it at the right prices.

Munger: Insurance has done well over time. Since Ajit has come in, it has become very profitable.

Buffett: The reinsurance business was not a good business for the first 15 years. That all changed when Ajit got there. It looks like an easy business. It's like having a pair of dice and accepting bets on box cars. If you keep doing it long enough, you lose a lot of money. You need to be able to price in infrequent events. You have to be careful not to fool yourself into thinking reinsurance is an easy business if you make money for 3-4 years.

Munger: Investment bankers have sold a lot of derivatives that have really hurt customers when things went wrong. Don't trust a salesman selling a new derivative.

Question 49: Crowd- Can you talk about how you met Todd Combs and how shareholders can assess his progress?

Munger: Todd Combs sent Munger a letter. Then Munger had a meal with him and thought Warren should meet him as well. Clearly, they have a very complicated business with intricate procedures. Can't you tell? Todd has the advantage that he has been thinking about financial companies like BRK for a long time.

Buffett: It is more likely than not that there will be more than one money manager running BRK's portfolio in the future. They choose people not just based on IQ or a nice record. Whether they like you or not has to do with the type of person you are. Todd's returns will be judged over 5 years, not over 6 months.

Question 50: Becky Quick- Regarding the Johnson & Johnson (JNJ) acquisition of Swiss medical device company Synthes, did he support this deal? Did he have concerns over the deal like he had on the Kraft-Cadbury deal?

Buffett: He said he would have liked the deal better if it had been all cash --- the deal was 2/3rds stock. JNJ has the ability to pay cash for a \$21B deal and they traded away shares of their businesses by using stock. You can draw the inference that the JNJ management team is not valuing the company's own businesses as attractively as they should be. If you use your stock to pay a 20% or higher premium without a lot of synergies, that is not a good thing.

Munger: The disadvantage is that Warren knows a lot more about chocolate and pizza (referring to the business that Cadbury is in and the sale of the pizza business to Nestle) than he does about medical devices, implying that it was easier for Warren to scrutinize the Kraft-Cadbury deal.

Question 51: Crowd- Glenn Tongue of T2 Partners- What size is too big for a deal? Has the phone been ringing? What's the deal size he wants?

Buffett: The deal he mentioned earlier-- the "elephant" he was working on-- was too big to complete without using stock or borrowing money. BRK will only issue shares in a small amounts in a deal. They will also never sell a business to buy another business. Cash balances will build month-to-month unless they do something. They can always sell portfolio securities if need be. The LZ deal will require about \$9B in cash. They are looking at some other similar sized deals and Buffett would be comfortable doing those in order to add to BRK's earning power. But, they can't to do a big elephant deal now. He said BRK never stretches or takes on large risks. They will not trade something that they have and need for something that they don't have and would like to have.

Munger: Said he had a friend who sold out to a socialist country and got shares of a state-owned enterprise. The buyer then commented on how nice it was to buy such a great company for free.

Buffett: Selling confetti for real assets has been employed successfully at times for certain companies but it runs out of gas at some point. BRK hates issuing shares because they are divesting themselves of their great businesses like GEICO and Iscar. They would rather buy more of these companies like they are with Marmon each year. They want to do that with managers and businesses they like.

Question 52: Andrew Ross Sorkin- Do they have any insight into state of the housing and commercial real estate markets as a result of BRK's position in businesses peripheral to real estate?

Buffett: In the short run, the impact of the crisis on residential and commercial real estate has been terrible and has really affected Shaw, Acme and Johns Manville. He has seen no bounce at all but you can also see that in the housing starts figures. Buffett sees this each month with pain. However, BRK bought the largest brick company in Alabama (for cash) because he likes their operations. Shaw is spending a lot of money this year to prepare for changes in the business. This country will build houses commensurate with household growth and BRK's companies are in a great position to make money when homebuilding normalizes. Nothing has changed since he wrote the annual report that tells him that the rebound he foresaw will occur, but he is willing to bet that it will turn up by yearend. They didn't buy the brick company because they thought the business would turn up in one year though. Instead, he thought it was a good investment at the price they paid. But, he will not feel good about brick results in the next year. That's for sure.

Munger: One great thing about cyclical business is that people often don't like them. They don't worry about lumpy earnings. They like being in a position in which no one else was bidding for a brick plant in Alabama with no customers.

Buffett: See's Candy loses money 8 months of the year. But, they understand the seasonal patterns and know that Christmas will come—they have 2000 years on their side. But if you only look at 1 month or 1 of quarter of See's business, you would wonder what Buffett was doing. However, looking at seasonal

companies is like looking at cyclical companies. You just need to have a longer time frame. It doesn't matter if the returns come in a lumpy manner if they come consistently for 20 years.