Ruane, Cunniff & Goldfarb Investor Day

St. Regis Hotel, New York City – May 17, 2013

Remarks have been edited for clarity and relevance.

Bob Goldfarb:

Good morning and welcome to our investor day. We will take questions until 12:30. We have to vacate the room by one o'clock, but we will be around between 12:30 and 1:00 to answer any questions you might still have. Before we begin, I would like to introduce our team. On my right are Greg Alexander and Joe Quinones, who runs the operations of our firm. On my left are David Poppe, who is the president of our firm, Greg Steinmetz, and Jon Brandt. The rest of our team is seated in the front of the room. In alphabetical order, they are Saatvik Agarwal, Girish Bhakoo, John Harris, Jake Hennemuth, Arman Kline, Trevor Magyar, Will Pan, Terence Paré, Rory Priday, Chase Sheridan, Michael Sloyer, and Marc Wallach. Stephan van der Mersch is traveling and cannot be with us today. I would also like to introduce Jon Gross who is our director of client services. In the front row are the directors of Sequoia Fund: Vinny Ahooja, Roger Lowenstein, Bill Neuhauser, Sharon Osberg, and Bob Swiggett. With that, we are ready for your questions.

Question:

Suppose that you had a position that grew to 40-50% of your fund, but you felt that the price was still fairly reasonable. Would you feel comfortable about this or what would you do?

Bob Goldfarb:

We are so far from any position being at that level that it is a hypothetical at this point. A 40% position on our current $17 billion asset base would be $6.8 billion. Even if we were able to own 20% of a company, it would have to have a market capitalization of $34 billion and the prospect of a substantially higher market capitalization in order to make it a compelling investment. If we owned 10%, the market capitalization would have to be $68 billion. That is above our sweet spot for stocks that compound rapidly. Reaching the 40% level would be more difficult in Sequoia than in the separately managed portfolios because of diversification restrictions that apply to registered investment companies. If an existing position reached that level, it would limit our ability to establish other positions of 5% or more of the fund. But if a stock were compelling enough and truly bulletproof, then we would certainly give consideration to holding it at that level. I hope we have that opportunity someday but we are far from there at this point.

Question:

I see that not too long ago you added First Solar to your portfolio. Could you please go through the investment thesis on that?

Bob Goldfarb:

We no longer own First Solar. So our investment thesis was wrong. At least we thought it was wrong, and we sold it.

Question:

Could you discuss Valeant a little? Does it have the ability to finance future acquisitions without issuing stock?

Rory Priday:

My guess is probably not. The board would have to decide that it needed to extend or increase the amount of leverage that the company should have. Right now it has set a limit of about four times debt to EBITDA. So Valeant could borrow a lot of money and buy something. If, after Valeant cut a lot of costs, the company or assets it bought generated enough EBITDA relative to the amount of money borrowed, Valeant could stay within that four times limit. But based on the comments the management team has made over the last six months, it is pretty clear that it wants to issue equity to buy something. I think the benefit of using stock is that management could issue equity and cut a lot of the costs of the company that Valeant merged with. Then the debt levels would be reduced; so maybe the leverage would go to less than four times. I would imagine that after that, management would be interested in borrowing more money to do more deals. But I doubt that Valeant is going to do something big without equity.

Question:

My question is about World Fuel Services. Could we get some color on that?

Rory Priday:

World Fuel Services is a fuel intermediary. A number of the major oil companies like Exxon, Shell, and BP had marketing departments for their fuel operations. They needed to find buyers for their production. They also needed to figure out what credit standards they wanted to establish for customers, and they had to do this across all markets including aviation, land, and marine. Over the last twenty years, they have lost interest in staying in that downstream business. We have seen them selling off

gas stations. The folks that buy fuel from the refinery and sell to the gas station are called jobbers or wholesalers. You have seen the oil companies get out of that business. So World Fuel has stepped in and become the intermediary. In most cases, it is buying the fuel and reselling it, but it also functions as a credit agency, assessing the credit of its customers. In some cases, companies like to use World Fuel Services for hedging operations. You cannot go to Exxon or BP to do that.

Our investment thesis when we first bought it was that World Fuel would grow because it could take market share. We expected at the time that the markets would grow. But most of those markets are pretty growth-challenged, especially the marine market. The company does most of its land business in the US, where demand for gasoline and diesel fuel is not increasing. So the company is trying to grow in the face of declining markets — by growing organically or by buying other companies. World Fuel has bought companies in the past and we think that it is earning between 10% and15% returns after tax on those acquisitions. As long as it can do that and as long as the markets that it is in do not decline too much, then in theory the compound of the earnings should be good enough to make it a satisfactory investment. But we will see. The end markets are not as strong and the market share that World Fuel is taking is not as significant as we hoped for over the two or three years since we bought the stock.

Question:

My question is about Ritchie Brothers. It is a great company and had a great run from 2001 to 2009. It expanded from 27 to 40 auction sites, but it is not growing like that today. It has new competition from companies like Iron Planet and CAT Auctions. I think Ritchie, the biggest shareholder, sold several million of his shares earlier this year. I am wondering what your view is on it going forward.

David Poppe:

Ritchie Brothers is a terrific company. Management was clearly overconfident in 2007 – 2008 and the business was more dependent on the US housing bubble than its management or we realized. Ritchie Brothers is an auctioneer. It sells industrial and construction equipment. It is a really good model. Ritchie built 45 permanent auction sites around the world, a good bit of them in North America. Contractors tend to go from job to job and they win bids on different jobs that require different equipment. Ritchie gives them a really good way to manage their fleets by buying and selling equipment as they need it.

It also turns out because management runs the company very well — it tends to be a good proposition for sellers because you tap into a world market or at least a North American market when you try to sell a piece of equipment as opposed to taking it to your CAT dealer or your Komatsu dealer. Those dealers really are supposed to sell in a prescribed geography. So Ritchie reaches a bigger market of potential buyers. Within two to three weeks of putting a piece of machinery in an auction you can get cash for it — some of these are $200,000 – $300,000 items. They are not easy to sell. It is not that liquid a market.

Obviously, Ritchie is very exposed to the US construction market. And the company over-expanded before the housing downturn; so now it is stuck with sites that are operating far below capacity. If the US housing market recovers, Ritchie Brothers will do very well. If the US housing market does not recover, Ritchie Brothers will muddle along. That is how we look at it at this point.

Dave Ritchie’s sale — I am a little sympathetic to him. He is 77 years old, and I do not think he and his wife are in very good health. I think he chose to exit the business and focus on his personal situation.

Question:

With the market almost daily making all-time highs, and your cash already getting close to 20%, what might you be able to do to protect the portfolio when we get the eventual, maybe, short decline? If you could also possibly comment on the bond market.

Bob Goldfarb:

We do not know how we will perform in a general market decline. The cash that you referred to is a buffer against such a decline. Historically we have tended to lag in strong markets and to lead or outperform in down markets. The margin of outperformance in down markets has exceeded the margin of underperformance in strong markets by enough to make the aggregate returns better than those of the S&P. The reason I am not as confident this time about our performance in a down market is that the portfolio has changed somewhat. One of those changes is that Berkshire Hathaway was about 30% of our assets through a number of declines and it is now closer to a 10% position. Berkshire itself

used to be regarded as a fortress and it would outperform quite a bit in down markets and lag in strong markets. But more recently its performance has been more correlated with that of the overall market. So you just cannot predict. But given that it is performing well in strong markets, it is certainly possible that it might not outperform as much in down markets going forward.

Secondly, Valeant, our largest holding, is not very cyclical but its stock tends to be somewhat more volatile than the market. Thus it would not be a big surprise if it lagged in a down market as well.

Greg Alexander:

I just have one tiny thought to add, which is that most of the companies we own are within what we perceive to be a reasonable range of their value. So as long as the companies within that range become more valuable every year or over time ... take Mohawk. During the last few years, which have been tough years for housing, management has paid off huge amounts of debt which has permitted the company to buy several of its competitors all around the world. We think that value can still increase in bad years, even if it does not show up right away.

Bob Goldfarb:

If we have any bond bulls, speak up! We do not have any.

Question:

My question is about the modest position in Goldman Sachs. I wonder if the complexity or perhaps opacity of its financial statements is at all a deterrent to that becoming a larger position. Just generally I would like to hear the basis for that investment.

