

**Berkshire Hathaway Annual Meeting**  
**May 5, 2012**

(Notes taken by Professor **David Kass**, Department of Finance, Robert H. Smith School of Business,  
University of Maryland)

A one hour humorous film was shown starring Warren Buffett's secretary (Debbie Bosanek), who has been made famous by the "Buffett Rule" which is based on Bosanek paying a higher tax rate than Buffett. In the skit, Buffett is forced to take phone calls for Bosanek (including calls from Oprah Winfrey and President Obama), while Bosanek keeps talking on personal calls. The movie also featured an animated cartoon of the national championship football game between the University of Nebraska and the all-robot team from the University of Washington. The Nebraska team is coached by the legendary Tom Osborne, while the Washington team is coached by Herman Cain (who has strong ties to Omaha's Godfather's Pizza Chain). The game is being broadcast by Marv Albert. At half time, with Nebraska trailing 7-0, and many Nebraska players having been injured during the first half, Buffett prevails on Coach Osborne to put him in at quarterback. Buffett argues: "I have some good ideas". In the final play, Buffett throws a long pass to his vice chairman, Charlie Munger, who tips the ball to the Geico gecko in the end zone to win the game.

**Warren Buffett** (age 81) and **Charlie Munger** (age 88) then walk on the stage and sit down. The format for asking questions was similar to the last three annual meetings. One-third of the questions were selected by three business journalists: **Andrew Ross Sorkin** (*The New York Times* and *CNBC*), **Becky Quick** (*CNBC*) and **Carol Loomis** (*Fortune*). Shareholders had e-mailed over 2,000 questions to the journalists, who then selected 20 questions relating to Berkshire and its operations. The journalists who were seated on the stage, alternated with three insurance industry analysts (**Cliff Gallant** – KBW, **Jay Gelb** – Barclays, and **Gary Ransom** – Dowling & Partners), and with shareholders in the audience in the asking of questions.

Approximately 36,000 – 40,000 were in attendance, similar to the last two years' turnout. (This is compared to previous records of 35,000 in 2009, 31,000 in 2008, 27,000 in 2007, and 24,000 in 2006.)

Buffett initially commented on first quarter earnings. In general, all of Berkshire's companies did well except those relating to residential construction. He feels good about the first quarter and the year.

Questions were asked in the following order:

**(1) Loomis: What about the heavy responsibilities of Buffett's successor? Does the leading CEO candidate have the knowledge and temperament to be the chief risk officer? In terms of the recent Goldman Sachs and Bank of America deals, could they have been done by your successor?**

**Buffett:** The CEO should be the chief risk officer. I am the chief risk officer. It is up to me to understand what could hit us catastrophically. We would not select anyone who could not do it. The primary responsibilities of a CEO are to allocate capital, select managers, and being the chief risk officer. Berkshire can act with speed and finality and it is rare in corporate America. It takes a willing party on the other side. I dreamt up the BAC deal, and I had never talked to Brian Moynihan before. I said we would do it and he knew we had the money. Not every deal could have been made by my successor. But the new CEO can do things better than I can. Those deals have not been key to Berkshire. The BAC, GE, GS deals were okay, but they were not as remotely important as buying Coke when we did, and buying IBM in the market over 8-9 months in 2011.

**(2) Gallant: Question about mortality rates and reserving for Berkshire's insurance companies.**

**Buffett:** Gen Re was under reserved when we bought it, but reserves are developing well currently. There is no coordination between Ajit, Tad, and Tony.

**(3) Audience: You have made a few investments in China (BYD, PTR). What advice would you give the Chinese leadership and to corporate CEO's?**

**Munger:** We don't give advice to China. China has been doing well. In some ways we should seek their advice.

**Buffett:** We are not in the business of giving advice. If success in our investments depended on them following our advice, we would go somewhere else.

**(4) Quick: BRK is willing to buy back its stock at 1.1 times book value. Why have you not warned us when the stock was overvalued?**

**Buffett:** They have never consciously tried to encourage people to buy the stock at a price above intrinsic value. Currently, they know the intrinsic value is significantly above 110% of book value. But, they will never announce if the stock is above intrinsic value.

**(5) Gelb: What is BRK's capacity for buybacks? How attractive are buybacks vs. acquisitions?**

**Buffett:** Buying shares at 1.1 times book value is something they feel comfortable with. They want the shareholders to know that they think the stock is undervalued. None of BRK's businesses are worth less than their book value. Some are worth considerably more. They would love to buy back billions of dollars of their stock at 1.1 times book value. They could buy back shares as long as their cash did not drop below \$20 billion. The value per share goes up when they buy at 1.1 times book value.

**(6) Audience: What is your view on the European and U.S. Banks?**

**Buffett:** U.S. banks are in far better position than they were a few years ago. They have taken many of their abnormal losses and buttressed capital in a big way. They have built capital and have liquidity coming out of their ears. The American banking system is in fine shape. The EU banking system, on the other hand, is gasping for air. Overall the TARP policy was very sound for the U.S. The Federal Reserve and Treasury acted very sensibly.

