Berkshire Hathaway annual meeting 2014_0503

You didn't make the five-year test of outperforming the SP500:

WB: We said in the 2012 annual letter that if the stock market was up again a lot in 2013 then our five year rule would be broken, as we would clearly underperform such a sustained move in the market.

CM: Warren has set a ridiculously high bar as BRK is dealing with after-tax while the SP500 return is measured as not taxed. If this is failure, we'll take it.

Will you spin out any units?

WB: We don't know another company that discusses intrinsic value or at least talks about it as much as we do. GEICO is worth $10B over tangible assets and arguably worth at least $20B over tangible assets. We would be happy—eager to buy BRK at 120% P/BV.

If Charlie and I had to write down a value we would probably be within 5% of each other, but we wouldn't be within 1% of each.

We try to give shareholders enough information to value the business. We try to tell you exactly the numbers and use exactly the words we use ourselves when we estimate intrinsic value, but we don't want to go beyond that.

The 120% of book value buy back is a large shout out that says just how cheap we think that 120% is—and if we are buying there we think the shares are significantly undervalued.

If you buy shares for 90 cents, you are doing shareholders a favor and if you pay 110 cents, you are doing them a disservice.

CM: We are not into ballooning the value of our stock up so that we can take advantage of that for ourselves.

WB: In the 1960's it was quite a game to get your stock as high as possible so that you could use it as a currency to acquire other companies. And if they will game to get the stock higher, they will game the earnings and other numbers. It happens in different cycles of the market. I have to stop there before Charlie starts to name names.

Keeping legacy businesses that have deteriorated?

WB: We list the economic principles in the annual report and explain our principles—that we won't sell the business, and we won't promise that we won't have layoffs, and we can't promise that we will keep the business forever, but we will continue to work with the business as long as it doesn't face never-ending losses or labor difficulties.

A private equity firm wouldn't do that, and for someone who has built up their company over twenty or thirty years and maybe their father or grandfather before that, they don't want to hand it over to a bunch of MBA's who want to show their stuff and tear it apart.

It's how we personally like to operate.

CM: It's worked well and we don't want to stop.

WB: You can see that he doesn't get paid by the word.

Howard Buffett is on the board of Coke and voted for the recent compensation package. How can we know that Howard will keep future BRK management from benefitting at the expense of shareholders?

WB: I've voted for compensation plans and acquisitions that I didn't agree with. Boards are part business organization and part social group.

I don't think I've ever seen a comp committee plan come in and ever get a dissenting vote. It's almost unheard of to question that. I'm not saying that is the way it should work.

The so-called independent directors are receiving perhaps $200,000 to $300,000 per year for working six days a year, with a lot of prestige attached to it. They want to get more directorships just like it.

I've been on the comp committee once—Charlie can tell you about that, and let me tell you that they aren't looking for Dobermans.

Howard's role as non-executive chairman is not there to select a CEO but is there to facilitate a change if something is happening that is disrupting the clearly defined culture that we have laid out over time at BRK.

CM: Warren was totally voted down at Salomon Inc. They were asking what the hell was he doing messing with compensation on Wall Street. It doesn't do much good to go shouting down everything that you don't approve of. If we all did that, we wouldn't be able to hear each other.

WB: In any social organization, if you keep belching at the dinner table, you'll soon be eating in the kitchen. It's not only when you do it, but how you do it. It's not helped by shouting a lot.

CB: I get into this more than you do, and I'm quite happy to not have your level of disapproval.

Berkshire's cost of capital?

WB: There's no question that size inhibits performance, and we are going to keep trying to push that size. We don't have Archimedes lever at Berkshire and we can't move the world.

To Charlie, our cost-of-capital is what can produce our second best idea, and that is the cost of capital. I've never heard an intelligent discussion of cost-of-capital. I've heard CEO's come in and talk about something and how it exceeds their cost of capital, and I think he doesn't know what he is talking about, so I just apply things in my own way and then vote for it, whether I like it or not—with a few exceptions (laughs).

We are paying $3B for the electrical transmission company in Canada because we think that is the best use of our dollars on that day.

"Cost of capital" evaluation is just a game as far as we consider. We are constantly measuring opportunity cost, as Charlie talked about in the movie.

CM: We just don't use that term. Warren's way of describing it as trying to use a dollar is a better way.

Nebraska Furniture Mart purchase price was below book value and two times earnings? What were the general market conditions that allowed you to purchase it at such a bargain price?

We paid 11 or 12 times pre-tax earnings. We bought 80% of it. $60M was the valuation, which was more than book at the time. Sales were about $100M. Pre-tax margins were in the 7% range, 4.5% after-tax—that's ballpark. It wasn't a bargain purchase, it was a great business, and we got to get involved with a great family.

A German firm was trying to buy them at the same time, and they were represented by Erskine Bowles.

I brought over a contract and Mrs. B didn't read so her son read it to her. I asked Mrs. B if she owed any money and if she owned the building. I told her that I didn't want to do an audit.

If you want to talk about bargain purchases, you should go out to Nebraska Furniture Mart…

On Tuesday, we did $7.8 million as an organization, which is more than we did in a month when we purchased the company. We own the largest in Sacramento, Boise, Las Vegas, etc.

And it's not too late for you to get out there and do your part to purchase something.

The new Dallas store is a remarkable store. We're putting in streets, utilities. This wonderful woman Michelle showed me around—the Blumkins told me that she started as a cashier. She's now in charge of this project worth hundreds of millions. Her number two was following her around and I found out that he is her husband. That will make for interesting pillow talk.

Why you are advising a trustee to put 90% of your wife's trust in the SP500 instead of Berkshire shares?

WB: We would like to clarify. That letter didn't come from Vanguard by the way?

When I die, every BRK share will have been designated to charities, and will not be distributed for the next twelve years after my death. I can't think of anything better to do in those next twelve years.