Jon Brandt:

I do not think it will ever be a big position in part for that reason. I can understand a lot of Goldman's financial statements; I do not understand everything. A big issue with Goldman is what kind of returns it can earn going forward, given the new regulations. There have been many proposals and new regulations passed, but not all of them have been implemented. Goldman used to earn 20% on equity over the course of the cycle. But now it has to hold more equity versus its assets. The derivatives market has changed a lot, in part because of regulations, in part because of market participant skittishness. It is really hard to know what the company will earn going forward. Goldman has a few inherently high return businesses like investment management and investment banking that should stand the company in good stead. It has some of its own capital at risk in principal positions that, even given the new regulations, should be able to do well. I have thrown out the number of a 13% return on tangible equity, which I think Goldman could maybe earn over the cycle. It has not come out with guidance, and I am not sure I would rely on any guidance. But given that it is trading at only 1.1 times tangible book, I think the price is reasonable. I think Goldman is best-in-class across most of its businesses, and that is the reason why we hold it.

Question:

Can you talk about the addition of Sirona Dental Systems and your investment thesis there?

Trevor Magyar:

Sirona Dental Systems is a roughly $4 billion global provider of dental equipment. Our interest in Sirona is centered on the types of products that it sells. Sirona sells a whole range of products, everything from handheld instruments to some very fancy high-tech equipment. More than any other dental equipment company in the world, Sirona really has the market leading high-tech equipment. So everything from digital imaging, which you have probably seen in some dentists' offices, to other products that you may or may not have seen, one of which is CEREC — computer-aided design and manufacturing machinery that allows the dentist to produce a crown in a single visit. He designs it right there chairside with a computer, and mills it chairside, and puts it in your mouth. You walk out within an hour with a new crown.

When we look at it, we are pretty convinced that over time, dentists are going to use more high-tech equipment. Dentists have been adopting some of these technologies slowly — dentists are conservative, which is why the adoption rate has been slow. But it feels inevitable to us, and in our view Sirona is better positioned to ride that wave than is any other company in the world.

It is domiciled in the US, but it operates out of Germany. It has a long history of dental innovation going back over 100 years. For instance, CEREC is something Sirona has been working on for 25 or 30 years now. It is really the crown jewel of the company's business. People have been trying to copy it for a decade or more and frankly right now no one is even close. It is an exciting company and it has

the right products for the market change that we see coming — which is more technology in dentists' offices.

Question:

A follow-up question on Valeant. It seems like it has been buying a lot of things over the years and now it is trying to buy big stuff. How far away are we from the point in time where there is no more stuff for Valeant to buy at bargain prices? If management has to get into a bidding war, the benefits to shareholders might not be what they used to be.

Rory Priday:

That is a good question. The big issue is not just whether Valeant can buy businesses at good value, but whether the company can buy big businesses at good value, because that is what will move the needle. If you look at a list of the largest 20 to 25 pharmaceutical companies in the world, maybe the bottom half of those would be candidates for mergers. For the last six months, Valeant has been talking about a "merger of equals." The types of companies Valeant does really well with — when Mike Pearson came to Valeant, he successfully restructured a company that was losing money. He also successfully restructured Biovail after it merged with Valeant. You really want to acquire a company that maybe does not have strong leadership, that is not operating well, that may be overspending in certain areas, so that you can really restructure the assets and be creative with raising prices on products or divesting units and possibly reducing the tax rate very significantly. Valeant has a 5% tax rate, which is substantially less than most other pharma companies.

There might be four or five companies that you consider weaker in the bottom half of the top 25, and there are idiosyncratic reasons that a deal would not work out for each of those companies. A CEO that is selling his company may not want to lose his job or see all the people whom he has worked with for 10 or 15 years get fired. And that is what is going to happen if Valeant merges with it. There are a lot of specific circumstances around a deal not working. On the other hand, the shareholders of large companies — if they did merge with Valeant — shareholders would probably do pretty well. The Biovail shareholders have done extremely well since Valeant and Biovail merged. I think if Valeant merged with something very large, then the shareholders of that company would do well. But there are a lot of companies out there; not just public companies. There are some private ones that are available. Management has also talked about not just merging with companies but also acquiring divisions that other companies are divesting.

It is a huge market. I was looking this morning; the pharma market worldwide if you take the market cap of all the publically traded companies is over $2.5 trillion. Valeant has a $23 billion market cap. It is less than 1% of the whole industry. So, it is a big market out there, and management will find things to do. It seems like Mike Pearson is on his own timeline and it is a fast timeline. My guess is you will probably see something sooner rather than later. But we do not really know what is going to happen. In the past three years we have often been surprised by some of the things that Valeant has done.

Bob Goldfarb:

One of the problems is that with larger companies, a higher percentage of them is publicly traded. Valeant's close rate on publicly traded companies has certainly been less than that on its acquisitions of privately owned companies. That is another hurdle that it is going to have to deal with. We saw that recently with Actavis. Valeant was reportedly engaged in talks with Actavis. Then Mylan came around with a bid. But Actavis took itself off the block entirely by acquiring Warner Chilcott. It was not Valeant's first failure to consummate the acquisition of a publicly traded company. So if management cannot find a big company to do an equity deal with, Mike Pearson will do something else that will be smart and accretive to value.

Question:

Two questions on Corning. Is the Corning story basically a Gorilla Glass growth story tied to the expansion of the smart phone market? Second question, what is the credibility of management, given its performance in recent years?

Bob Goldfarb:

We no longer own Corning.

David Poppe:

I think Corning was more about TV glass, though. As important as Gorilla Glass is, the television market is so much larger.

Question:

I would like to talk about executive pay for a second. TJX is doing wonderfully but the board took

Carol Meyrowitz's pay, which was $11 million, and raised it to $22 million and also gave her tons of stock options. I think that is not fair to the stockholders. How will you vote your Sequoia proxies?

David Poppe:

Carol is underpaid. Carol should just write a check with as many zeroes after it as she wants. She is unbelievable. The stock, the income has tripled in seven or eight years. The operating margins have doubled since 2006. She has hired and trained the best management team that TJX has ever had. The company is as strong managerially as it has ever been. Margins are at record levels. I really think Carol is just tremendous. It is a $3 billion operating profit company. When we bought it, it was in the hundreds of millions. It has been a remarkable run. I do think there are all sorts of examples of CEOs who are paid for non-performance. But in the case of Carol Meyrowitz, she has earned every penny.

Bob Goldfarb:

If you compare her compensation with that of her predecessor, he was paid less. But I think you would much rather have her better paid and the stock at $50. I do not know where the stock would be if her predecessor were still running the company, but I know that it would be significantly lower.

David Poppe:

We have owned the stock since 2000. There have been stock splits since then, but adjusted for the splits, the stock has gone from $4 to $50. You should get paid for that.

Question:

With respect to Tiffany, where do you see its business going from here and what might be the consequences of its arbitration with Swatch?

David Poppe:

I do not have good visibility into the arbitration with Swatch. I tend to think that Tiffany was mistreated, but I do not really have great insight into it. Beyond that I would be speculating. In terms of the outlook, Tiffany — again, this is another one that we followed for a long time and owned for a good bit of the last 10 – 12 years. Earnings per share have grown at a low double-digit rate over a decade. Management has done a wonderful job of building the brand and expanding the franchise. It is still very heavily a US and Japan-centric business. But Tiffany does extremely well all over the world. It has been successful across Europe. Brazil has been good; Asia-Pac, China, in particular, has been good. But so have other markets. As I see it, the future looks better to me today than it did ten years ago because Tiffany is still in a very early stage in places like Asia Pacific. The company lags behind Richemont and some of the other luxury brands in getting into China. Tiffany management, however, has done a really wonderful job managing the brand; it is strong everywhere in the world. You go to Paris with its history of luxury brands, history of craftsmanship, and Tiffany, an American company, does really well. It does well in Germany. So I think the outlook is good.

Question:

I would like to return to the previous question about the world economy. What is your biggest nightmare? Because I see Europe in total recession. China, who knows where we are heading from here? In the US, the government just cannot get it together. Here you are sitting together every day — what are your fears about the future? Are we revisiting the 1930s again?

Bob Goldfarb:

I do not believe we are going to revisit the 1930s. Bernanke is a student of the '30s and his policy responses are a reflection of his deep knowledge of the '30s. So I do not think we are going to see a replay of the 1930s.

Question:

I have two questions. What is the long-term outlook for Mohawk? Then the second question, which I am sure is on everybody's mind, is if you would like to comment on any distributions in this coming year.

Joe Quinones:

As of last night if we were to close the tax year, which ends on October 31st, it would be $1.49 per share of long-term capital gains. That, of course, may change between now and October 31st.