**Munger:** Europe has a lot of problems that we don't. We have a full federal union and central bank that can print money. EU does not have a full federal union. We are more comfortable with the risk profile in the U.S.

**Buffett:** The difference between the two is like day and night. When Bernanke and Paulson said that they would do whatever it took to stem the crisis, they had the power and the will to do whatever it took. That is hard to do when you have 17 countries that do not have their own currencies. You never know what country to call if you want to call Europe. If the governors of 17 states had gone to Washington to try to agree on how to stem the panic in the money markets during the financial crisis, we would have had a different outcome.

**(7) Sorkin: Can you describe your views on coal and natural gas? How do the low costs of coal and natural gas impact Berkshire?**

**Buffett:** MidAmerican will never be hurt by, or benefit from, coal prices. It is a regulated utility that passes through its costs. It needs to be operated efficiently to earn a good return. What happens to coal prices affects its customers more. In terms of BNSF, coal traffic is important to all U.S. railroads and that traffic is down. The number of kilowatt hours used in the U.S. went down 4.7% last year. That is a very large decrease and that affected the demand for coal. The other thing that is affecting coal is the price of gas being under \$2. If you told Buffett and Munger 5 years ago that there would be a 50X multiple between oil and gas they would have thought you were crazy.

**Munger:** We should use up every ounce of coal before we use a drop of natural gas. The gas we have found is the most precious thing we could leave to our children.

**Buffett:** In the future we will see less energy generated by coal, but it will not be dramatic.

**(8) Ransom: Telematics is the new pricing tool in the automobile insurance industry. What is GEICO doing in that area?**

**Buffett:** Progressive is the leader in this area, but GEICO has not done anything with it yet. If they think there is a better way to evaluate accident probabilities, they will look at it. There are 51 questions on the GEICO website that are used to assess the propensity for someone to get into an accident. The move to telematics is not a big change, but if it makes sense to adopt it, they will. GEICO is quite a business. BRK carries GEICO at \$1 billion over tangible book value. But GEICO is worth \$15 billion more.

**(9) Audience: Should we change what future leaders are taught in business schools?**

**Buffett:** Business schools have taught a lot of nonsense about investing.

**Munger:** What business schools have taught has been a big sin. But, business school education is improving from a low base.

**Buffett:** When it comes to business education, he would say that the silliest stuff that has been taught is in the area of investing. Schools have focused on one fad after another in finance theory, and the fads have usually been very math heavy. When an idea becomes popular it becomes hard to resist if a professor wants to advance within a faculty. There should be one course on how to value a business, and one on how to look at markets. This would be far more valuable than option pricing and Modern Portfolio Theory. If you know the difference between a business you can value and one you cannot, you can make money.

**Munger:** What is taught in business schools affects accounting. A long-term option on a stock or an index should not be priced by Black-Scholes. But the accounting profession decides to use that formula because they want a standardized solution that does not require them to think too hard.

**(10) Loomis: Is the Buffett Rule being discussed in the media different from what you had in mind?**

**Buffett:** This idea has been used in different ways. It was more fun to attack what he did not say than what he did say. People who have very large incomes should pay a rate that is commensurate with what people think those people pay. If you make \$30 million per year, people think you are paying a 30% rate. But 131 of the 400 largest income earners paid rates below 15%. That amount is less than what the standard payroll tax was for most of the last decade – 15.3%. Under the Buffett Rule there would be a minimum tax on high earners, and the rate would be restored to what it used to be. There are still wealthy people paying in the 30% range. But if you are asking for shared sacrifice, people with large incomes should get taxed at a rate similar to how they used to be taxed. Two-thirds of the people do pay that much, and it would raise a lot of money. Even though his income was \$20-\$65 million over the past few years, he had the lowest tax rate in his office. The 20 people in his office were paying in the 30% range, and he was at 17%. The tax law has been changed to favor the high income earners. There were 31 people in the top 400 earners who paid less than 10%. The cleaning lady in the office has been paying 15.3% on her Social Security taxes, when people who make hundreds of millions are paying less than that. It is time to look at this discrepancy.

**(11) Gallant: The world has seen a lot of catastrophes lately. Is there a trend to more catastrophes? What impact will this have on reinsurance?**

**Buffett:** The trend is hard to predict. It is hard to separate randomness from new trends. Right now BRK is willing to take on large risks for the right price.

**(12) Audience: MidAmerican has a large investment in wind and solar power. How important are subsidies in this area?**

**Buffett:** With respect to wind power, they receive 2.2 cents subsidy per kilowatt hour for 10 years. That makes wind projects work. They would not work without it. Neither wind nor solar projects would be working without their subsidies. You cannot count on wind for the base load. It works and it is clean, but if the wind is not blowing, people do not want the risk of having their lights go off. Therefore, it is only for supplemental generation.