The part that I care about maximizing is for the trustees and I've instructed them to not sell a single share for the next twelve years.

CM: Warren is a little bit peculiar in the way he distributes money in the family, and I think he should be allowed to do whatever he damn pleases.

I've never had this feeling that I should starve the family. Warren's wife Susan before she died felt the same way as I do.

Warren is really quite a meritocrat, and he is quite insistent on it going back to the society he got it with. I like being associated with him.

Service problems on Burlington Northern routes?

WB: We have had difficulties on the northern route, particularly due to the volumes from the Bakken. There were a lot of days when it was fifteen degrees below or worse, and sending people out to work in those circumstances can be life threatening.

Matt Rose: Last year the industry grew 800,000 units (?—not sure of the figures he stated) and BN took 53% of that growth, and we had to build rapidly to absorb it. We had 83 inches of snow in Chicago—we had over 30 days where it didn't get to zero in the Minnesota are. When it gets to 0 or 10 degrees below, things just don't work.

WB: We will spend $5 billion on the railroad this year. No railroad has ever spent that kind of money.

We are talking about 22,000 miles of track. One of the weak links for all the railroads is Chicago—and that's for everyone and that's where the weather was tough as well.

Mix on natural gas versus coal for the utilities?

WB: Greg Abel would know more about the mix—Greg?

Greg Abel: As Matt mentioned, we had a very cold winter in the Midwest. If you look at natural gas and the gas availability, we are concerned with both the ability to generate electricity and to heat homes. There was enough gas available this year to do both.

If you look at what we produced on the renewable side in Iowa, it was 39% and that was wind.

We have very unique recovery mechanisms in each of our states to both service our customers and protect the economics of our business.

Our pipeline subsidiaries move about 8% of the natural gas in the United States. We just renamed the pipeline company from Mid-American Natural Energy to Berkshire Natural Energy. We have a lot of pride that we purchased the pipeline from Enron—well, it was held by Dynegy in the interim. When we purchased it, Enron had skimped on maintenance and it was ranked number 42 out of 42 pipelines in the U.S. for maintenance. Now it is number one and by the way we also own the number two pipeline.

Will you keep the dynamic duo going after you and Charlie go?

WB: Charlie has been my canary in the coalmine.

It's certainly likely to me that whoever succeeds me is going to have their own person who they've worked with closely. There's no doubt that Berkshire is better as a result of the two of us working together than it could have ever been without the combination.

It's a great way to operate, but you can't will it to somebody.

Matt Rose's chairman role change and Ajit Jain's successor?

WB: The only successor plan for Ajit is reincarnation. Matt Rose's move (to non-executive chairman at BNSF) had to do with Burlington Northern succession planning, and I wouldn't take any cues from succession plans at the subsidiaries as reflecting on what might be the succession plans at the parent.

You mentioned in 2009 as Wells Fargo being the best security to invest in if you had to put 100% of your money in it, what would you say today?

WB: Did you get that right? I would have said Berkshire. (The questioner answers that he had asked in 2009 any security other than Berkshire—and that today's question is what security besides Berkshire?)

I'm not going to answer that, and you won't be the first person disappointed with my answer. Anything to add to that Charlie?

CM: I think that is exactly the right answer.

Compensation for future CEO at Berkshire?

We are going to write about that a lot next year in the annual letter.

The next CEO is going to make a lot of money.

We follow the compensation guidelines of the SEC, and there are people in companies such as Comcast that would be hurt if you had to publish the five highest salaries paid at each subsidiary as they would have to publish what the highest anchors got paid at CNBC, etc.

At Salomon virtually everyone was dissatisfied with what they were getting paid, but not because of what they got paid but because of what other people got paid. When Salomon management made a secret deal to pay John Meriwether's group, it caused a lot of problems when people saw what they got paid, and I would say that they deservedly earned what they got paid.

It's only human to look at a bunch of proxy statements and say I'm worth more than that guy. American shareholders are paying a significant price for the ability to look at that proxy statement and see what the top five guys are getting paid.

CM: You are asking that in the interests of transparency, we should work against the interests of shareholders in providing compensation information that will lead to the company having to increase compensation. We are better off not adding to the culture of envy in America.

WB: There's no CEO who looks at other proxy statements and comes away saying I should get paid less.

CM: Envy is doing our country a lot of harm.

You spent a lot of money on NV Energy and the transmission lines in Canada, and it was done in one subsidiary, but not in another, while BNSF had $3 billion harvested from it—why does one sub buy something while another sub pays back to the holding company?

WB: BRK owns 90% of Mid-American Energy while Greg Abel and Walter Scott own the other 10%. BNSF isn't going to buy anything else and it can handle the debt. Mid-American has the right amount of debt.

We will invest a lot of money in the railroad, but it will be in the railroad and not for acquisitions. The utility will be making acquisitions.

We are finding things to do that will sop up the cash. We will always have $20 billion around Berkshire, and we will never depend on the kindness of strangers. We won't depend on bank lines. There will be sometime in the next 100 years where we will need to rely on our own strengths. We will not let one moment destroy us.

We lent money to Harley Davidson at 15% when short rates were something like half a percent.

Not having cash is like not having oxygen—you don't notice it most of the time, but when you need it and don't have it, you really notice it.

We'll always have $20 billion in cash, and above that we'll try to find intelligent ways to use it. So far we feel that we are able to put the cash out at reasonable returns.

CM: We love the opportunity that Mid-American and Burlington Northern represents to put a lot of capital to work, particularly in a world of lower rates. We consider it a real blessing.

Partnership with Charlie and moving money around subsidiaries?

WB: Charlie and I have never had an argument. We met in 1949 when I was 29 and Charlie was 35, and in the 55 years since we've never had an argument. We have argued with others.

I called up Charlie when I read the Coke proxy statement and I read it to him and he thought about it the same way I did.

I'm a little more inclined to action than Charlie—is that right Charlie?