Terence Paré:

On Mohawk, what we have seen over the course of our ownership, we have owned it now for over ten years — is that the company has come through a very violent economic dislocation. The business is quite different from what it was when we first took our position in it. You may have noticed that management has done a string of acquisitions over the last five or six months. Now in addition to being in the carpet business and the tile business in the US, the company is in the tile business in Russia

and Europe. It has a wood distribution business in Australia and a tile business in China. It bought the brand name in laminate, a Swedish company called Pergo, which dominates the category in Home Depot. Mohawk bought a company in Belgium called Spano, which makes chipboard and MDF board, a substrate used for laminate. So now the company has a global footprint. It is much more complex than it was when we first acquired it and it is subject to economic forces well outside the United States. About 20% of sales are in Southern Europe. The rest of it is scattered around the world. What was a US company is now a global company.

Management has paid up for some of the companies it has bought and not all of them have generated the sort of returns we hoped for and management hoped for at the time. But overall management has done a terrific job in positioning itself for future growth. It is probably fair to say that we are less enthusiastic about the legacy business because it turned out to be a lot tougher. For instance, when we first invested in Mohawk, one of the elements of our hypothesis was that the carpet business would continue to consolidate because there were really only a couple companies that were making any money — Mohawk and Shaw Industries. And there was a third company called Beaulieu which was on its uppers at the time. We thought sooner or later those guys are going to go under. We will have a duopoly and we can get a little bit more pricing power on the part of the manufacturers. Ten years later, one way or another, Beaulieu is shuffling along like those characters in zombie movies. It still has not given up the ghost. Bob Shaw, who was running Shaw Industries, has quit Shaw Industries and has gone back into the business building production facilities in Georgia. God bless him, he is going to stay in the business and he is going to keep on going. The fact is he is putting real pricing pressure on the survivors. And the growing popularity of carpet tile in the commercial market has made Interface a more serious competitor. So the carpet business is tougher than we thought it would be, but overall Mohawk management has positioned the company pretty well for the future. As the housing market recovers, if we can get a little bit more remodeling spending loosened up, Mohawk will do quite well. We are going to need a little bit more employment first though, I think.

Question:

When I started investing with Sequoia over a quarter century ago, you were charging 1% which looked pretty cheap compared to the 6 – 7% upfront charges other funds were using. Today I see articles in the *Wall Street Journal* in which Sequoia was mentioned asking ‘‘Are High-Priced Managers Worth It?’’ I wonder how you justify that, especially versus a 20% cash holding that is not really producing anything. Still you are charging us 1% on it.

Bob Goldfarb:

I cannot envision a fee structure which would vary the fee with the percentage invested in cash. We held a lot more cash through most of the decade of the ’80s and maybe we were being overpaid but we were charging 1% then. I did not see the article that you referred to. So I do not know whether it spoke to all expenses or strictly the management fee. Our firm bears all the expenses of Sequoia; the 1% management fee is the same as the total expenses, which is not the case for most other actively managed funds. In the end it is the directors’ decision but it is our responsibility to produce performance that warrants the 1% fee. Furthermore, it has been a long time since we went from .75% to 1%. But at that time we made a commitment that we would limit the assets under management in the fund. And we are going to stand by that commitment. We could charge less and manage significantly more money. But I do not think that tradeoff would favor our investors.

Question:

I have a two-part question about Idexx Labs. First of all, are you concerned at all about the competition from Abaxis now that it has distribution through MWI Vet? The second part is can you talk about how you think about valuation with Idexx? It seems like the stock has traded between a low twenties and low thirties multiple for the past ten years. What do you think it is really worth? Do you even look at P/E multiples with that or do you do something else? If you ever wanted to buy more, do you have to buy it at a discount to the fair value?

Greg Steinmetz:

Idexx has two large, core businesses. One sells instruments and high-margin reagents that allow veterinarians to perform tests in their offices. Idexx also has a business that is more akin to one in the human world. The vet takes a sample and he sends it out to a lab. Because of network effects, the reference lab business is terrific. You need a lot of people driving around and you need route density, meaning that the more people you have on a courier route, the more money you can make because you

spread the costs of driving all over the place across a wider customer base. The lab business is an excellent business and hard to get into. Now Abaxis is trying to compete by doing everything by mail order through which the vet drops a sample into a FedEx envelope and sends it over to the Abaxis lab in Kansas City.

It is hard to compete that way because the turnaround time is longer. Abaxis does not have the same volume. Those are two problems for Abaxis. Another one is that Idexx has a unique ability to package its offering with other products. Idexx can go to a vet and say, "In addition to your lab services, how would you like some in-house diagnostics?" A lot of vets are receptive to that. Maybe Abaxis gets some customers, but it really has not made much of a dent yet. Given the barriers to entry, it is going to be hard for that company.

Then you were asking about valuation. We think the long-term for Idexx is very good. Arman, why not add something to that?

Arman Kline:

When you find companies that can grow as it has and have the outlook it does — yes, Idexx has a high multiple, but it has a very strong position, and it continues to be able to take advantage of that. We are seeing veterinary spending growing quite quickly in some parts of the world, which Idexx is helping to make happen. When you see that type of runway, when you see that ability to grow at what we would consider a rapid rate for a long period of time, that is worth a lot. So yes, the multiple is almost always high but I would argue that it is deservedly so.

Question:

Can you elaborate on your process to value the company?

Arman Kline:

Sure. I would look at it as a multiple of earnings not only one year out, but many years out. What would you pay for a company that you have a high degree of confidence can produce double-digit earnings growth for a long, long period of time? Yes, that earnings yield looks low in the short term. But as time goes on, the multiple shrinks.

Question:

I am a newcomer to Sequoia. So I am only interested in a general question. What do you feel is positive about you, generally speaking? Not just from performance but also philosophically. And what is to your disadvantage? Also, the 1% fee — some other good funds charge less than 1%.

Bob Goldfarb:

Hopefully we are good at in-depth analysis and at valuing companies. As far as the fee is concerned, I would go back to my previous comments: You ought to look at the overall expenses of the fund rather than just the management fee. In our case, the overall expenses are one and the same as the management fee, which as I mentioned is not the case with most other funds. Our job is to outperform the S&P over a long period of time — including that 1% — in order to warrant the 1%.

Roger Lowenstein:

We look very carefully at the fees every year, and not just compared with those in the fund market generally. We look at how Sequoia stacks up against other value funds that would be its natural competitors. We think the fee is fair. You do not want to get too obsessed with cutting off 20 basis points and go to some other fund that earns 300, 400 basis points less every year. Sequoia has an amazing stable of talent for whom hedge funds are the competitor. Hedge funds are not charging 1%, they are charging 2% plus they are taking a fifth of the profits in a wholly different model. So although we look very carefully at the fees every year, I actually think we are getting them at a bargain.

Bob Goldfarb:

Again, I would reiterate our limiting the size of the fund. I think it would be better for you to have a 1% management fee at our current level of assets than a half-a-percent fee, say, at twice the level of assets.

Question:

When you were talking about Idexx before, you were talking about paying up for a company with a long runway. Based on that, why have you not acquired more MasterCard in the last three years?

John Harris:

It is funny, I was thinking the other day.... I can remember some years ago sitting in my office with Bob having a very intense debate about the merits of buying it for $40 in the aftermarket on the day of the offering. It seemed like a scary thing to do at the time — not so much anymore. We should have. Every sale has been a mistake. Every failure to purchase, same thing. The company has had a great run. I would say that we have a pretty high willingness among people with an orientation like

ours to pay up for a high-quality business with a bright outlook. It is something we have done for other stocks. With MasterCard, there were some clouds around the business and there were some large uncertainties related to regulation, related to a big litigation that it had outstanding for many years, and also related to the way the mobile payments market would develop in the future. Pretty much on every count, the breaks have gone the company's way over the last few years. Certainly the litigation turned out significantly better than I would have guessed, and that was a big cloud. So things worked out better than we expected. At the same time, it is an excellent business. You certainly could have made a case for having owned more even at high prices in the past, and with the benefit of hindsight, no question, it was a mistake.

Question:

Yes, but what about at today's valuation, what prevents you from thinking that it is attractively enough valued to purchase more? It seems like you are anchoring a little bit when you discuss it.

John Harris:

First of all, we own ... it is a decent-sized position in the fund and we are happy with it. Certainly not interested in selling it. Also the business, the growth over the next five years probably will not look like that of the last five for a couple reasons. First of all, I think its pricing power has diminished relative to what it was in the past. It is still an excellently positioned company from a competitive standpoint. But the pressure on interchange around the world has been almost never-ending. At some point when your customers face so much pressure, and it has not been just interchange for the banks — the banks are its customers — the banks have been facing pressure in every conceivable area of their business. When your customer is under that much pressure, no matter how strong your competitive position is, your ability to take price with that customer is somewhat limited. We have been waiting for MasterCard to reach the ceiling in terms of pricing power for awhile and the results over the last couple years indicate that it has reached that limit. So that is one lever that it has had in the past that it probably does not have in the future. Also, there was a dynamic for the first few years after these companies essentially demutualized. They used to be bank-owned cooperatives and they demutualized. And like many companies that do that, the managements, when they are motivated with stock options and stock ownership, find all kinds of opportunities to reduce expenses that they might not have reduced in the past. There was really a wonderful dynamic when the revenues kept going up and the expenses would stay flat or go down.

