

**RUANE, CUNNIFF & GOLDFARB INVESTOR DAY 2015**

**ST. REGIS HOTEL, NEW YORK CITY**

**MAY 15, 2015**



## Disclosures

Please consider the investment objectives, risks and charges and expenses of Sequoia Fund, Inc. (the “Fund”) carefully before investing. The Fund’s prospectus contains this and other information about the Fund. You may obtain year-to-date performance as of the most recent month end, and a copy of the prospectus by calling (800) 686-6884, or on the Fund’s website at [www.sequoiafund.com](http://www.sequoiafund.com). Please read the prospectus carefully before investing. An investment in the Fund is not a deposit of a bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Average Annual Total Returns as of June 30, 2015	Year to Date	1 Year	5 Years*	10 Years*
Sequoia Fund . . . . .	9.78%	17.04%	19.04%	10.30%
S&P 500 . . . . .	1.23%	7.42%	17.34%	7.89%

\* Average Annual Total Return

The performance data shown represents past performance and assumes reinvestment of dividends. Past performance does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Year-to-date performance as of the most recent month end can be obtained by calling DST Systems, Inc. at (800) 686-6884.

The S&P 500 Index (the “Index”) is an unmanaged, capitalization-weighted index of the common stocks of 500 major US corporations. The Index is not meant to be indicative of the performance, asset composition or volatility of the Fund. The Fund’s results may differ markedly from those of the Index, in either up or down market trends and interest rate environments. Unlike a mutual fund, the performance of an index assumes no taxes, transaction costs, management fees or other expenses. It is not possible to invest directly in an unmanaged index.

As reflected in the current prospectus, the Fund’s Annual Fund Operating Expenses for 2014 were 1.03%. Ruane, Cunniff & Goldfarb, the Fund’s investment adviser, has agreed to reimburse a portion of the Fund’s operating expenses. This reimbursement is a provision of Ruane, Cunniff & Goldfarb’s investment advisory agreement with the Fund and will be in effect only so long as that investment advisory agreement is in effect.

Investing in the Fund involves risk. Investors should carefully review the risks associated with an investment in the Fund and understand those risks before investing. The principal risks of investing in the Fund include market risk, value investing risk, non-diversification risk, foreign (non-US) risk, currency risk, small-cap and mid-cap company risk, managed fund risk and liquidity risk. As of June 30, 2015, the top ten holdings of the Fund included:

Valeant Pharmaceuticals International, Inc. . . . .	28.7%
Berkshire Hathaway, Inc. . . . .	10.6%
TJX Companies, Inc. . . . .	5.0%
O’Reilly Automotive, Inc. . . . .	4.3%
Fastenal Company . . . . .	4.2%
MasterCard, Inc. . . . .	3.2%
Precision Castparts Corp. . . . .	2.7%
Mohawk Industries, Inc. . . . .	2.5%
Idexx Laboratories, Inc. . . . .	2.3%
Google, Inc. . . . .	2.0%

**Disclosures (continued)**

*Any sector focuses of the Fund are subject to change, and past returns are not indicative of future returns. The cash generation of a company in which the Fund invests may not continue given market or other conditions, and portfolio turnover may change depending on future circumstances.*

*Fund holdings and/or sector weighting are subject to change and should not be considered recommendations to buy or sell any securities. Current and future portfolio holdings are subject to risk.*

*Shares of the Fund are offered through the Fund's distributor, Ruane, Cunniff & Goldfarb LLC. Ruane, Cunniff & Goldfarb LLC is an affiliate of Ruane, Cunniff & Goldfarb Inc. and is a member of FINRA.*

*The opinions expressed below are those of the personnel of Ruane, Cunniff & Goldfarb and should not be considered a forecast of future events, a guarantee of future results, or investment advice. The following has been edited for clarity.*

---

---

# Ruane, Cunniff & Goldfarb Investor Day 2015

*St. Regis Hotel, New York City – May 15, 2015*

---

---

*Remarks have been edited for clarity and relevance.*

**Bob Goldfarb:**

Good morning and welcome to our investor day. We are going to follow the same format we have followed for a number of years. 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 one o'clock to answer any questions that you may still have. Before we begin, I would like to introduce our team. On my right are Greg Alexander and Greg Steinmetz. On my left are David Poppe, who is the president of our firm, 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, Jon Gross, who is our director of client services, John Harris, Jake Hennemuth, Arman Kline, Antonius Kufferath, Trevor Magyar, Scott O'Connell, Will Pan, Terence Paré, Rory Priday, Chase Sheridan, Inder Soni, Stephan van der Mersch, and Marc Wallach. I would also like to introduce the directors of the Sequoia Fund, who are seated in the front row: Vinny Ahooja, Roger Lowenstein, and Sharon Osberg. Bob Swiggett is away in Africa. Who wants to ask the first question?