**Greg Abel (MidAmerican):** In solar power there is a 30% construction cost recovery, which is especially useful to BRK since it is a full tax payer.

**Buffett:** BRK has a large competitive advantage since BRK pays lots of income taxes. When there are programs that involve tax credits, BRK can use them. 80% of utilities in the U.S. cannot reap full or any benefits from doing those things because they do not pay income taxes.

**(13) Quick: Some shareholders are concerned that the recent publicity around the Buffett Rule could be having a negative impact on the price of BRK stock. Should Buffett's involvement be more limited?**

**Buffett:** No employee at BRK or any of the CEO's who run the companies that BRK owns have had their citizenship restricted. When he and Charlie started BRK, they decided to put their citizenship in a blind trust. He does not know the politics or religions of the CEO's who run BRK's companies. All he cares about is how they run their businesses. If a man invests in a company based on whether or not he agrees with management team's politics, it sounds like he ought to own Fox.

**(14) Gelb: Would you consider an acquisition over \$20 billion? How would you finance it?**

**Buffett:** They considered a \$22 billion deal recently that did not work out. They will not use stock anymore as they did in the BNSF deal. But they would not let cash fall below \$20 billion. Money build ups month to month, so next year they might do a \$30 billion deal.

**(15) Audience: There are reports that jobs are coming back to the U.S. as companies that have outsourced jobs are hiring in the U.S. again. Could BRK do that?**

**Buffett:** Of BRK's 270,000 employees, only 15,000 work outside of the U.S. Last year BRK invested \$8 billion in plant and equipment, with 95% being spent in the U.S. 10 years from now most of BRK's employees will still be working in the U.S.

**(16) Sorkin: How are you feeling?**

**Buffett:** He feels terrific and always feels terrific. He loves what he does and he loves the people he works with. He has more fun every day. He has a good immune system. He has 4 doctors, a few of whom own BRK stock. Maybe he will be shot by a jealous husband, but he doesn't think that cancer is a major threat.

**Munger:** He resents all of the sympathy Buffett is getting. Munger probably has more prostate cancer than Buffett. He doesn't know since he will not let them test for it. So, he wants the sympathy that Buffett is getting.

**Buffett:** His secretary was getting too much attention, so he decided to put attention back on himself. It is a non-event. He may have less energy, but that might stop him from doing stupid things.

**(17) Ransom: Would you look at buying an annuity business or buying more annuities?**

**Buffett:** BRK would accept annuities if we could earn a good rate of return. They prefer writing P&C policies.

**(18) Audience: If Buffett were starting over, what would he be looking at and what would he do differently?**

**Buffett:** He would do things the same way, but do it a little better. He would try to aggregate money a little faster. He would try to get an audited record as fast as possible and try to raise money quickly. Then he would buy entire businesses to keep and run. This is different from private equity firms that buy and then sell businesses.

**(19) Loomis: Why is BRK undervalued?**

**Buffett:** Over 45 years there have been several times that BRK has been significantly undervalued. At times its price has been cut in half over fairly short time frames. Tom Murphy ran one of the most successful companies ever (Capital Cities Broadcasting), in the early 1970's it was selling for 1/3 the value of his properties. BRK in 1971 was selling at a very low price. The beauty of stocks is that they sell at silly prices from time to time. That is how we got rich. BRK has traded closer to intrinsic value over 47 years than most companies. There is less fluctuation in BRK's stock than with most companies. This is a good sign. Buy stocks based on what you think the businesses are worth. Stick with businesses you can value and you will make money.

**(20) Gallant: Have systematic risk fears ever caused them to be afraid to buy stocks?**

**Buffett:** He and Munger have never had a discussion about buying or selling in which they discussed macroeconomics. If they find a business they like and can understand, they buy it. It doesn't matter what the Fed is doing or what is going on in Europe. There is always going to be bad news. Buffett bought his first stock in June of 1942 when the U.S. was losing the war. Stocks were cheap. He knew that the panic would flow into the economy, but the U.S. would not go away.

**Munger:** BRK did keep liquid reserves at the bottom of the financial panic just in case things did get worse.

**Buffett:** A fair amount of liquid reserves. The first rule is to be able to play tomorrow.

**(21) Audience: Which of BRK's businesses have done better and which have done worse over the last 5 years?**

**Buffett:** The large ones have done well. BNSF has improved dramatically over the past 15-20 years. Railroads are an extremely efficient and environmentally friendly way to move things. The infrastructure could not be duplicated for 3 - 6 times what it cost them to buy it. GEICO is a much better business today than it was 10 years ago. It is approaching a 10% market share now versus 2% in 1995. Tony Nicely has maximized what needed to be done. It is worth billions more than what we paid for it. BNSF and Iscar are worth billions more than their purchase price.