I am not going to say that there is no more expense leverage in the businesses. But it is reduced relative to what it was. So that is another reason why the earnings may not grow as fast in the future as they have in the past. Then there is some additional uncertainty. So far the breaks have gone MasterCard's way in mobile. But mobile is still nascent as a technology for payments. There is certainly going to be change there over the next few years. I can construct scenarios that are benign from the perspective of the card associations. But I can also construct scenarios that are not. I think the stock is fairly valued where it is. Do I think it is a great bargain? Probably not. Could you justify buying more? I suppose you could. But I think we are happy with what we have.

Bob Goldfarb:

I would just add — one could make the argument that companies whose customers hate them deserve a premium because it attests to the power of their businesses. But the problem with a business that its customers — in this case, the retailers — really hate is that if an alternative becomes available, the customers are much more likely to experiment with it and try it. Actually we have seen some of that in the credit card business already, to a minor extent.

Question:

My question is about Google. When did you first take your position and are you at all concerned that it might be priced to perfection?

Chase Sheridan:

We first took our position in mid-2010, but we first looked at it in 2008. So it was a two-year process. As for whether it is priced for perfection now, as I see it, the tailwinds that Google enjoys, the migration of consumption of media from offline to online, show no signs of abating. There is a big lever for growth in mobile and mobile is still very nascent. It is not well monetized. People do not respond to ads on their cellphones very well. But the Holy Grail for mobile advertising is attribution. That is being able to track a consumer's purchase back through previous advertisements he has seen across the different devices such as tablet, cellphone, what have you. Who will solve this problem first is very much

up in the air. But Google is in the catbird's seat. I really do not see anyone challenging Google on this front. But what you see management doing — investing in all these sometimes disparate businesses — that seems a little bit crazy, I think has a method to its madness. The endgame is to offer such compelling value to the user that you want to remain logged into either Google's app or to its browser or to your Gmail site at all times. The best example of this is Google Now.

Google Now is the anticipatory search product it is unrolling. It gives you things like traffic, upcoming flights. It will tell you your best route to and from the office. It does this without any action on your part; it just sends you a card. To do that, it has to know who you are. You have to be logged in. Once you are logged into Google at that level and you participate at that level, you are much more monetizeable. We will see how it shakes out. But given the growth it already has, 20%-plus topline revenue growth every year, it clearly could earn a lot more money than it does earn because management is defending the business so aggressively. In technology you get painted with a brush of, "Well, market shares change very quickly; we do not know where the business is going to be in five years." The thing is you know that Google's market shares in search are very stable and we know that Google will dominate search in five years. So that gives me comfort with the valuation.

Greg Alexander:

I will just say Google is a good example of — somebody asked before how our firm is different. When we bought Google back then, everyone was worried that Facebook was going to crush it when it added a search feature. Apple was going to crush it because everyone was going to do Siri voice searches on their iPhones. Google's capital allocation was abominable because management wasted money on this silly YouTube and the driverless car, which apparently is working pretty well now, by the way. When the conventional wisdom is X, we say is that really true? As it has proven, Facebook has not crushed Google, Apple has not crushed it. The capital allocation — management is thinking very, very long-term. Sometimes people have a difference of opinion. If you buy something and it has no return for five years but then it turns out to be really okay, maybe that is okay.

Question:

The public seems enamored with Apple products. With the recent downturn in its stock price is Apple something that you would ever take a look at?

David Poppe:

Apple — not to say we would or we would not. Because it is probably not smart for us to talk about what we might or might not do a research project on, and you never know. But Apple's is a hit-driven products business and we probably would have a hard time getting comfortable that there will always be hits in the pipeline. So if I think about Google, I have a pretty good feeling that we are all going to be doing search in five years. I do not have a good feeling what phones are going to look like in five years. When are we going to start teleporting? I do not know. Apple really has a lot of pressure to have one hit product after another after another. So it would be a little bit harder for us to analyze is all I am saying. Not to say we would not do it but it would be hard for us.

Question:

Could we move to pharmaceuticals and discuss Novozymes as well as West Pharmaceuticals?

Arman Kline:

I will start with Novozymes. I cover both. Novozymes is actually not so much pharma — bio-pharmaceutical ingredients are a small part of its business. Novozymes is industrial enzymes. It has a dominant market share in enzymes used in detergents, laundry care, dishwashers, also in food. That bread that you see in the aisle that has been there for a week and not molded — that is thanks to an enzyme the company developed many years ago. Novozymes is in animal nutrition, feed. It has enzymes that are added to feed, which help chickens or pigs absorb more nutrients per ounce of feed, which obviously is a positive for the farmer. More recently the company entered the corn ethanol business. It has the dominant share in this country, over 60%, of the market for the enzyme used to make corn into ethanol.

I would say we are big fans of Novozymes' core business. It is very hard to get into; that is why DuPont decided that the only way to get into the business was by acquiring Genencor, which had been in it for a long time. Manufacturing enzymes involves bioengineering microbes, yeast, to induce products to do what you want them to do and to do

it better and to do it more efficiently. That requires a lot of history, a lot of work, a lot of data. When a company has done that for 20 years it is very hard to catch up. The concern is around the ethanol industry. We are not quite sure how sustainable that is. It is mostly a US business. Offsetting that somewhat is an economic business case for cellulosic ethanol, mostly outside this country. In Brazil, fuel is 20% sugarcane ethanol, which does not require enzymes. But the stalk of the sugarcane is being burned, which is an inefficient way to use the stalk. Novozymes has started developing enzymes to take that stalk and turn it into ethanol as well, which adds economic value. There is also some talk around palm growers in Indonesia. So there are some opportunities there.

Then further, the reason DuPont got into the business is that long-term there is a lot of excitement — it is a new part of this business — around renewable chemicals. Essentially using crops to produce chemicals that you would be buying from BASF or DuPont today. Moving that purchase away from the petrochemical chain. There is interest in doing that because we have seen what has gone on with oil prices over the last decade. So we feel good about that business. We followed it for five years before we bought it because it was always very expensive. Then we took advantage of a price dip when it came around a little bit over a year ago.

West is more tied to the pharmaceutical industry. It is the largest supplier of little rubber closures for prefilled as well as non-prefilled syringes. If you get a shot, you will notice there is a little rubber stopper at the end of the plunger. You will also notice there is sometimes a little rubber cap at the end of the needle. The material in that is not ordinary rubber; it is very highly designed. There is a lot of IP around it. When a drug gets approved by the FDA, it has to use that rubber material from that manufacturer for the life of the drug. If Pfizer wanted to change, move away from West, management would have to go back to the FDA and get approval. That is a very expensive process. So that is a good business. It is not a particularly fast-growing business and West historically was not a very fast-growing company. What has gotten a lot of people excited and why the stock has done quite well is that it has ownership of a Japanese company that makes a prefilled polymer syringe. The product is called CZ. There are a lot of issues now with very high-value biotech products that cost $10,000 for a single shot of the drug. Because glass breaks, there is a move towards polymers. West seems to be ahead of everyone in that. The company has been working on it for a long time. There is lots of talk about that happening — it has not happened yet. It is a little bit out in the future and we will see if that happens. If it does, then West will be worth more than it is today. If it does not, I think the core business will continue to grow nicely and will do okay.

Question

My question concerns Linear Technology. As of the end of last year, the position was tiny. It looks like a good business with very high returns on capital that has been operating for a couple of decades in a rational fashion. I wonder why Sequoia does not hold a bigger stake.

Bob Goldfarb:

We had a price limit and we bought as much as we could at that limit. The P/E is not extraordinary nor was the multiple at our price limit terribly excessive. It is an outstanding business as you describe but it does not grow very fast. So that is a limitation that caused us to set a price and we bought as much as we could at that price.

Question:

First, as somebody who, for clients, owns lots of funds, some with higher expense ratios, some with lower, the only issue I have is that you limited the amount of money that can flow in from different sources. Second, I have a question — what did you learn that you did not already know from the Berkshire annual meeting?

Bob Goldfarb:

In regard to your first question, we really did not have a choice but to limit the flow from the intermediaries because the cash position was building to a level that we were uncomfortable with. Almost all that cash was coming from those intermediaries. So we think it was the right thing to do for the shareholders of the fund.