**Question:**

Howard Schiller has resigned as the chief financial officer at Valeant Pharmaceuticals after four years. The *Financial Times* joked that he may be exhausted from "all this fiddling." With Valeant's lofty stock price likely bringing its percentage of our fund's assets to upwards of 20% and with the company's accelerated growth likely to be impacted by the specter of rising interest rates, have you been reevaluating our position?

**Rory Priday:**

He has done quite a bit of fiddling. The market cap since Howard Schiller joined Valeant went from less than \$15 billion to over \$70 billion today. But I think some people get burned out at the company just because of the number of deals that they do and the number of products that they manage. Some people refer to their time at Valeant as a tour of duty. It was a little concerning for us that he left, but he is going to be on the board hopefully for a long time. He told us that he would be there as long as

investors wanted to have him. So I do not think he is going anywhere.<sup>1</sup>

**David Poppe:**

The fact that Howard is staying on the board is a pretty strong sign that there are no disagreements or unhappiness. Not so long ago, he was telling us that Valeant closed a deal at eight o'clock at night on New Year's Eve. It is a very intense pace. Sometimes you make a lot of money and that pace is too much. I think it is more about that than it is about anything else.<sup>2</sup>

**Question:**

Last year you spoke about your investment in Rolls-Royce. In your December report, it was quite a horror show that was reported for Rolls-Royce. Could you give us an update?

**Arman Kline:**

We try to be supportive of the companies we invest in, but sometimes we do not agree with the management team. That is what happened at Rolls-Royce. The board has now chosen a new chief executive with whom we are pleased. We have not had a chance to meet him yet, but I was in London last week and met with the board. The strategy seems to be more in line with what we would like to see. We are looking forward to meeting the new CEO. Our initial research on him has been positive. So we are cautiously optimistic, and we continue to think that the core aerospace business at Rolls-Royce is very attractive.

**Question:**

How do you think about selling a company? Is it because there is a negative development at that company or is it more because of a change in your thesis about an industry?

**David Poppe:**

If I understood the question correctly, you have noticed that we sometimes sell when there is a negative development at one of our companies. So, is our general strategy to sell upon negative news or do we sell for some other reason? Speaking broadly, we always sell based on valuation. Valuation can seem too high because of negative developments, but

---

<sup>1</sup> Subsequent to the Ruane, Cunniff & Goldfarb Investor Day, Mike Pearson announced in a public forum that Howard Schiller was one of two potential successors.

<sup>2</sup> On 11 June 2015, Valeant announced that Robert L. Rosiello, formerly McKinsey's Senior Partner in charge of its global merger practice, would take over for Howard Schiller as Valeant's Chief Financial Officer on 1 July 2015.

every situation is unique. So it depends on what the negative development is. Some things are temporary and fixable, and some things may seem more intractable. We would not be sellers because there is negative news like a short term earnings miss or something like that.

**Question:**

If I could ask about Valeant as well.... Being students of the family of Berkshire, can you discuss your views and perhaps comment on what Mr. Munger insinuated about Valeant recently?

**Bob Goldfarb:**

After reading about Mr. Munger's comments, Rory looked for all the books on Harold Geneen that he could find. I think he is the man to answer your question. Rory?

**Rory Friday:**

We were not at the *Daily Journal* meeting, where Mr. Munger made the remark comparing Valeant and ITT. So we do not know exactly what he said. But it was something to the effect that Valeant was like ITT, except that Mike Pearson was worse than Harold Geneen, who became CEO of ITT in 1959. ITT was one of a number of serial acquirers that were active particularly in 1960s. Geneen bought a raft of companies — some of the names you will recognize today like Sheraton and Avis. Bob can provide more context than I can because he is pretty familiar with the company as well. But Geneen bought a lot of disparate businesses in different industries. I recall from the books I read that ITT's sales went from \$700 million to \$17 billion over eighteen years and the earnings went from \$29 million to \$550 million. But ITT also issued a lot of equity and was prone to issue equity in order to buy these companies. By the time Geneen stepped down from the CEO's spot, ITT's share count had increased tenfold.

One of the big differences is that Valeant is focused on the healthcare sector. Last year, 57% of sales came from pharmaceuticals. The company is not really going outside the healthcare space, and it is not going far outside pharmaceuticals. There are plenty of pharma companies that operate in different therapeutic areas, and the main ones for Valeant today are dermatology, ophthalmology, and gastroenterology. Another difference is that Mike does not like to issue equity. Even though the

Bausch & Lomb and Salix acquisitions required him to issue some equity, the share count has not really moved that much.