**Munger:** At least 80% of their businesses add to values each year.

**Buffett:** The mistakes were made in purchasing, when he misjudged the competitive position of a company. The big deals have worked out – even General Re. Ajit Jain has created something from nothing and now it is worth billions of dollars. All he had was brains, energy, and character and he has created a business like no one I have ever seen.

**Munger:** They have been fortunate and the success will not go away after Buffett dies.

**(22) Quick: Who will manage the derivatives book after Buffett is gone?**

**Buffett:** There will not be much of a derivatives book when he is gone. There will be some derivatives in the utility business that are required by regulators as a hedge. BRK companies also engage in swaps and a number of activities. BNSF formerly hedged diesel fuel and may do so again. Some operating companies will have minor positions. It is unlikely that the people who follow him, and there will be at least two with Todd Combs and Ted Weschler, will do anything in derivatives. BRK will do well with the positions they have. They have done well with the positions that have expired. He does not like the new rules for collateralizing derivative positions. He and Munger always think about the worst case all of the time. They are never going to expose themselves to a worse case and collateralization means you could have to come up with cash tomorrow morning.

**Munger:** BRK would not have entered their derivative contracts without the favorable terms they received. BRK should earn a profit of \$10 billion on them, and maybe a lot more.

**(23) Gelb: How do you value the operating companies and the insurance companies?**

**Buffett:** He would value GEICO differently from valuing General Re. GEICO has an intrinsic value that is much greater than the sum of its net worth and float. With GEICO it is rational to assume a large underwriting profit and that it will grow. Different operating businesses have different characteristics. He would love to buy operating businesses that have similar characteristics at 9-10X pre-tax earnings. EBITDA is ridiculous. It works for people who want to sell businesses.

**(24) Audience: Since 1999 gold has gone up a lot, while BRK has not. Why?**

**Buffett:** When they took over BRK (1965) gold was \$20 an ounce and BRK was \$15. Now gold is at \$1600 and BRK at \$120,000. So, the return depends on your time period. Over time BRK will do better than gold, as will farm land and common stocks. If you own an ounce of gold today, you will still own an ounce in 100 years. But if you own farm land, in 100 years you will still own the farm land plus all of the earnings from that land. It is hard for unproductive assets to beat productive assets over long periods.

**(25) Sorkin: How does Buffett distinguish between purchases for his own account such as J.P. Morgan versus purchases for Berkshire (Wells Fargo)?**

**Buffett:** He likes WFC more than JPM. But since BRK owns WFC, he cannot buy WFC for his own account. So, he bought JPM as a second choice. His best ideas are all held by BRK. He likes JPM but he knows WFC better and thinks it is easier to understand. BRK bought WFC last quarter, last year, and during many years.

**Munger:** He likes WFC more than JPM. If he wasn't managing BRK, he would have a lot of money with WFC and BRK.

**(26) Ransom: With all of the companies within BRK, is there a problem with using capital efficiently?**

**Buffett:** He would prefer money being held in the property and casualty businesses instead of the life insurance businesses. But some has to be held there for regulatory reasons. The best place to have money is in the holding company where they have \$10 billion now. That gives them maximum flexibility. Most of the operating businesses keep more cash than they need. He wants BRK to have at least \$20 billion. BNSF is combined with National Indemnity. The rating agencies should like the idea of having a cash generating business tied to National Indemnity. BNSF earns \$5 billion per year.

**(27) Audience: Wouldn't a dividend help the stock go up and get it closer to intrinsic value?**

**Buffett:** A dividend might not help the stock trade higher. BRK is willing to pay 110% of book value to buy back stock. Their goal is to have the stock trade as close to intrinsic value as it can. When it trades at intrinsic value or higher they would consider using stock for acquisitions, but they would rather use cash. He gives away BRK stock each year, and those gifts will do more for charity if the stock trades at a higher price.

**(28) Loomis: With the newspaper industry in decline, why did BRK buy the Omaha World-Herald?**

**Buffett:** BRK will do more with newspapers in places where people care about their communities. When people have strong ties to a specific region, they care about things that cannot be found on the Internet. People will pay for newspapers and advertisers will pay to access those people.

**(29) Galant: Are there other BRK businesses that could be impacted by technological change? What about Amazon's impact?**

**Buffett:** Amazon could affect a lot of businesses including some of BRK's retailing operations. It will not affect Nebraska Furniture Mart which did \$6 million of business this past Tuesday. That business will expand to Dallas in a few years and we will have a store that will break all records. GEICO was affected by the Internet and they were slow to respond. GEICO was mail based in the 1930's and 40's, and then it moved to TV. People love Amazon and it has millions of happy customers. It will be a power house, and it could affect a lot of businesses.

**(30) Audience: Please explain BRK's unique model and the free float.**

**Buffett:** It has taken a long time to build what they have and the consistency has come from Buffett and Munger being controlling shareholders. It took a long time to get people with large private businesses to offer to sell to BRK first. BRK does not do well buying at auctions.