Jon Brandt:

I do not think that we learned that much from the Berkshire meeting. You like to see how sharp Warren and Charlie are in terms of mental acuity and I do not really see any erosion there. There are just so many businesses; there is a limit to the number of businesses that are actually material to the valuation equation. The forum is not one where you are going to get the in-depth analysis that I am sure Warren performs in private. At the annual meeting, he will spend four minutes answering a question that is very important and he will spend four minutes answering

a question that is not all that relevant. I think a lot of the people who go to the meeting do not go to learn about Berkshire. They are interested in his outlook on life, his philosophy, advice he might have. Over the years I have been frustrated by that. I think there has been some improvement in the way the format of the meeting has gone. But he is sensitive to the fact that people are coming there for other reasons. Over time I have become more sympathetic to that.

This is a meeting here where we are dealing with substantive questions on each of the businesses we own, and that is why I think 99% of you are here. But most of the people that go to the Berkshire meeting are not necessarily there to learn about the competitive landscape of each of the businesses Berkshire owns. I would prefer that their meeting be more like our meeting. But I do not know whether that will ever change. One idea that has been bandied about over the years is to have a separate analyst meeting so that people could talk to the business managers and talk about the different issues facing all the businesses and their growth prospects. But Warren has been loath to do that because he says once you join the Berkshire fold, he has set you free from the terror that analysts inflict on the managers of their businesses. He wants to keep that promise. Whether twenty years from now Berkshire will have an analyst meeting, I cannot predict. I think it will always be a little bit different in the way that it deals with investors.

But there were little things. The *New York Post* had reported that the CEO of Benjamin Moore had been fired because he had a big cruise, and he was spending too much. Warren intimated that the reason he replaced him had more to do with the fact that he was considering selling Benjamin Moore paint in home centers. Warren said that he had promised the independent dealer network that that would never happen. I take him at his word. Is that material information? No. Benjamin Moore at most makes $200 million pretax, which is less than a percent.

The railroad is the only material, owned business that is a single entity. I think of MidAmerican as comprising a number of disparate businesses. Insurance is obviously more significant. But what can you ask about insurance? There were some good questions about Geico, whether it would follow Progressive's lead in offering usage-based insurance or not. I do not think we got a really good answer to that question. I would like some more depth on the more important questions, more time spent on those. Over time they have been changing the format and the progress is positive. I hope that keeps up. But my valuation of Berkshire did not change by even one dollar per share based on what I learned at the meeting.

Question:

I have a question on your two automobile parts retailers, O'Reilly and Advance. To what extent does O'Reilly have a competitive advantage over Advance and its distribution system? If it does, what would be required for Advance to catch up? And if Advance cannot close the gap, what are its prospects as an investment?

Rory Priday:

O'Reilly does have a pretty big advantage over Advance in distribution systems. Just to lay it out for you, O'Reilly replenishes its auto parts stores daily and Advance has historically done it weekly. O'Reilly delivers multiple times a day to some stores. That allows the stores to stock a smaller supply of an individual SKU but to go broader. The reason that is important is that when a garage calls O'Reilly, it wants the part in the garage within 30 minutes. If the garage calls O'Reilly, and it does not have the part, then the garage will go to the next guy. So you build up a relationship with the garages. They trust that if they call O'Reilly it will have the part. That is broadly speaking because it really depends on which market you are in and whether the parts pro behind the counter at the store has a good relationship with the mechanics in the garage and whether they went to high school together; sometimes those factors are important too. But the main difference is that O'Reilly has 24 distribution centers. It has a lot more distribution space at the warehouses relative to the amount of square footage at the stores.

Advance, when we first bought the stock, was not interested in spending a lot of money on big DC's or refitting its DC's so that they could do daily replenishment. Over the last few years Advance has changed that stance and it just built a DC in Remington, Indiana that does daily replenishment. It seems like management is going to expand that to other distribution centers in Connecticut and Texas. In theory Advance could retrofit a lot of their DC's so that they can do daily replenishment. In effect Advance is trying to look a little bit more like O'Reilly and not only on the distribution side. The new stores that Advance is building are smaller

boxes that have less space in the front for retail and more space in the back for hard parts to sell to garages.

I think Advance hopes that it can become competitive with O'Reilly in the commercial space. When we bought the stock, one of our big theses was that it would grow in the commercial business. We thought Advance could grow its commercial business about 10% a year because it was putting delivery trucks at stores that previously did not have a commercial business. Advance was increasing the number of available parts. The company hit a wall, it seems like, in that it has not been able to get into big accounts. Daily replenishment is one way for Advance to do that. But O'Reilly has those relationships; Advance does not. This is one of the reasons why you have seen poor comp performance out of Advance. It has hit this wall and management needs to figure out a way to get into those larger accounts. At the same time, it has to defend some of the areas in which it has parts stores like the Northeast and Florida, where O'Reilly is entering.

Question:

I have a question on your sell discipline particularly when it comes to Target but also with Becton, Dickinson. Would you explain why you eliminated those positions?

David Poppe:

In the case of Target, what concerned us is management had undertaken a couple of concrete measures to stimulate store traffic and comp store sales. One was a fresh food initiative that executives call PFresh, which is a horrible name. I do not think the marketing team was involved in that one. But basically it meant putting more fresh food in the stores, more groceries, and it was fairly successful. You look at the food offering, and Target looks much better today than it did five or seven years ago. The second one was a discount program around its internal credit card called the Red Card which gives you 5% back on everything that you buy. That 5% discount is pretty expensive and in fact fresh food is pretty expensive. It is really hard to manage those departments. You need a lot more labor hours; it has got to look really good. The presentation is hard. Neither one of those initiatives generated the kind of sales in discretionary, higher-margin categories, namely apparel and home, that management hoped for.

While the company is an extremely disciplined manager, and it stayed on top of expenses, we were a little worried that these initiatives, which were very important and very expensive to roll out, had not really gotten the results that we expected, part one.

Part two, even more than Walmart, Costco or some others, Target seems to be in the crosshairs of Amazon, long-term. A lot of what Target sells, you can buy on Amazon. Walmart's customer is less likely to live life online than Target's customer is likely to live life online. When we started thinking long-term about what is likely to happen to earnings, those two factors concerned us.

Will Pan:

We owned Becton, Dickinson for about two years. Our thesis going in was that it was a high-quality company, especially the medical surgical products, which was about a third of the business. The company makes syringes and it is the low-cost producer in that area with really high market shares across all of its businesses. But at the same time it is a challenging environment. Healthcare spending has not gone up very much and it is under constraint. Governments today are looking harder at it than ever before, especially in Europe, where you see a lot of bundle buying and pricing pressure. So that was one thing. We had not seen a lot of growth.

The second thing was that we felt in an environment in which you do have to take prices down, the best way to continue to grow is by innovating. We had been a little bit worried about the company's R&D function. One thing we knew before we made the investment was that in Becton's higher-tech areas management made what looked like defensive acquisitions. Things that maybe it should have developed internally but missed the boat on. That was a concern going in. So we wanted to see more innovation coming out of that business. Management acknowledged this. It realized that. But we did not see a lot of movement in the R&D budget over time, and we saw at least one other acquisition that looked kind of defensive and not likely to make a great return.

Going forward, the strategy has been to get more of its growth, to expand its markets, by acquisition because it already has very high market shares across all of its divisions. And in a world where acquisitions are high-priced, we wondered whether we would really see good free cash flow and growth from Becton over time. We were concerned about its long-term competitiveness and whether it would be able to turn that R&D function around in a reasonable amount of time.

Bob Goldfarb:

In regard to Target, in the United States its income from retail operations has not grown at all. The reason I am saying the United States is that Target is entering Canada and it is losing money initially because it is assuming a lot of leases. So factoring out Canada, I think for the reasons David cited that the growth has come from ... Target has bought the growth. But there has been only modest growth in sales in the United States and no growth in operating earnings from US retail operations, which is the core of Target's business.

Question:

Going back for a moment to Richemont, when you were talking about Tiffany, you said that it is a much better stock than Richemont. I wonder whether you have done any work on Cartier as a standalone unique moated company?

David Poppe:

If I said that, I misspoke. Richemont is not a worse stock than Tiffany. Tiffany is not better than Richemont. Richemont might have a little higher volatility over time because it is a little more exposed to the very high end of the luxury market. Tiffany — my niece just graduated from high school and my wife and I bought her a Tiffany gift for a few hundred dollars. You can do that at Tiffany, and that is a big part of Tiffany's business — gifts for anniversaries, graduations. That does not exist for most of the other luxury players. It makes Tiffany a little bit different and maybe a little steadier. But certainly not better. Just different. The highs at Tiffany are less high than for Richemont or some others. And the lows might be a little less low. I hope that is clear. I do not think that Tiffany is better. Both stocks performed very, very well over ten years. Richemont probably performed a little bit better on the stock price and a fair amount better on its earnings growth.