If you adjust for the dividend that Valeant paid out before the Biovail merger, earnings per share have gone from 81 cents to probably close to \$27 this year. Next year's EPS will be close to \$38 a share. So the earnings will have gone up over 45 times in seven years.

**Bob Goldfarb:**

My guess, when I saw the comments, was that Charlie might have been targeting Valeant's accounting. If I were going to question the accounting, the principal issue I would have would be with the accounting for the restructuring charges after Valeant makes a large acquisition. The company and the analysts who follow it add back these restructuring charges to derive the company's cash earnings. What we do is add back the restructuring charges to the purchase price; so that if Valeant buys a company for \$9 billion and there are \$500 million of after-tax restructuring charges, the company effectively paid \$9.5 billion rather than the \$9 billion that it announced initially.

If you deduct the restructuring charges associated with significant acquisitions from a given year's earnings, I do not think that is accurate accounting even though it does conform to GAAP. When we look at a company's reported earnings in a given year, we are always searching for a sense of what the true earning power of that company is relative to the stock price. If you deduct the large restructuring charges in a given year, you are not going to get an accurate number for the earning power. Heinz — Berkshire acquired 50% of the company — is an example. Jonny, Heinz had very low earnings last year, right, because of the restructuring charges?

**Jon Brandt:**

Yes, it did.

**Bob Goldfarb:**

That was GAAP accounting. Heinz's earning power is clearly very substantial but it was masked in the accounting by that huge restructuring charge. So when we looked at Berkshire in the year Heinz was acquired, we just added back those restructuring charges to get a better idea of what Heinz was earning, half of which Berkshire<sup>3</sup> was earning as well.

---

<sup>3</sup> Upon exercising warrants on 7 June 2015, Berkshire increased its ownership to 52.5% of Heinz.

**Question:**

I guess it is no surprise that most of the questions are about Valeant. So I will add one more. A few weeks ago in the papers it was reported that Valeant raised the price on a particular drug by 400% – 500%, within a very short period of time after purchasing the rights to that drug from another company. I was troubled by reading that. I am curious to hear your reaction.

**Rory Priday:**

I understand why reaction to that could be negative. Obviously, Sequoia and our clients that own Valeant are benefiting from those price increases. But in general, the capitalistic approach to pricing is to charge what the market will bear. Valeant believes that when it buys a drug and it is underpriced, it should charge a price that will maximize the company's long term cash earnings. Some people maybe feel differently about healthcare. It is obviously a more sensitive topic.

**Bob Goldfarb:**

Embedded in the asking price for Marathon—which is the company that sold these drugs to Valeant—embedded in the sale price was a significant increase in the price of those drugs. In fact, Rory, what had Marathon's management been advised to do with its prices?

**Rory Priday:**

We were told that Marathon had hired a consulting firm that advised it to take huge price increases. So Valeant was following the advice of the consulting firm, not that Mike would shy away from taking a price increase if he saw an opportunity. We are not really sure why the company decided to sell these drugs, but I think part of the reason was that management was looking at selling another asset. So Marathon needed to get this deal done. That is the one that David mentioned earlier when Valeant was working at 8:00 p.m. on New Year's Eve.

**Bob Goldfarb:**

A point that the article missed, and I am not faulting the *Wall Street Journal*, is that either those prices or the volumes at those elevated prices are going to be very short-lived because both of those drugs are subject to genericization and Valeant management expects that they will be genericized within a couple of years. So Valeant had to recoup its investment and more within that short window of time in order to achieve the returns that management was expecting.

**Question:**

I have a question about World Fuel. I wanted to ask about the level of confidence that you have in volume growth and pricing trends in the marine, aviation, and land segment over the mid-to-long term and how important you think acquisitions are to the future. I find those mid-to-longer term numbers hard to get my hands around.

**Rory Priday:**

We did too. We do not own the stock anymore. As I mentioned last year, World Fuel Services is a fuel supplier. It gets credit from some of the major oil companies and uses that credit to buy fuel to sell to various customers in marine, aviation, and land markets. When you talk to the company's managers, they will point out that World Fuel has very small shares of those markets; so you can get excited about the potential. Any time you look at an investment, you want to look at what percentage of its market it has and how big it can get. One of its biggest competitors in marine fuel went into bankruptcy late last year, but the trouble is that it is still going to be pretty difficult for the company to grow organically at a good enough pace in each of its markets. The markets may be huge, but there are structural reasons why organic growth is difficult to come by.