CM: Well, you once called me the Abominable No-Man.

WB: What was the first part of the question? (How cash moves around the subsidiaries and operating companies?)

We don't count the money in the regulated energy business or the railroad. We only count the money that we could make a phone call and get.

All of our companies probably have more cash in it than a large conglomerate might do with a sweep account. I know what the cash is and I know what I may possibly do with a 50/50 probability of happening in the next several months, but it doesn't mean we try to get it all in the parent company on a day-by-day basis. We might do a sweep account sometime and that could make sense. We really don't want to get into that on a day-by-day basis. But I do know where it is and when I want it I'll grab it.

We have a subsidiary that we have had for ten years and I've talked to the guy who runs it maybe two or three times in those ten years, and there will be a lot of money occasionally in that business and every once in a while that will happen and he'll send a bunch to me.

Efficiencies?

WB: We are not that efficient in all things.

CM: I had a friend who was very skinny and went to give blood and when the needle went in the blood stopped flowing so the nurse starting milking his arms like they were udders and he thought they were going to get every drop from him no matter what it took and so he feinted.

We don't want our subsidiaries to feel that way with a sweep account where every dollar comes in and we reach in with our hand and take it away.

WB: Be careful Charlie, the managers of our subsidiaries are listening and I don't want them to have that analogy of sucking the blood out of them.

There will be some things that will happen because we didn't have some procedure in place that another company has, and we will naturally get criticized for it. But they won't be able to measure the benefits of doing things our way.

CM: By the standards of the rest of the world, we over trust. And our results have been better because of the selective way we have chosen people to over trust. I think cultures work better when there is a strong measure of trust. And this internal accounting system of controls culture that people are developing is going to make things worse.

Profit growth at See's in 1970's, 80's, and 90's but not since then? Can the relatively recent geographic expansion work?

WB: The box chocolate business has not been growing for a while. Box chocolate stores used to be everywhere—Chicago was a great example.

The predecessor to Pepsi was a candy shop company—he acquired Pepsi for a few thousand bucks.

See's has done very well. We can't do much about increasing the size of the market, and we've tried moving out of our strong geography many times. We looked at what we were earning in California and said if we could do this in the other 49 states then we could get rich, but it has never worked.

CM: But you've got to try.

WB: It's interesting, because in the East they like dark chocolates, 2/3rds to 1/3rd, while in the Midwest they like milk chocolate, 2/3rds to 1/3rd.

You can argue that we made a lot of money with Coca-Cola because in 1972 we bought See's and learned a lot about owning a brand. I don't think that we would have necessarily bought Coke in 1988.

CM: See's biggest contribution to us was primarily ignorance removal. Without that, we would never have amounted to much. We were very ignorant at the time, and that only removed a small amount of our ignorance. If there's one thing we are good at it is ignorance removal. And the good news is that we have a tremendous amount of ignorance that still needs to be removed.

WB: Well, that's what happens when I call on him.

Change in terms on the Bank of America warrants?

WB: I was happy to make the tradeoff to have five more years of non-callable 6% preferred that we can use to pay the warrants—and BofA can use it in their calculation of capital. And that was all before the error they made in their calculation of structured notes from Merrill Lynch—and by the way, that error didn't bother me, and it didn't change my feelings about BofA one iota. It did change their capital plan and they'll have to pay a penalty.

Making the preferred non-callable to us was good for us and it was good for them. Charlie?

CM: I agree with you.

NetJets was mentioned ten years ago as an exciting growth opportunity, five years ago as having problems, then nothing since—what is the current status of NetJets?

WB: There were a lot of people whose income fell off because it was tied to the stock market's fortunes, and when their contracts ran off and a lot of those ran off in 2011, they did not renew.

It is not a growth business at all. It is a very large business, and we are the biggest at 60% and it is a premier product.

We are going to China very soon and that is a very long-range play. We are Europe and that is declining in unit volume, but the hours have picked up after falling off a lot in the 2008 period.

I'm glad we own it and it is a very satisfactory business.

CM: I demonstrated my optimism by buying another 25 hours.

WB: He was a tough sell, let me tell you that.

How realistic is it to think of the stakes in Coke and Wells Fargo as a source of funds for future deals?

They could be used as a source but they probably won't be. Berkshire is all about purchasing earnings power.

If we found something we really liked, we have a huge reservoir of securities that we can dip into. It hasn't come to that. We have $40 billion and we want to keep it at $20 billion, so we have enough. It could happen this year, it could happen ten years in the future.

CM: Our purchases happen at irregular intervals. But our regular reinvestment opportunity in the railroads and the utility is very good for us and will play an increasing role.

WB: People think that what we really get excited about is finding a cheap marketable security, but what we really get excited about is finding a good business. We have Ted and Todd looking at marketable securities.

If we did need $10 billion, we wouldn't be getting it from those securities that you mentioned.

Borrowing money long term? Borrowing money to do acquisitions rather than using stock (BNSF)?

WB: If you had asked us a few decades ago about borrowing money long term when we saw lots of bargains around, we would have been happy to do it.

We don't like the idea of operating a conservatively operated company and then suddenly leveraging up and the bondholders finding they own a lower-rated company than what they thought they were buying.

We're fine with having conventional debt ratios at the operating subsidiaries.

Having another $30 billion or $40 billion of debt at the parent company would make a lot of sense, but…

We are selling structured settlements for example, and those have an interest cost to us that are less to us than if we sold bonds.

If we see a really good $50 billion deal, we'd find a way to do it.

CM: Even though what the questions suggests (of carrying long term debt) in anticipation of it is probably a good idea, we probably aren't going to do it.

Climate change?

WB: You mentioned a lot of businesses. I get lot of questions from people asking how it will affect our insurance business, and it really doesn't affect us in that time frame. Our year-to-year change in probabilities in any given year has no real effect on the pricing of our super catastrophe insurance policies.