Question:

I would like to know how you approach the issues that come before you as a shareholder in the matter of voting about corporate issues. Are your policies based on your social ideas or what the company should promote?

David Poppe:

We want to own good businesses. If we are doing a good job, we do not have to vote against management very often. If we are picking high quality companies with good ethical management teams and good boards of directors, we should not often be in conflict with proposals in the proxy. Every now and then we own a company that we like but we disagree fundamentally with something that its management does, and we vote against management. We do not follow any of the services. We do not pay close attention to their recommendations. We do read the proxies and we do meet internally when there is something that bothers us. And we have from time to time voted against management in a couple of high-profile situations. We voted against management at Omnicom a couple years ago on a pay package. And everyone knows we voted against Goldman Sachs on one of their directors.

Question:

Do you meet regularly as each issue arises?

David Poppe:

We do not. Bob more likely will walk into my office and say, "I do not like this in the proxy." Or I will walk into Jonny's office. Recently Jonny and I have been talking — this thing in the proxy really bothered me — there was a say on pay that I just thought was not appropriate. We talked and then Jonny went to Bob and we ended up talking about it. But no, we do not have an internal governance committee that meets. We tend to review the proxies as they come in.

Bob Goldfarb:

If you prescreen before you buy the stock, you are less likely to be surprised. Take a company like Fastenal — it is just inconceivable to me that there would be an issue in its proxy that we would differ with management about, given the kind of people they are. If you prescreen, that eliminates a lot of the work that you are talking about.

Question:

Could we get an update on Fastenal? Is there still a compelling argument there?

Chase Sheridan:

When I first joined the firm, I was assigned Fastenal. The first thing I did was do a discounted cash flow analysis of the company. I went to Greg Steinmetz and I said, "Fastenal needs to grow at the current rate for 13 years to justify its current stock price. I do not want to put a sell on one of our holdings in my first week at the firm. Am I going to get fired?" Greg said, "You need to meet the management."

I was looking at Fastenal's valuation, and it is trading for 32 times forward earnings right now; so it is a rich valuation. It has traded at that level many, many times in the past. What I will tell you is that in every case it would have been foolish to sell the stock simply for valuation reasons. What we see now is a company that is certainly more mature; it is not going to grow at the rates it grew at ten or fifteen years ago. But it still has a very long ramp ahead of it. I do not think it has ever operated at a higher level than it is operating at today. Management is always doing something. It is improving the business on multiple fronts. The company is improving its gross margins, particularly in recent quarters.

But the way I think about the company is the founder, Bob Kierlin — I will paraphrase him — he used to say that Fastenal could sell anything in the business of work. He said, "Fastenal could sell cabbages and we would succeed." His point was that it was the culture and the business model of the company that enabled its success. When I think about Fastenal in a general sense, what I think about is that it is perhaps the best-designed selling machine in the industrial economy. Its sales are a little over $3 billion. The industrial distribution market in the US is $160 billion. As long as Fastenal is the most aggressive, the most cost-conscious business with the highest focus on customer service, it can just continue to take out of its competitors' cookie jars. When it started, it just sold fasteners. Now it has another thirteen or so different product lines; it has demonstrated that it can expand its product lines, and its sales force can sell ancillary products as it grows. International is a very small percentage of its sales today. It is a rich valuation. It is a place it has been many times before; so I would say stick with the odds — hang on to your Fastenal.

Bob Goldfarb:

I made the mistake of selling it once before over Greg Steinmetz's objection. Greg was following it at the time. The memory of that sale is still painful.

Chase Sheridan:

One thing I will add to that. Actually, I do have one concern — which is the people who are running the business today are the people who were running the business when it started. Bob Kierlin is still the chairman and Will Oberton was at Fastenal when there were only twelve stores. Today there are 2,660 stores, more or less. The management team has a very deep bench. All have been there for a very long time. In the long-term what I worry about is when the management team running Fastenal has not been there from the beginning, when managers are people who joined when Fastenal already had 1,000 stores, who were not there from the very early days. Will that have an effect? Will those managers be able to maintain the culture? That is a little ways off. I am not worried about the immediate successor, Lee Hein. But that is something to think about.

Question:

I am curious what approximate percentage of your own money is in the fund and if there are any guidelines or requirements for people who work at your firm to invest in Sequoia.

Bob Goldfarb:

There are not. Ownership varies by individual; it is generally not that high.

David Poppe:

I would just add a couple of things. All of our profit sharing is in Sequoia. But I would say if you looked at most of the personal accounts of the people here and certainly mine, it is all Sequoia stocks. I do not think you see a lot of people owning non-Sequoia companies in their personal portfolios. Here and there — we do not discourage that partly because the bar is really high to get ideas into Sequoia. Occasionally analysts will work on something that they feel strongly about and just cannot get it into the fund. It is probably good for morale if they can then own that stock on their own. We put pretty hard limitations on people, but for the most part, the stocks people own in their personal accounts are the same stocks that are in Sequoia. But they do not necessarily own Sequoia Fund.

Bob Goldfarb:

I would just add that I know there are firms that require their analysts and portfolio managers to have a certain percentage of their capital in their funds. I think that is a mistake, at least for ourselves it would be. Having each analyst be his own portfolio manager for at least one portfolio is a good idea and it is something that we could not accomplish if we had the kind of restrictions that some other firms have.

Question:

I would like to ask about Waters.

Trevor Magyar:

Waters is a Massachusetts-based provider of scientific instruments. It has a market cap of roughly

$8 billion. We have been invested in it now for two years. When we look at this company, the first thing that really stands out is the track record. If you spread the financials, you see a company that has grown its revenues very nicely over a long, long period of time. It has grown profits even faster. High, high returns on capital and a great deal of management stability. The team that is in place now has been in place for the past 15 – 20 years. When I stumbled upon this, my first reaction was, "What do I know about scientific instruments?" The answer is, "Not much." I look around our office, and frankly we do not have many scientists among us. So the first real hurdle with this investment was getting comfortable with the product itself. Is this something that we can actually understand? The core product for Waters Corp. is liquid chromatography. When we first looked into this, we scratched our head and said, "Do we really understand this?" What we have convinced ourselves of is that we understand it well enough.

Liquid chromatography is a very basic scientific method. The instruments that the company is making are used in a wide variety of industries, industrial and life science industries. It is really nothing more than a filter with some software. A lot of brain power goes into it but at the end of the day, it is really nothing more than a filter and some software. What we have seen is the company has established a clear leadership position in this particular market and we have reason to believe that it is going to be able to sustain that competitive position. We went out and we talked to customers and what we discovered is that once they are used to using a particular type of instrument, in this case a Waters liquid chromatography instrument, they are very unlikely to switch. Or if they are going to switch, they are really going to think hard before they do so. There are many reasons for that, one of which is that these instruments format all your data in a particular way. If you were to switch instruments, you would lose comparability of data. Your whole laboratory gets standardized on these instruments. And for a significant portion of Waters' customer base, there are regulatory issues.

I mentioned earlier that life sciences is an important end market. When these products are used to safety-test drugs, which is a big piece of the Waters story, the regulators look at the instruments companies are using and say you cannot switch them out. If you set up a QA/QC line in the pharma industry and you are using Waters instruments, you have got to use Waters instruments more or less for the life of that QA/QC line. We looked and said, "We may not be scientists but this is a product we think we understand." We talked to the customers, and we understand why customers are sticking with Waters.

I would say on top of that, it is a great service organization. Roughly half of its business comes from service and consumables, and the company does a bang-up job of providing that customer service all over the world. So with Waters it is really a case of a company that is extremely well-managed from a financial perspective. The bet is that we are going to get more of the same in the future. The thing I worry most about is the growth of the end markets. Life science is the company's most important market; it accounts for roughly 60% of its sales. That market has grown nicely over the past 10 – 20 years. People are going to invest in R&D whether it be big pharma or little pharma, biotech — and frankly that should enable the company to continue to do what it has done for many, many years.

Question:

Can you comment on Canadian Natural?

David Poppe:

Canadian Natural is a really small position in Sequoia. So economically it is not material to you. It could double and it would still not be material; it is that small. We did some work on it and liked it. Bought it at the bottom of the market in the spring of '09. Prices got absurdly low. We do not think of ourselves as being commodity investors or energy investors, but it seemed so low. It was so low that the price in fact quickly moved away from the price we had set and that is why it ended up being an inconsequential position.