**(31) Quick: How does BRK vote in the annual proxies for publicly held companies?**

**Buffett:** BRK has almost never voted against management. But they have voted against management when the issue of stock option expensing was on the ballot. They are large shareholders of companies they like. They may not always think the same way as those managers.

**(32) Gelb: Do you want to increase your commercial insurance operations?**

**Buffett:** BRK could expand by buying a great company. They got into medical malpractice when they bought a division from GE with a first class manager. If they could find a quality company in commercial lines with good management they would buy it in an instant.

**(33) Audience (Whitney Tilson – T2 Partners): Has BRK's plans to buyback its own stock at less than 1.1 times book value put a ceiling and a floor on the stock? Would you consider being more flexible?**

**Buffett:** He does not think this put a ceiling on the stock. Floors disappear when things get chaotic. If he thought they would buy a lot more stock at a higher price, he would adjust the multiple up.

**(34) Sorkin (Question submitted by David Kass, University of Maryland): One of Berkshire's largest investments is in Wal-Mart. Have you changed your opinion of this company as a result of the Mexican bribery scandal?**

**Buffett:** It may lead to a large fine and is a huge diversion of management time. The earning power of Wal-Mart five years from now will not be materially affected. There is nothing fundamentally dishonest about Wal-Mart.



### Comments Prior to Lunch

**Buffett:** He made a \$1 million bet with hedge fund managers at Protégé Partners as to which index would outperform the other: an index of hedge funds or an S&P 500 index (Buffett's bet). Over the first four years of this bet, the S&P 500 is down 6.27%, while the hedge fund index is down 5.89%. They each bought a \$1 million zero coupon bond to make sure the money was there at the end. So far the bond has been the best performer. The proceeds from this bet will be donated to charity.

#### **(35) Ransom: What personnel adjustments were made at General Re and do they have room to grow?**

**Buffett:** General Re was more concerned with premium volume rather than profitability when BRK bought it. It took BRK awhile to figure that out. But, when Joe Brandon came in, he focused solely on profitability. Tad Montross followed up on that which required getting rid of a lot of business. The life business kept growing during that period, while P&C business shrank. They will not miss the business they lost. General Re is a great business that will grow.

#### **(36) Audience: In a post-Buffett BRK, will senior managers leave and will a large investor try to gain control?**

**Buffett:** The successor they have in mind has the culture deeply embedded. People would probably not leave for more lucrative jobs. Many could retire. They do not need to work at all. They only work because they love it. A takeover would be very hard given the size and the share structure. Even 10 years from now, either Buffett or his estate will probably still own 20% of the company. The Buffett family would own 20% of the company and have 10 times the voting power of anyone else. Also, BRK will grow larger over time and its size will be an inhibitor. BRK's businesses will take its market cap from the current \$200 billion to \$400 billion.

#### **(37) Loomis: When would BRK buy a capital intensive business?**

**Buffett:** Cash consuming businesses are unattractive unless they earn a target return. In the electric utility business, we can earn 12% which we are comfortable with. BRK will also earn a reasonable return on BNSF with high capital expenditures. It is difficult to earn 20% ROE so we are satisfied with 12%.

#### **(38) Galant: Buffett suggested in the annual report that the float will stop growing. But, could it actually shrink?**

**Buffett:** It could shrink due to the nature of some retroactive contracts. The float of GEICO and the smaller companies will grow. In Ajit's operation there is a lot of stuff that runs off. When the float was \$40 billion Buffett was concerned it would not grow. Now it is \$70 billion. It is possible the float will grow slowly or decline.

**Munger:** The casualty business is not a great business and you have to be in the top 10% to be good. BRK has the best casualty business in the world. Ajit and Tony Nicely have done a great job in helping the float grow.

**(39) Audience: How do you value declining businesses such as the encyclopedia business?**

**Buffett:** It usually pays to stay away from declining businesses. The newspaper business is a declining business. They will pay a price to be in that business, but they will not earn a big profit. He will not spend a lot of time to value a declining business just to get one last puff out of the cigar. The same amount of energy and intelligence brought to other businesses will work out better. BRK started out in U.S. made shoes and textiles in New England as well as a trading stamp company. They are experienced in declining businesses. They have a business that did millions in revenue in the 1960's but only \$20 thousand this year. Munger is still in charge of this business, but Buffett can't get him to sell it. They were masochistic and ignorant in those days. In 1966 Buffett, Munger, and Sandy Gottesman bought department store in Baltimore for \$6 million through Diversified Retailing. That store and others at its location are all gone.

**(40) Quick: What types of investments should we avoid?**

**Buffett:** We should stay away from things we do not understand. He needs to understand competitive position and earnings power 5 -10 years into the future. If the price is too high, that eliminates another group of potential investments. Company size (small) eliminates other investments. BRK has not bought an IPO in 30 years. The idea that a new issue is going to be the cheapest thing to buy among thousands of stocks is crazy.