We are happy to carry the coal, but we are a common carrier, so by law we are required to carry the freight that is offered to us.

CM: We are agnostic—it's not that we don't acknowledge global warming because it is clearly happening, but those who say that they know the consequences are talking out of their hat.

As economic variables, it isn't something by which we can change our whole investment policy.

We are very well positioned. Just like GEICO was well positioned when the Internet came along, so will we be well positioned when more energy is generated by the sun. We didn't plan for either; we just kinda stumbled into it.

How much do Ted and Todd now run? How much further will their roles expand? Etc., etc. When will they join you on the dais at the annual meeting? Etc.

WB: I got through college answering fewer questions than all of that.

They are managing $7 billion. They will be managing more in the future.

It makes sense to move more money away from me and over to them as the years go by. They know a lot about business and management and when I get involved in ideas that come across my desk that might involve a lot of time and I don't want to get involved in negotiating some small points, I am glad to let them do it.

They are happy to do it for no further compensation. They are very attuned to the BRK culture. I might say to them here's something to do if you want to put in the time to get the various points put together, and they are happy to do it.

Low interest rates and bubbles—how would you run the Fed?

WB: I would have been surprised five years ago that rates stayed so low for so long, but it has worked so well that I would hope that I would have done the same thing as has been done.

This is an interesting movie because it hasn't been seen before.

Bernanke has been a real hero.

It was interesting to me that when the notes from 2007 and 2008 came out, it was fascinating to me that there were a number of Fed members who just didn't get what was happening. I give Bernanke the credit to do the things he knew was necessary even when there wasn't consensus around him.

CM: No one in Japan would have predicted that interest rates could have gone down and stayed down for twenty years nor that stocks could go down and stay down for twenty years.

WB: I wrote on article in the WSJ that cash is king if you are going to use it, but is not king if you are not going to use it.

This is not a bubble situation that we are living in but it is an unusual situation.

The BRK model of owning disparate business hasn't worked well for anyone but you, so how well can it work when you go?

WB: Actually if you look at America, it has worked very well as a model. Look at the Dow index. Obviously it hasn't all been under one management.

Owning a group of businesses is a good idea.

Many of the financial conglomerates were put together to work financial magic. The Lytton industries, etc. and the conglomerates were put together to run a chain letter scheme of using 20x P/E stocks to purchase 10x P/E stocks.

I think our business plan makes tremendous success—to have a diverse group of businesses that is conservatively capitalized and managed well.

People forget that the issue of capital is really the allocation of capital. We have a tremendous advantage in that we can distribute cash among these subsidiaries without tax consequences.

Many of the conglomerates have had the primary focus of stock promotion. If you wanted to see the primary consideration of a business, you can look at stock issuance.

CM: We have an alternative when there are no other businesses to buy—we can buy securities. We are also different in that we feel no compulsion to buy. We are more like the Mellon Brothers than Gulf & Western. The Mellon Brothers did very well for forty years, and they were happy to own minority stakes in businesses and to own businesses.

Forest River and can companies come out of nowhere to compete with them?

Pete from Forest River is a terrific guy and not an MBA at all—and that's a statement not an observation.

Pete sold his company to a private equity firm who ran it into the ground so he bought it out of bankruptcy, rebuilt it and sold it to BRK ten years later.

I've never been to Forest River, it's in Elkhart, Indiana. I hope it's there. I hope they're not just making up numbers and laughing about it.

It's now a $4 billion business. I've had maybe three or four phone calls with him over the years.

I don't know the Thor vs. Forest River thing, but I think it would be very tough to compete with Pete on anything.

It's a tough business—maybe 11% gross margins with 5% SG&A, so 6% net margins. He's got an IT department of six people.

Your view on the oil sands industry and the impact on BRK?

WB: We have a crane business at Marmon that does a lot of business in oil development generally and certainly including the oil sands. We have just acquired an electrical transmission lines business that covers 80% of Alberta.

We move a lot of oil by train. Mentally you think of oil as gushing through pipelines, but rail is twice as fast as moving oil as pipelines.

We bought a specialty chemicals company from Phillips that has a specialty chemical product that moves oil through pipelines about 10% faster.

The oil sands are an important asset for mankind over the centuries to come, but I don't think it will dramatically change Berkshire.

CM: A lot of the oil sands production uses natural gas to produce the heavy oil. It is economic only if oil stays at a high price, and also only if natural gas remains peculiarly cheap, but it is a real benefit to mankind.

Before the lunch break, the update at the six year mark for SP500 vs. Hedge Funds. Now 43.8% for SP500 vs. 12.5% for Hedge Funds. Actually, we sold the treasury zeroes to fund the $1M wager and bought BRK stock, guaranteeing the $1M, and since that has worked out well, everyone is happy.

Makes errors due to business changes?

WB: Texas Industries went down because of changes in natural gas prices. It held on for a while because of some futures hedges, but it was going to topple.

All of our businesses are subject to change. GEICO started out by trying to acquire customers via letter.

BNSF is looking at locomotives that run on LNG.

To answer your questions, I will continue to make mistakes. We are not going to make

There were four department stores on the corner on the Howard and Lexington in Baltimore in 1966 when Charlie and I and Sandy Gottesman bought it. You can't think of a worse idea than buying a department store in the mid-1960's. Luckily for us, Sandy was good at scrambling out of it and sold it and we took that $6M and turned that into about $45 billion in Berkshire Hathaway.

CM: I talked about removing your ignorance. There is also not quite as important a thing as scrambling out of one's mistakes—the department store, the trading stamps, the textile company. Imagine what we would be if we had a better starting story.

Heinz earnings?

WB: Heinz will be filing their first 10-Q and you will be getting to see their figures.

It was a reasonably well-run food company, running at 15% pre-tax operating margins, which isn't unusual for the industry.

We think that the numbers going forward will be considerably improved from those historical norms.