I like Canadian Natural Resources. I think the management is very good, but probably the biggest reason is that it has the ability to grow production probably 6 – 7% per year for many years to come, partly because it has a giant oil sands investment in Alberta, Canada. The production there currently is about 100,000 – 110,000 barrels of oil per day, and should ultimately scale up over many years, a decade or more, to 500,000 barrels per day. It has an enormous resource in Alberta. When we look at the oil majors, they really struggle to grow production. We thought Canadian Natural was interesting because between all its different investments ... and Horizon, in Alberta, is only one; it is the biggest

one — but between all its different investments, it looked to us like it would be able to grow production every year for 20 years or more. That is hard to do.

The stock subsequently — it has performed okay. I think we are happy holding it. Again, it is not a very big position. But this year production will grow 6 – 7%. There may have been a couple years in there when it did not grow much, but that was partly because the company scaled back its natural gas production as prices collapsed in North America. The company has a good blend of gas and oil. It has a lot of heavy oil, which is not as good. But again that 6 – 7 – 8% production growth over time ought to create a lot of value for the investor.

Question:

I was wondering what you think about all the cash that is going into the market and how that distorts pricing.

David Poppe:

In the letter that we wrote in the annual report, Bob made a pointed remark — it is very difficult to invest based on a long-term 2% interest rate because you know that the long-term interest rate will not be 2%. So one issue for us is we are conservative and we have not wanted to invest based on these ultra-low interest rates lasting forever. The market is up 50% in 20 months. Someone asked earlier about Linear. I think there are a number of rounding error positions in Sequoia, but when the market goes up 50% in 20 months and you think of yourself as a conservative investor, it is hard to chase prices as they go up. But another way to say that is that it is very, very difficult to make long-term investments that you want to own for ten years when the market is heavily influenced by 2% long-term interest rates.

Question:

Given the firm's investment in Danaher, I am curious if you have looked at Colfax which is also owned largely by the Rales brothers, run by a lot of ex-Danaher employees and has the Colfax business system.

Terence Paré:

We have done a little work on Colfax. It is kind of hard not to just because we have owned Danaher for a long time. One of the ways you keep on track of the companies you own is you watch what the other guys are doing. The Rales brothers do have a significant investment in Colfax but it is a little bit different from Danaher. It is not as big as Danaher, certainly. I would say overall that it is a tough thing to build a company like Danaher and it takes time. So far management at Colfax has done a good job.

Bob Goldfarb:

I would just say I do see one of the Rales brothers selling Danaher and the other buying Colfax, and that has to make you wonder if the better value is not in Colfax.

Question:

When Warren Buffett and Charlie Munger are no longer at Berkshire, what would make you reduce your stake?

Bob Goldfarb:

We would have to see what the price was at that time and what the businesses and investment portfolio look like. They are probably going to be somewhat different from the set of businesses and the portfolio that they own today.

Jon Brandt:

You can do some math based on the buyback price limit and what Warren said about wanting to buy 80-cent dollars and infer that he and Charlie think the company is worth at least $180,000 per A share. I would be above that, somewhat above that number. I do not think it is selling at a premium to its intrinsic value. A larger question is whether the discount would widen if Warren and Charlie were not there. You can look at conglomerate discounts all over the world, and you can find anything from 10% discounts to 40% discounts. Given that, again the math of the buybacks, the company will buy back at 120% of book value, I think if the discount gets over a certain amount, management would buy back stock and that would be accretive. So it would actually be good for long-term intrinsic value growth if the stock did trade down.

Question:

Berkshire recently announced that it is going to buy Heinz. As far as I can tell, it is the first time Berkshire has done something like that on a joint venture basis. Furthermore, as I understand it, Berkshire is leaving the management control to its 50% partner. I would like to know what insight you have into that and whether this is foretelling something else in the future.

Bob Goldfarb:

I think it is a terrific idea. Berkshire is long capital and partnering with someone who will take management actions that Warren himself or Berkshire would not take. I think the CEO of Heinz

and a number of top executives are departing. That would not be the case if Berkshire bought Heinz outright. So it is a big plus for Berkshire to partner with people who are very smart and who are going to be profit maximizers in a way that Berkshire may not be in certain situations because of its unwillingness to remove management. Berkshire was going to put up capital to purchase Avon with former executives of Reckitt Benckiser, who now run Coty. I think they would have taken actions with Avon similar to those that 3G is taking with Heinz.

Question:

My question is about Corning. Earlier you said that you liquidated your position. What was the reason?

Will Pan:

When we bought into Corning, we went in thinking that it would be an oligopoly with two Japanese producers. Corning produces 50% of the world's display glass that goes into TVs, monitors, et cetera. We knew that it sold this glass into a market denominated in yen. The yen had strengthened for a long time. So we knew there was a risk that the yen would weaken. In the first setback, we thought that because there were only three producers, the company would be able to maintain an oligopoly. It turns out that the customer base is also concentrated enough that the customers' decisions in terms of supply chain and inventory could also disrupt pricing in the supplier oligopoly. That is what happened. One customer, LG Display, which is the second largest panel maker in the world, decided that it was not so happy buying a lot of its display glass from a joint venture that Corning had with LG's main rival, Samsung. So that happened and caught the glassmaker flatfooted in terms of excess capacity. Because of that, pricing came down. In this industry, it is very, very difficult to get pricing because as you have no doubt noticed the price of LCD TVs has come down and down and down. The only way to sell more of these things is to produce and sell them for a lower price. So that happened and the stock fell a lot. In fact, we felt it was cheap at the time because it was hugging book value. We felt that what the management should have done is buy back a lot more shares. But historically, Corning's management has been very good at managing science projects so that every so often one will turn into a billion dollar business — Gorilla Glass being an example. Capital allocation, however, is not its first priority. We were a little bit disappointed by that. We took an opportunity to sell our shares.

Question:

I am curious when you began purchasing shares of IBM. I think Warren Buffett mentioned at the annual meeting that he is less confident about IBM's moat than he is about those of his other big concentrated stock positions. In light of that comment, the last couple quarters in which IBM had some challenging earnings reports, and speculation that the cloud is changing things in such a way that companies will increasingly consider outsourcing a lot of their infrastructure versus building it in-house, which has been one of IBM's strong points, your thoughts on IBM?

Will Pan:

We bought IBM in early 2010 and that was before Mr. Buffett bought it. I will note that his answer at the meeting was a little more lukewarm than it was the first time that he commented on it. At that point he talked about the strong customer relationships that IBM had and the way that its customers partnered with the company. This time he neglected to do that. I do not know what to read into that. But I would say that when we talk to customers, there is still this idea that IBM is a strong partner, not just a vendor. These are strong relationships that go back decades and decades. In more than one instance IBM has bailed out these customers; so they have strong loyalty to the company. We have noticed that IBM has struggled in the last few quarters, We would hesitate to put it all down to the cloud right now because the cloud is still a relatively small portion of total IT spending.

The cloud is a new way of delivering applications. A company wanting to build an application has to procure a server, wait for the server to come in, configure the server to work on its network, sell the application, and train everybody on the application. That takes a long time and upfront capital. In the case of the cloud you would have these vendors put together enormous pools of computing and offer it charging by the drip, basically, over the Internet. Instead of going through the rigamarole of buying their own servers and doing all this installation themselves, companies would call up their cloud vendor and just say, "We would like to use this application, will you turn it on for us?" And that is how they pay for it. It cuts down on a lot of the internal management costs.

IBM has said that the cloud is probably its biggest threat. IBM has said it is a $7 billion revenue opportunity but that $4 billion would be a shift of revenue that the company could lose to the cloud. So the management thinks it is a $3 billion opportunity over the current roadmap. That shift would happen — and that is obviously what you would be most concerned about — that shift would primarily happen in hardware because cloud vendors would buy a lot of commodity servers, put them all into a pool and sell by the drip again. Their scale could really further commoditize that business. Luckily, IBM is relatively small in that area. There are also some services that could be obviated. IBM does provide a lot of services to build the internal IT infrastructure, which could be outsourced to the cloud. But typical large enterprises have not just one or two applications, but thousands if not tens of thousands of applications. Today, they often rely on IBM to manage them. Even if a lot of these applications moved to the cloud, they would still require the ones that remain onsite to be able to communicate with the ones that they have moved to the cloud. Companies would still need integration and training to make sure that their business processes work with the new applications. So while there may be some shift away, we still think that IBM services will have work to do even in an era of cloud applications. We think that the trend is quite long-term. As I said, the spending on cloud computing is nascent right now. IBM is cognizant of the fact that over time this will be a more desirable way to consume corporate IT. Recently management has said that outside of a couple of core applications, things that are unique to a company and the company would want to keep in-house, up to 90% of the rest of the applications could be in the cloud, but it will take a very long time. In the meantime customers will want IBM to help them with that transition. IBM, by the way, sells ... you should think of it as, to a significant degree, a software company because 45% of the profits are coming from software. IBM is going to offer that service or all that software as a service over the cloud itself. So IBM will be able to take advantage of that opportunity as well.