**Munger:** Especially when it carries a 7% commission (investment bank underwriting fee).

**Buffett:** IPO's come to the market when the seller wants to sell. It makes no sense to spend 5 seconds on new issues. In investing, you just need to have some investments that do really well, while avoiding huge disasters.

**Munger:** Buffett made people rich who copied him.

**(41) Gelb: What are the implications if BRK were to become subject to the Investment Act of 1940?**

**Munger:** The chances of that happening are very remote.

**Buffett:** There is no way they would be considered an investment company. BRK owns 8 companies that would be part of the Fortune 500 if they were stand alone companies. BRK also has 275 thousand employees.

**(42) Audience: How long do you think it will take China to create great companies like those in the U.S. such as Coca-Cola?**

**Munger:** China has some great companies, but there are not many branded companies there.

**Buffett:** China is not yet exporting fast food companies to the U.S. BRK has 500 Dairy Queens in China. China has some huge companies that may eclipse Coca-Cola in market value some day.

**(43) Sorkin: Now that you own IBM, are there other entrenched leaders in technology that are “inevitables”? What about Google and Apple?**

**Buffett:** Apple and Google are extraordinary companies. They are huge, make money and achieve high returns on capital. They look tough to dislodge. They could be worth a lot more in 10 years, but he would not buy either. Neither would he short them.

**Munger:** Other people understand those companies better than they do. They have the reverse of an edge. How are those companies different from IBM?

**Buffett:** The chances of being very wrong in IBM are way lower. They understand IBM better but that does not mean Google and Apple will not do better than IBM. It is hard to know how successful Apple will be over the next 10 years. There are a lot of people trying to compete with them.

**(44) Ransom: Can you discuss political issues facing BNSF such as coal plant shutdowns?**

**Buffett:** Railroads, utilities, and insurance companies are affected by the political process. Railroads are much more efficient than trucking and move 42% of intercity freight. BNSF will spend \$3.9 billion this year and it will go to improve the present system and to expansion. The government will not have to write a check and the country will be better off. The railroad industry after World War II had 1.7 million employees. Now there are fewer than 200,000 as railroads have become more efficient.

**(45) Loomis: The chart that BRK includes in its filings compares the S&P 500's returns with changes in book value of BRK. Shouldn't the change in BRK's price be used instead?**

**Buffett:** You could look at BRK's market value versus that of the S&P. BRK would still perform better even though it would bounce around a lot. The gain would be about 35% higher in aggregate over the time period as compared to the book value gain. You could also show the book value of the S&P versus the book value of BRK, but that relative outperformance would be about the same as the previous metric. They could show calculations that are favorable to BRK, but there aren't any calculations that would make them worse.

**Munger:** Over the long-term, the stock returns have tracked book value growth. But the stock has outperformed slightly over time.

**(46) Gallant: In terms of risk management, how do you share information across insurance units?**

**Buffett:** Information is not shared. Tad Montross, Tony Nicely, and Ajit Jain are friends and see each other sometimes. But they do not coordinate. Buffett and Munger want the businesses to run autonomously and the managers to feel they have freedom. They don't tell people at Clayton to buy carpets from Shaw. Any gains they would receive by doing that would be offset by the negative feelings of the managers. When they buy companies, they hand people billions of dollars in return for stock certificates. They want managers to act the same way the next day after they have received those billions. They do not want to change anyone.

**(47) Audience: Would a well run forest products firm fit with BRK given the potential synergies with other BRK units?**

**Buffett:** When they buy a business they do not consider synergies between the new business and other BRK businesses. They have looked at several forest product companies but they have not met BRK's hurdle rates of return.

**(48) Quick: Please explain why you target a minimum of \$20 billion in cash on BRK's balance sheet?**

**Buffett:** There is no magic number. They think of the worst case and then add an extra margin for safety. They have 600,000 shareholders and members of his family have 80% of their net worth in BRK. So they do not want to go broke because they took a chance. They are never going to risk what they have and need for what they do not have and do not need. At BRK, risk is at the top of their mind all of the time. Accordingly, BRK's returns 99 out of 100 years will be less than they would otherwise have been. But they will survive that 1 year when no one else does. Life in financial markets has nothing to do with sigmas and standard errors.

**Munger:** Mathematical techniques have created a lot of false confidence. People on Wall Street know a lot about fat tails, but they don't know how to quantify them. In Salomon meetings we would roll our eyes when risk control people were talking.

**(49) Gelb: Does BRK plan to replace Swiss Re premium volume that runs off in 2012?**

**Buffett:** They will not do anything to replace those billions. They would love to write new business, but they are not going to write dumb business. It is a non-event in terms of future strategy. Every decision is independent. Some opportunities will come along that will be terrific.

**Munger:** There is not an insurance company in the world that enjoys losing volume as much as they do. They are happy to lose bad business.