Should you have invested more in tradable securities in 2008 and 2009 rather than in operating businesses?

Looking back, I was too early when I purchased $16B in October/November of 2008. And we had $6B committed to the Mars purchase of Wrigley.

The timing could have been improved dramatically, but we don't really know how to do that.

In late 2009, when the economy was still in the dumps we were able to buy BNSF.

When we bought Harley Davidson bonds at 15%, looking back we should have been buying the stock.

At our present size and scope and with the objectives we have for our shareholders, we want to buy good businesses of reasonable size and try to build those over time, and make sure we don't issue any shares in the process.

CM: The private companies are now worth way more than the stocks, and I think that will continue.

WB: When we write about stocks, it shows up as net worth, but when we talk about businesses, we talk about future earnings value. The latter is more enduring and it doesn't require going from flower-to-flower.

CM: If you are involved in investing moderate amounts of capital, you can do enough at the bottom tick, but if you have a lot of capital, there's often not much you can do there.

I love it when we buy transmission lines in Alberta. I don't think anything bad is going to happen in Alberta.

Since change is inevitable, how you adapt to it is terribly important. I'd say that any changes that you've seen over the years and how we adapted to it has been pretty good.

We bought Wells Fargo at that time, and buying banks of lesser quality would have earned higher returns. The recovery of the economy bailed them all out.

It's like buying the worst copper company—if the price of copper goes up, it'll perform the best.

Looking back, you could say that we should have just bought them all (the banks), and especially the ones that did the worst since those that had the worst sell-off had the highest possibilities in a recovery.

GEICO and usage based pricing?

WB: Progressive does "snap shot", which is the most known usage based pricing. There's no doubt that knowing the habits of your drivers will help you evaluate the propensity of loss. It's easiest to know with life insurance—at 90 and at 83, someone is more likely to die than someone at 20.

There are various variables in insurance and you try to assess those variables and set the proper price for the policy. If you lived in a state with 1 person, there would be a lot less likelihood of getting into an accident.

Usage info is trying to figure out the likelihood of that particular driver to be in an accident. We think we have a lot of very good and important variables. I feel very good about GEICO's management and their ability to evaluate risk. But we ought to keep asking ourselves can we do it better?

When you get to the self-driving car, that is a real threat to the auto insurance industry. If that leads to less accidents, then that is very good for society and not good for the auto insurance industry—but in any case we would not be thinking about selling GEICO.

CM: These changes can take quite a while. Self-driving cars might take a while.

WB: But we could be wrong.

CM: We could be wrong.

WB: But if we are wrong, we'll be wrong together.

GEICO will be doing more business in ten years than it is doing now.

Attempts to make BRK better known as an international acquirer, such as with Iscar?

WB: We've never turned down a chance to make a significant acquisition outside the U.S. simply because we preferred to do something inside the U.S.

But we haven't had as much luck getting on the radar of owners around the world as we have been in the U.S.

Our strong suit is getting the owner to sell to us, and I think that is well recognized by companies in that situation in the U.S.

As with Iscar, there has been some awareness, but I've been disappointed with not having more.

BTW, Iscar is seeing strength in their business, which makes it hard to believe that there is weakness in the industrial world.

How does one figure out what one's circle of competence is?

WB: It is a good question. It is a question of being self-realistic, and that applies outside of business as well.

I think Charlie and I have been reasonably good at defining the perimeter of that limit. For myself, I have gone out of that area more often in retail than in other areas. I was outside my circle of competence when I decided to change my plan from selling shares of BRK to buying control, but that ended up working out.

Mrs. Blumkin didn't take BRK stock, which some people might consider a mistake, but it wasn't. She knew what she didn't know. She knew real estate and retail and that took her a long long way.

CM: I don't think it takes that much to figure out competence. If you're 5'2" you probably shouldn't count on the NBA, if you're 95 years old you probably shouldn't count on being the romantic lead in a Hollywood movie, if you're 300 pounds you shouldn't count on dancing in the Bolshoi ballet…

WB: You're ruling out all the things I want to do.

CM: I just knew that it would help to compete against idiots, and luckily there are a lot of them around.

What is the logic in comparing the rise in the SP500 versus the performance of an operating company?

CM: Let me answer that. It's insane, you're right. It's Warren just trying to make it impossibly hard on himself.

WB: Normally when he goes all wishy-washy I like to clarify, but I'll just leave it at that.

Multiples paid over time for Iscar and Marmon?

WB: We made a structure struck at the time of the deal for Iscar with a put and call structure—they owned the put and we owned the call. Our style would be to never call the call away from the family. The Iscar family put the put to us, but it was in the same pricing as the original 80%.

Marmon was different—it was an installment sale. The family wouldn't have sold us the 64% in the original piece if they didn't have the levels for the second levels. We looked at it all as a combined price.

CM: The price went up because the value went up, and we agreed that we'd pay value.

WB: Both with the Pritzker family with Marmon and the family with Iskar, they couldn't have behaved better. It pays better to deal with good people like that.

CM: The more involved we got with those companies, the more respect we felt toward both those families and what they accomplished.

By the way, the Union Tank Car that is inside Marmon is the original company that John D. Rockefeller owned.

WB: Actually, the Rockwood company, which is what it is wrapped in, was the original structure that I met Jay Pritzker with (referring to the Cocoa play?)

The more you think that these things are just something you will see once, the more it seems they come back around to you fifty years later.

If you were 23 years old and not a software/tech engineer, what would you do with your entrepreneurial instincts—what area would you go into?

WB: I would do what I did at 23 years old and go into the investment business. And I would look at lots of securities and talk to lots of people.

When I visited 12 coal companies—I just showed up and talked to the managers. I always asked them the same questions—I asked them what company besides their own would they put in 100% of their money for 10 years if they couldn't touch it. And then I asked them if they had to short an equivalent amount via another coal company, which one would they choose. And after going around all those companies, I'd know a lot more about the coal industry than a lot of those managers would know.