Question:

A follow-up question on Ritchie Brothers — are you concerned that the company changed auditors last October after some investors seemed to raise questions about capitalizing some operating costs?

David Poppe:

Not really. This is completely subjective, but Arman and I have known the people there for a really long time. We probably followed it for three or four years before we owned the stock. The managers there are the last people I would worry about as far as that goes. They are not manipulators. I just would not worry about it. I do not think they are trying to put one past anybody.

Question:

If you could discuss Rolls-Royce?

Arman Kline:

Rolls is the second largest manufacturer of commercial jet engines in the world. It is increasingly getting into marine. Rolls, along with Daimler purchased Tognum out of Germany, which makes engines largely for marine but also for defense applications. Rolls is in defense aerospace as well. Rolls has been doing exceptionally well the last couple of years. I would say even better than we had imagined with the appointment of the new CEO, John Rishton. He was on the Rolls board, but he was also CEO of the supermarket chain, Ahold, which made him a surprising choice. However, he has done a wonderful job. He is zeroing in on the operational issues there. The business has very good growth prospects. Rolls has 100% of the Airbus A350 engine market, around 70% of the Airbus A380 and about 40% of the Boeing 787. Those are going to be 30 – 40 year programs and the A350 has not even flown yet. 787 production is just starting. So we are going to see some nice growth in production there. The common criticism people have of Rolls-Royce is not the earnings growth or the revenue growth, which is fine. It is that the cash flows do not keep up.

It amuses me because the reason that cash flows are not keeping up is that the company has to double its production capacity and spend a lot of money to insure that it can produce all these engines that Rolls has sold. That is a good problem to have, especially when your returns on capital are over 20%. So we feel just fine about Rolls.

Question:

What is keeping you up at night as far as how the economy is going to affect the portfolio?

David Poppe:

Clearly not much. Just what I said before; it is harder to source ideas when the market is up 50% in 20 months. We do have a lot of cash so there is

some — I would not say urgency but some need over time to find some good new ideas. It is difficult to make investments when you do not believe that interest rates are going to stay at this level for the long-term. You have to be pretty conservative. But I would just say it is hard to source ideas when the markets run this fast.

Greg Alexander:

The economy has things that it is vulnerable to such as higher interest rates, as David and Bob have alluded to. But it is not like it is at full capacity. If you take out three million retirees or something like that, who have had to go back to work because they no longer earn enough interest income to live on — there are barely any more jobs now than there were at the bottom. So seen from that point of view, you do not really know whether you are more hopeful that it could grow more or worried about some mishap down the road.

Question:

I have a question about Praxair. Would you talk specifically about its competitive advantage?

Trevor Magyar:

Praxair is an industrial gas player. It is one of four big global players. At this point the industry is consolidated around those players. That was something that happened over the last 10 – 20-plus years. Praxair's competitive advantage — I would probably focus less on Praxair's competitive advantage and really focus on the industry itself. It is an inherently good business. If you lined up the financial performance of the top players over the past twenty years, you would be pleased by all of the numbers. We think Praxair is the best house in a good neighborhood. The reason for that is Praxair, perhaps more than its competitors, is particularly focused on the way it manages the business from a financial perspective. The industry is rational and, as I said, it is a good business. But Praxair, more than its competitors, is focused on eking out every last point of margin. In particular, management is focused on return on capital, which is something not all businesses focus on. I would say that is the metric the company comes back to time and again, when you hear its managers talk about the business.

Over time, we think we are going to do incrementally better owning Praxair than owning any of its competitors. It is well recognized that Praxair manages the business in this way and it trades at a slight premium to its competitors. But it is one we really are comfortable paying. So again, I think Praxair, is probably the best house in a good neighborhood. We are happy with the business and we are happy to pay the slight premium for what we consider superior financial management of the business.

During the crisis we really saw that play out. Everybody in the end did quite well in this business; the industrial gas business turned out to be more stable than many people might have thought it would have been. Praxair in particular cut costs very early and very aggressively. If you look at the earnings trajectory of Praxair's business through the downturn, it managed it much better than its competitors and that was evidence of our thesis going in.

Question:

Can you tell us a little bit more about your research process when you are looking at a new stock? If you were looking at Fastenal for the first time today, can you tell us all the things you would do to get comfortable with it?

Greg Steinmetz:

In addition to reading everything, we also try to talk to a lot of people. In the case of Fastenal, we visited a significant percentage of its stores. The benefit of that is that it helped us get a lot of conviction and we saw a consistent story everywhere we went. Maybe that is what sets us apart a little bit; we really kick the tires. When David and I started, not too many people were doing that. Now a lot more do. So maybe our advantage there is not as great as it used to be. The way we can maybe still get an advantage is by redoubling our efforts and do it even more.

Question:

How long does it take to research a new idea, on average?

Greg Steinmetz:

Some things we look at two or three years before we buy them. But if we are really cranking on something — there are occasions when we throw bodies at something just to cover all the bases quickly because we think the price is good and might not last long.

David Poppe:

I would say a few weeks to a few years. And a few years is really not because we cannot figure the company out. It is most often because we do not like

the price. We know it and we will just put it on the shelf and wait and see, and continue to follow it.

Bob Goldfarb:

In the case of Fastenal, I would say going out to Winona, seeing its roots, meeting this eccentric visionary Bob Kierlin, who founded the company, and Will Oberton who was his choice to succeed him running the company — that was worth a lot.

Question:

Could you comment on QinetiQ?

Arman Kline:

We have talked about QinetiQ in meetings past, not always in a positive light. QinetiQ is a mid-tier UK defense contractor that had fallen on some very hard times. It was spun out of the UK military. People like to joke that it was named after the James Bond Q. But that is what the company does, develop high-end technology for the military. The folks who spun it out spent a lot of money acquiring a lot of businesses, put a lot of debt on the company and it was in rough shape. We used to own De La Rue, which did currency printing, and the CEO who turned that business around came in to take over QinetiQ a few years ago. He has done a very good job with QinetiQ even while its end markets, to no one's surprise, have been very pressured. The UK and the US are the two markets the company does business in. He reduced the debt position from almost 600 million pounds to net cash. He reduced the pension deficit from over 200 million pounds to about 30 million. He renewed a 25-year contract with the UK military. He has done an excellent job with that business.

He has actually found two or three technologies that have potential commercial applications today that could be quite valuable. OptaSense is the one application that everyone seems to be focused on. It uses a fiber optic cable, and it is just any old fiberoptic cable, and they put a box at the end of the cable. It can look anywhere within thousands of feet on each side of that cable and tell you what is happening. So people can use it to monitor oil pipelines to make sure no one is trying to break the pipeline. It has been increasingly looked at by Shell and others for use in fracking operations to measure pressures down below in the frack sites, production values, exactly where the fracking fluid is going. There are a couple other products that the company is working on around rail tracking. So there is some exciting stuff happening there.

It is a business that has been turned around, has a pressured end market and a CEO who has found two or three gems that could potentially be worth quite a bit in the future. Leo Quinn, the CEO, we have a high degree of confidence, will maximize value.

Bob Goldfarb:

We have time for one more question.

Question:

I wonder if you could go back to World Fuel Services. I think it has a large book of receivables. Just wondering what gives you the confidence that these receivables will be good? I think a lot of those receivables are uncollateralized.

Rory Priday:

That is part of the business. I mentioned earlier that a number of oil companies outsource their marketing departments and they outsource the credit-checking of customers. What happens is the oil companies will lend money to World Fuel at, say, ten days. Then World Fuels will go out and sell the fuel and it will get a receivable but not get paid for 30 days. There is a differential between the 30 days and the 10 days. So obviously the company has this big book of receivables. World Fuel, which generated $257 million of operating income, has only about $100 million of property, plant and equipment. If you exclude the goodwill and the intangible assets and you just look at the working capital and the property plant and equipment, the returns have been in the 20% range.

Bob Goldfarb:

The company has a huge credit department and it is a real competitive advantage. If you look at its credit record, it has just been terrific. So it is an investment in people that has been well worth making. With that, we are going to adjourn the formal meeting. If anyone has any questions, please feel free to come up and if you do not know who the analyst is, we will connect you with him. I want to thank you all for attending and look forward to seeing you next year.