**(50) Audience: What about the housing market, especially relating to Fannie Mae (FNM) and Freddie Mac (FRE)? Have they become too big? How many years can they stay in conservatorship?**

**Buffett:** FRE and FNM are a mess because we haven't figured out yet what the best structure is to finance mortgages. A government guarantee program lowers the cost of financing mortgages. These institutions were half trying to serve a housing mission and half adhering to a profit mission. Eventually, the profit mission won out. This is a huge problem that Congress has not yet figured out. It is important that you have a market that minimizes costs for the right borrowers. They will stay in conservatorship until both parties can agree.

**Munger:** Canada had a more responsible system and had almost no problems. We departed from morality and soundness and the government was part of this. It was wrong not to step on a boom that was full of fraud and folly. Apparently, Alan Greenspan overdosed on Ayn Rand when he was young. A lot of damage was done by letting craziness go unchecked. We had no choice but to nationalize FNM and FRE.

**(51) Sorkin: How are Todd Combs and Ted Weschler compensated?**

**Buffett:** We pay them each a salary of \$1 million per year plus 10% of the amount by which they beat the S&P 500 on a rolling 3 year basis. Also, they get paid 80% based on their own record plus 20% based on the record of the other. So they have the incentive to work together. This is the same formula as was used to pay Lou Simpson. If they employ others, it comes out of their performance compensation. Each of the two had \$1.75 billion at year end. We added another \$1 billion at the end of March. So, they have \$2.75 billion each to manage. They use their own brokers. He wants to know the name of each investment only to make sure he does not have inside information on that company. They operate in different stocks and have a much larger universe of stocks to operate in than does Buffett (\$2.75 billion vs. \$175 billion). They have also pitched in for other duties that they do not get compensated for. They will do a great job. Ted joined us this year. Todd did substantially better than the S&P 500 last year. He was paid 1/3 of his incentive compensation, with 2/3 being deferred. He could lose it back.

**Munger:** At least 90% of the investment management business in the U.S. would starve to death on our formula, but Ted and Todd will do well. Each of them could earn more money elsewhere, but with a less desirable lifestyle.

**Buffett:** We have a free Coke machine.

**(52) Ransom: The GEICO combined ratio went over 100% in the fourth quarter. What is going on there?**

**Buffett:** The issue involved Florida and some interpretation of PIP rules that had to do with setting up one time higher reserves. In Q1 of this year, the combined ratio was only 91%. GEICO is a terrific asset.

**(53) Audience: What financial statement or other data do you use to see if a company represents an environmentally friendly investment?**

**Buffett:** They try to predict how a company will be performing in 5, 10, and 20 years. With respect to railroads, it takes fewer resources to move goods by rail than by trucking.

**(54) Audience: In terms of executive compensation, how do you provide incentives to managers?**

**Buffett:** Buffett and Munger have thought a lot about why they do what they do when they don't need the money. They have the opportunity to paint their own painting and they love that. The painting will never be finished. They have more fun doing it together than they would apart. They also like applause. If that works for them, it should work for BRK managers as well. In many cases these people have as much money as they need but they like what they are doing and that may be why they are good at it. They get to keep the paint brush, they receive applause, they are compensated fairly and Buffett and Munger do not tell them how to paint. As a result, there have not been compensation problems at BRK. Todd Combs and Ted Weschler are being compensated below hedge fund and private equity standards and are getting less favorable tax treatment. But, they will earn a lot of money and he hopes they will have a good time. Buffett and Munger want their managers to enjoy their lives – both business and personal. With respect to the managers of BRK's businesses, the businesses are so different they could not use the same metric to gauge their performance. For example, return on capital as a measure does not make sense for a lot of businesses. Managers at BRK have made a lot of money (8 figures). We use logical measures of performance. The amount of time they spend thinking about compensation is very little. Buffett is the compensation committee for 60 people and he is not overworked. Compensation consultants please the boss and get referred ("ratchet, ratchet, and bingo").

**Munger:** In past years he has said that for compensation consultants, prostitution would be a step up.

**(55) Audience: How do we get the U.S. to grow at 4% (GDP) again?**

**Buffett:** If the US population grows at 1% per year and GDP grows at 2.5% per year, that would be remarkable. It would lead to a 4x multiple of GDP per capita every century. But 2.5% growth may take a while to get the US out of the economic slump. But it is good for a country with a high standard of living. In his lifetime, real GDP per capita has gone up 6x.

**Munger:** For a mature economy with lots of competition, a 1% annual per capita growth rate would be good.

**(56) Audience: Would you consider giving money to a Super PAC?**

**Buffett:** He wishes Super PACs had never been created and he will not give them any money. He doesn't want to see democracy going in that direction.

**Munger:** If you could reduce legalized gambling in the US by giving money to a Super PAC, he would. Gambling is very bad. This is true of securities markets acting like a gambling casino.