CM: You should do like Larry Bird, who asked a lot of agents who would be their number two choice—and when they all said the same person, Bird hired him and negotiated the best contract of all time.

WB: It is literally true that if you talk to enough people about something they like to talk about, and here we are talking ourselves, you will find your spot. You will find what fascinates you. If you're lucky you find it early.

CM: If it is a very competitive business and requires qualities you lack, then you should probably avoid it. When I was at Caltech, I took a thermodynamics class and realized I wouldn't be a superstar. I did this again and again until there were only a few areas left.

WB: The same thing happened to me in athletics.

Berkshire weekend price gouging for hotel rooms in Omaha—don't your complaints amount to a complaint about supply and demand and basic business economics?

WB: Yes, and that's why we are trying to increase supply. We'd like to get AirBNB here.

You can totally outstrip the rational supply of rooms—Augusta can't size its hotel industry to the Masters event. And Omaha can't size its hotel size to the BRK weekend. What really bothered me about the three-day minimums is that it is a one-day event.

The Omaha Hilton, BTW, has been great, as have a lot of others. We're not moving the meeting to Dallas. We can't expect Omaha to build more hotels, but something like AirBNB will do well to meet flex supply needs.

CM: Nothing to add.

Can GEICO overtake State Farm despite State Farm also writing home owners insurance?

GEICO did overtake State Farm this year. State Farm has one of the great business stories in American history. It was started by a farmer in his 40's who had no insurance experience—the book *Farmer from Merna* writes about it.

State Farm has a net worth of $60B to $70B and has a strong presence in homeowners and a strong agency force, so being bigger than State Farm won't come fast, but it will come.

CM: GEICO is to me a lot like Costco. They both feel a very strong duty to bring their product to the customer at a very low price. It's in their bones.

WB: We don't lose people at GEICO, is that how it is at Costco?

CM: It's easy to talk the game, but it is very hard to play the game. It's hard to keep the prices coming down and the level of service going up.

Admiration of WB's frugality—at what point has your frugality hurt BRK?

CM: Warren has been more frugal in his personal life than I have been.

WB: Care to give some examples?

CM: In personal consumption, Warren is more frugal. Warren lives in the same house in 1958.

WB: You moved into yours in 1960.

CM: But I paid more.

WB: But you designed it yourself.

CM: I paid an architect $1900, which was 30% off his regular price.

WB: Notice how he remembers the numbers.

There's not a direct relationship between the amount you spend on lifestyle and your happiness.

My life wouldn't be happier if I had six or eight houses, in fact it would be significantly worse. Having everything I have, well, you can't have more than that. It only makes a difference up to a certain point. It makes a point up to X, but once you get to 10X or 100X it doesn't make a difference.

CM: I look around and see a lot of frugal people here. We collect people like you.

WB: Yea, but not this weekend. Get out there and spend. Remember, the more you spend the more you save.

Taxes:

WB: When we figure out our 20,000-page tax return and file it, we don't then say let's add on a 15% or 20% tip.

Railroads and Mexico:

WB: Union Pacific and Kansas City Southern have a big route advantage and presence in Mexico. It doesn't make sense for us, as the math doesn't work for Mexico. There are lots of possibilities for moving freight on the BNSF over the years. We won't forget about Mexico but we won't do anything silly either.

CM: There's a lot of things you can think of that will work well, like buying a competitor, that you just can't do. So there's not much use in spending time thinking about that. BNSF will have to get along well on its own.

WB: And I wouldn't worry about that.

Management generalities? Why has no one else done what you have done, Coke has its Pepsi?

WB: Graham didn't talk much about intrinsic value. I'm not sure where it started. Actually it started with Aesop. The intrinsic value of any business if you could see perfectly is the present value of every bit of cash generated between here and eternity. Aesop said a bird in the hand is worth two in the bush—he said that in about 600 B.C., and he then left it to us to work the rest of it out.

Graham emphasized financial factors for those birds in the bush, while Fischer emphasized business quality factors. I emphasized what Graham had said. Charlie came along and told me that I was wrong. He said that he had learned more in his law studies than I had learned in my business studies.

If I had a silver bullet, there isn't a competitor I'd shoot, because I don't see anybody doing what we are doing.

CM: I think the BRK model as now constructed will go a long time.

If you think about all the old businesses, not really any of them got big and stayed big and is still around. About the only one was Rockefeller's Standard Oil. I think we'll be like that. It's going to keep going.

There's nothing in American business school that teaches people to do what we do.

Dr. Ed Davis had an operation that had a 2% death rate while the other procedure had a 20% death rate. Doctors came to observe him and walked away saying they couldn't do that as it was too hard.

Likewise how people look at us.

WB: And it takes too long.

CM: Yes, and it takes too long and you'll be dead before you see it work.

Carole Loomis: With that happy thought, I've got something on a happier topic—Inflation?

WB: Let's assume tonight that drones are set up all over and drop a million dollars into every household tonight. The one thing I can guarantee you is that BRK would be worse off than before. The trick in that situation is to find out that you have a million dollars before anyone else knows they also have it.

You don't create wealth by moving money around.

CM: We had a test of hyperinflation in Weimar Germany. And the people who had stocks got through—they didn't prosper, but they got through. While people with insurance policies and bank accounts were wiped out. But if it leads to a Hitler and world war…I never forget Weimar Germany. I just don't trust politicians printing a lot of money.

WB: But if you had a home with a large mortgage, you'd benefit from that, as you'd own the home in the end.

Acquisitions?

CM: I think it is in the nature of large corporations to destroy wealth via acquisitions. It has worked for us, but we are peculiar in our own way.

WB: When we read that a company we don't control is going to make an acquisition, I'm more inclined to cry than to smile. But we make acquisitions ourselves, so I'm a bit hesitant to criticize.

I've sat in on over a hundred acquisitions in companies we had minority stakes, and most (nearly all) of them weren't a good idea.

CM: Sometimes they were just merely mediocre.

WB: The costs of the acquisitions are in two parts. The accounting costs are often poor but not disastrous, but taking your eye off the ball is a huge cost. For GEICO, taking their eye off the ball cost them twelve years they could never get back. That probably benefitted us, because we owned half and we were able to buy the other half as a result.

CEO's are generally not shrinking violets. They have people in charge of strategy, and what are those people going to do? They're not going to be sucking their thumbs. And Investment Bankers will be calling on them every day. There will be a lot of eagerness to do deals.

We are not in a hurry to do a deal. We don't have board members pushing a deal, or a strategy team coming to us with ideas and all sorts of institutional eagerness to get something done. The setting in which you operate can be really important.

Charlie, anything you want to add to that?

CM: Just notice how tactful he is.

WB: Well, the comparison isn't very tough.

Criminal charges against banks?

CM: Behavior on Wall Street has been improved as a result of the drama that we just put behind us.

WB: How do you feel about the prosecution of individuals versus the prosecution of businesses?

CM: I think that a few criminal prosecutions of individuals does change behavior a lot. When you put a few people from the steel companies into jail for price fixing, that changed behavior a lot.

WB: I may be influenced by my experience at Salomon Brothers, but the experience of a bad act by someone, maybe by a couple persons, followed by the lack of reporting by a few persons, that it could lead to the loss of jobs for thousands of people not to mention the financial investments being wiped out…

The prosecutor probably has an easier case and more of a headline-grabbing case if he goes against the company rather than the slog-it-out uncertain outcome of going against individuals, but I still think it would be better.

We have 300,000 people at BRK, and I know that right now there is somebody somewhere doing something wrong. We can do our best, but it is not going to cure everything. 300,000 people are not going to behave perfectly every day.

At Salomon Brothers, and I've written about this previously, the lesson is that the consequences have to fall on the individual and not merely come onto the company to write a big check.

Industry insurance fund for worst-case scenario railroad accidents?

WB: We are on both sides of that. Ajit has offered an industry policy with very high limits to the industry, but I guess they haven't liked the pricing of the policy.

The four railroads have a lot of financial strength.

The railroads, as common carriers, have to carry HazMat that they really don't want to carry and that they aren't getting compensated enough for to cover the risks.

The four railroads have a lot of financial resources. It isn't wise for them to discuss their insurance thresholds and disclose that to potential claimants. But they haven't sought out additional insurance at the pricing that Ajit has offered to provide.

The nuclear industry as well as the terrorism insurance is too big for the industries and the government has taken that on.

CM: No one thought the risk of drilling in the Gulf was as large as it was until BP. No one should want to drill in the Gulf again, as there was no possibility of gain that would outweigh that cost. It was a large field, but not even close to being large enough to pay that cost.

The worst railroad accident cost something like $200M…

WB: (Interrupting) I don't think Norfolk Southern ever publicly announced what that accident cost them…

CM: We saw how much one pilot could cost with a small plane in Asia.

Timing of recent entry into commercial insurance field?

WB: We entered the commercial insurance field in the last year with some terrific talent. We thought that we could both underwrite more intelligently than most with higher limits than anybody while managing at lower costs. Throw in Ajit Jain and we believe we have a great opportunity.

CM: I think it is a very logical thing for us to do. When something is logical for us, we don't hold back because of the timing of the business cycle.

WB: Yes, it is a forever play.

When we see a chance to enter a business where we have some competitive business advantages, we are going to enter and play the game and play the game hard.

Would you be interested in buying a sports team or sports management company?

CM: Warren's already done it.

WB: I own ¼ of a minor league team, but it's not responsible for my position on the Forbes 400. If you see either Charlie or I talking about owning a sports team, then it might be time to talk about successors.

We own Spalding and Russell sports equipment. Making sports equipment is not a particularly profitable business. We should definitely not own a helmet company. A helmet company should be owned by someone who owes a million dollars.

A company that provides guards at airports should be owned by someone whose net worth doesn't add up to two figures.

Charlie, are you looking at the Clippers?

…no answer…

Now I'm worried that he is!

CM: Whatever Warren thinks about sports team, I think even less.

Ackman comparing his purchase of Allergan to BRK's maneuvers with Coke—comment? And what do you think about the larger trend of activism?

WB: Clarify the Coke comparison? (More description.) We never used derivatives to acquire a stake and never did anything against the SEC rules.

As for activism, it's not going away and it is scaring lots of managers. The money flowing to activist hedge funds is getting bigger and anything on Wall Street that looks successful is going to be copied until it doesn't work.

CM: It is causing quite a stir in corporate management and nothing similar has happened in years. When an activist comes in, the shareholder base can change by 40% in a short amount of time. And in our culture, nobody seems to care where the money comes in, they just care that they made it.

What happens when somebody you wouldn't want to marry into your family goes after a business you wouldn't have an interest in buying into? It reminds me of Oscar Wilde's quote about fox hunting: "The pursuit of the uneatable by the unspeakable."

WB: Where do you think it will be three years from now?

CM: Bigger.

WB: Wow.

Building BRK earnings power?

WB: One $10B deal is equal to three $3B deals, which is equal to one hundred $30M deals. It makes more sense for us to look at the bigger deals. But I want to emphasize that one does not preclude the other.

What is the most intelligent question you've been asked recently about investing and what was your answer?

CM: I already answered that in reference to the question of comparing BRK's performance as an operating company to the SP500.

WB: I am asked that question by a lot of student groups, and I don't have a good answer.

CM: I don't like the question.

WB: Either do I—that's why I let you go first.

Allocation of capital to businesses where the return on tangible assets has been under 1%?

WB: You were doing great until you hit the return on tangible assets.

The return is not measured by the net cash generated.

It is measured by the operating earnings after depreciation.