**(57) Audience (Glenn Tongue – T2 Partners): Since the beginning of last year, BRK's portfolio has gone up, but the stock has not moved. Is the market manic?**

**Munger:** The market is not going to do what you want, when you want it. If you are short-term oriented you are not welcome in this room. He feels better about the margin for safety in the stock now.

**(58) Audience: Why not pay a dividend?**

**Buffett:** They can create more than \$1 in present value for each \$1 they invest in BRK's businesses. If you want an income stream, sell 2% of your stock each year.

**Munger:** MidAmerican will have the ability to deploy a lot of capital at high rates of return over the next 20 years. That is why they do not pay dividends.

**(59) Audience: If they were starting over now, what would they do differently?**

**Buffett:** They have learned a lot since they were managing only \$1 million and could probably earn a better return than they did when they were younger. Over 50 years they have learned how to make better use of small sums of money.

**(60) Audience: What are the best ways to minimize mistakes?**

**Buffett:** They have made mistakes and will make more. They try to not make mistakes that stop them from being in the market. They are always thinking of avoiding the worst case. They do things in a big way. He doesn't worry much about mistakes. He is making better judgments of people over time.

**Munger:** Prefers to learn from other people's mistakes.

**(61) Audience: How do you build barriers to entry?**

**Munger:** We buy them, we do not build them.

**Buffett:** Coca-Cola benefits from barriers to entry. BRK has a number of businesses that cannot be rebuilt, such as the railroad. Nobody is going to build another railroad.

**(62) Audience: What about BYD and the potential for its electric cars?**

**Munger:** The car market in China is huge and BYD is located in China. This is their focus. The first cars they will try to bring to the U.S. will be for fleets in California due to environmental restrictions there. There are subsidies for electric cars. BYD has 100 million sq. ft. of buildings and 180,000 employees.

**(63) Audience: How do we value the insurance business, especially in terms of float and economic goodwill?**

**Buffett:** The economic value comes from the ability to use the float at a bargain rate. At GEICO, one can expect an underwriting profit as well as growth along with a growing float. GEICO is the low cost producer. At GEICO, they have thousands of policies. By contrast, Ajit needs to be smart in each deal because people come to him with huge deals. They grow a large and low cost float. People are paying them to hold \$70 billion.

**(64) Audience: What about the current account deficit and how it relates to oil and natural gas imports and exports?**

**Buffett:** If we produce more of our energy needs, then our current account deficit will decline. The energy situation is improving as is the current account deficit.

**Munger:** Energy independence is a stupid idea. Our single most precious resource is our petroleum (hydrocarbon) reserves. We should use the other fellow's oil and keep our own.

**(65) Audience: Citing an example of excessive CEO compensation at Liberty Mutual (\$50 million per year), what good does it do if profits go to the top managers and not to policyholders and employees?**

**Buffett:** He hopes that the 1% growth in GDP per capita would not concentrate in the top 1% of society. The tax code has encouraged this concentration. Democracies are moving to plutocracies. The tax code issues are combined with what has happened in terms of the ratio of CEO pay to that of the average worker. There has been much more poor behavior in the corporate world than in the mutual insurance industry.

**Munger:** Most of the large mutual insurance companies do not have skewed compensation. State Farm is a good example. Liberty Mutual is an egregious example.

**(66) Audience: Are you concerned with large sovereign debt levels?**

**Buffett:** Governments do not have to pay you, and creditors cannot grab assets from them. Sovereigns have defaulted over history and there is a reallocation of wealth. The ECB has given 1 trillion Euros to banks that have large amounts of sovereign debt. These banks may be using these funds from the ECB to purchase more sovereign debt. There might be a bad ending in Europe. In the U.S. we have a budget deficit of 8-9% of GDP, which is a huge stimulus to our economy. Leaders of both parties know that we need to get revenues up to 19% of GDP and spending down to 21%. Both parties are worried about being seen as weak. The leaders of one party cannot even speak for their party. In general, he would avoid all medium-term and long-term government bonds (U.S. or other countries) at these interest rates.

**Munger:** He would spend on infrastructure that we need. People should pay much more cheerfully like the Romans during the Punic Wars. We need more sacrifice and more sensible ways of spending money, along with more civilized politics.

**(67) Audience: What do you think is the ideal corporate tax rate?**

**Buffett:** Last year the actual corporate tax rate paid was 13% as compared to the statutory corporate tax rate of 35%. Corporations were able to write off 100% of fixed asset purchases. Corporate liquidity, profits, and balance sheets are not the problem in the US economy. Corporations have a lot of money. The main issue is that medical costs are 17% of GDP, while corporate profits are only 1.2% of GDP. Medical costs in the US are 7% higher as a percentage of GDP than it is in other countries. Both parties agree that the corporate tax rate should be lower, but more equal across companies. But, this will be difficult to implement because those whose tax rate will go up will fight vigorously.

**Munger:** He recommends a value added tax. It makes sense to tax consumption.

**MEETING ADJOURNED**

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