We like the idea of having investments in regulated industries with required demands for investments, and we believe that the regulators will continue to treat us fairly.

We have been able to deliver rates significantly below our competitors.

If you look in Iowa, we have a director who owns a farm with two electricity providers and he is able to buy electricity at significantly lower rates than he can via the cooperative.

States welcome us as we are a good operator, and we believe that the regulators will treat us fairly.

CM: If the numbers you just quoted were coming from a declining department store, we'd feel that we were doing terribly, but when it is coming from a growing business, we feel good about it.

Greg Abel: We are generally the low cost provider or the lowest quartile. In Iowa, we had our first rate increase in 16 years and we don't see another one for a long time. Obviously with that type of track record, you have a lot of goodwill with the regulators. We have a $1.9 billion project in Iowa right now and we should earn 11.6% on that.

WB: Can you comment on the tech companies and Iowa?

Greg Abel: We service Google in Council Bluffs, and they are taking it to 40 or 50 megawatts, but they are talking about taking it to 1000 megawatts. It's two parts—one is that we have low rates, and the other part is that we are producing a lot of electricity with renewable power and the companies want those credits and want to be associated with that policy.

Education in America and China in the future?

CM: I think America made a big mistake when they decided to let the education system in some major areas go to hell. I don't think the Asian systems will make the same mistake.

Housing reform?

WB: The thirty year fixed rate mortgage is a terrific boon to homeowners. It might not be such a great investment for investors, but it has let people get into homes earlier than they might otherwise and more affordable than otherwise.

Government's guarantee is essential to that, as the mortgage market at something like $11 Trillion dollars is just too large for private sector guarantees.

The question is how do you keep government in the picture without keeping politics in the picture?

I wrote an article about this twenty years ago.

There could well be a way that a model could work with home mortgage insurance. I don't think that we'd be a player as others would probably be more optimistic than we would be.

Perhaps you could have private industry guarantee 5% and set the pricing and then the government could guarantee the other 95% and in turn guarantee that private industry 5% if they failed.

CM: When we let private industry take it over we got the biggest bunch of criminals and idiots and they nearly took us all down.

I'm not excited about politicians getting involved.

I don't want to get back to where investment banks were having a race to the bottom and creating phony securities.

WB: One of the things that led Freddie and Fannie astray was serving two masters. If they weren't trying to keep increasing earnings 15% and then become the largest hedge funds because they could borrow for very long, rather than just providing insurance.

CM:

WB: Would you let them have portfolio activities at all?

CM: No I wouldn't.

WB: I wouldn't either.

CM: I think that particular experiment in privatization was a total failure.

We made a billion dollars out of that by the way.

WB: I didn't want to mention it.

Whitney Tilson—book about George Paulo and the Brazilian team 3G who are running Heinz. We hear a lot about zero based budgeting, but what is really their secret sauce?

WB: That book was originally written in Portuguese. Now translated to English. Just want to mention we have the book downstairs.

Whitney Tilson: And it is the only place you can buy it in English, as amazon only has a kindle version.

WB: Raise the prices!

WB: They are a very good team. If you read the book, you'll learn a lot more about what they are.

We want to be good partners ourselves, because that attracts good partners.

Charlie and I ourselves do a lot of that ourselves, but it takes a lot more than that.

CM: The best way to get a good spouse it to deserve one. The best way to get a good partner is to deserve one.

You can't skirt the fact that they are very good at removing unnecessary costs. I don't think there is anything immoral about removing unnecessary costs. I think it should be done with sensitivity. But it needs to be done for the good of society and can't be ignored.

WB: Which is why we can't have government doing it (removing unnecessary costs).

Looking out to the future, BRK's value will double and then double again as will possibly its excess cash—what to do at that point?

WB: Who knows what the circumstances and tax law will be in the future? But I do know that there will eventually be a point at which we won't be able to intelligently deploy everything that is coming in. Maybe we will be able to intelligently buy back shares. All I can say is that whatever is done will be done in the best interests of the shareholder.

CM: It's not a tragedy to succeed so much that future returns go down. That's winning.

Disruptive businesses like AirBNB?

WB: Obviously those are disruptive businesses and competitors will fight back. They will try to fight back in many ways. Some will try to fight back with legislation.

If you look at the insurance industry, the objective was to get the agent, not the policyholder. Then State Farm and GEICO came back with a better mousetrap.

One way that insurance companies fought back was to seek state legislation on what agents could do and what insurance companies could not do.

We know there will be change and we sometimes don't know who the winners will be.

With the utilities and the railroads we feel we can know who the winners are going to be. With other industries, we don't know, but we watch and we find it very interesting.

CM: I think the new technology is going to be very disruptive to retail.

WB: Where do you think we are vulnerable?

CM: I don't really want to say.

Habits? Financial illiteracy?

WB: Habits are certainly important, and financial habits are important. I get letters all the time from people who have dug themselves into holes due to financial illiteracy.

You mention childhood financial illiteracy, but there is a big problem with adult financial illiteracy.

It's hard to be more financially illiterate than your parents; maybe the schools can do it. Television and Internet could educate. Anything you can do very early through the school system would be helpful.

CM: I don't think the fault lies with the schools, but with the behavior of the parents.

WB: How do you fix that?

CM: I don't think I can fix the people with the wrong parents.

WB: If you tried?

CM: I've only found I'm able to fix the people in the top 5%. Otherwise I can't do it. And I would say that you couldn't either.

WB: And you can imagine what he would say to me if we weren't in public!

CM: And don't think it gets better in the higher education. They are ridiculous. They say things like imagine the net utility is zero… How about talking in plain English?

WB: In the schools you had to subscribe to this orthodoxy that is just plain wrong. It may have soured my views on education in the fields I knew something about. It's starting to move away from that, but…

CM: You may have liked education better if you had studied physics rather than finance.

WB: I'm glad I didn't.