We thought that most of the growth going forward would come from acquisitions, which is fine—the management team has been terrific. It has presided over a lot of value creation. Mike Kasbar is a great operator and has built a really nice company. The company does smart acquisitions. If you run through the list of deals, on average over the last five or six years, World Fuel probably earns, by my math, between 10% – 12% on its acquisitions. If you had a company that was not growing at all organically and it could invest all its earnings at 10% – 12% each year, it could grow earnings at that rate. But we did not feel confident, owning something like that over a long period of time, that it would get a bigger at a fast enough pace to meet our hurdle rate. So that is why we are out of it.

**Bob Goldfarb:**

We sold World Fuel Services because it reported a very strong quarter, which to a fair extent was based on the volatility of oil prices, which usually benefits the company. Going back to an earlier question, there are some occasions when we are selling into strength, and others when we are selling because there is a disappointment.

**Question:**

Would you comment on TJX please?

**David Poppe:**

We have owned TJX for ... it will be fifteen years this summer. Obviously it has been a terrific stock, a terrific compounder. It still has a very good future. TJX is the largest off-price retailer in the country. Nothing has really changed from prior years, but at this point TJ has become a very large customer for many of the biggest apparel brands in the country and in the world. So it has a very important buying position and great access to merchandise. As a result, it can become a question — the company has become so large in the United States — of how much of what is in the store is actually true surplus that TJX bought versus product that was made for it. That is a tricky thing for TJX to manage. But there are still good growth opportunities in the US, Canada, and Europe. We think Carol Meyrowitz is an excellent CEO, and she has done a fine job. TJ's number one competitor, Ross, also does very well. So you are at the top; it is a very strong industry; the consumer has shown over time that she is willing to buy this way as opposed to paying a higher price in a department store. So TJ and Ross continue to capture market share, the two of them. But even today, TJ, Ross, and if you add Burlington and Nordstrom Rack and combine them all, they are less than 15% of the US apparel market. So we do not think they are close to a ceiling.

The other thing I would say about TJ is that I get some pushback from people who believe that, to exaggerate a little, all retail sales are just going to move to the Internet, and that people do not want to be in the stores anymore. To go to TJ, you are making a trade of time for price. You are making the trip to the store and combing through those racks of clothes that are not always very well organized. But at the lower price points, it is showing to be very, very hard to make money online in apparel. The average ticket at TJ is about \$15 and at Ross probably \$10 or \$11. We think that there is a consumer who is very willing to make that trade of time for price. Off-price is also difficult — there are very shallow levels of inventory of a very broad assortment of product. And it is very hard to manage a website when the product turns over and is never replenished as it is in conventional retail. So for all those reasons, we think that TJ is fine.

There are a couple negatives. Currency is very much against the company this year. TJ also has a

minor pension issue, which will restrain earnings this year. We could have flattish earnings this year after many years of 15%-plus earnings growth. So the stock looks a little more expensive than it has in the past. But I still think the long term outlook for the business is quite good.

**Question:**

A couple of questions on MasterCard. Visa benefits from a lot of the same secular trends that MasterCard does; so I am curious why you guys own MasterCard and not Visa. Secondly, if you could comment on some of the recent acquisitions that MasterCard has made, and the strategic and financial rationale, if you agree with those.

**John Harris:**

Let's see, why do we own MasterCard instead of Visa? There is not really a good answer. We should have owned both. We should have owned more of both. We should have owned a lot more of both. It is a tremendous mistake for which I bear significant responsibility. So that is the answer to that.

The acquisitions — I have to be honest with you, and this is self-deprecating and not intentionally so — I have had a tough time understanding many of the acquisitions that these two companies have done over the years. Not just MasterCard, Visa also. Visa plunked down a sizeable amount of money to buy a business called CyberSource, which worked for a couple years and now is not working so well. There is an understanding at the card networks that things will eventually change. It has been remarkable and surprising to me how slow the pace of change has actually been and how as threats have emerged, they have quickly gone by the wayside. It just turns out that the network business model is incredibly resilient. But there is some concern — subconscious, whatever you want to call it — that eventually things may change and that the change is going to be driven by technology. So there is a desire on both of their parts, especially when new CEOs took over at both companies I noticed a marked increase in this desire, to try to ramp up the pace of innovation hopefully to head off some of the technological threats that they see on the horizon. The fact of the matter is that Visa and MasterCard have not traditionally been terribly innovative organizations. They were cooperatives for most of their lives and overseen by bankers. That is all you need to know on that subject.

They are doing their best. To be totally honest, they feel like part of being innovative and doing a good job is buying small innovative businesses. Whether any of them have really added anything, there certainly is no perceptible evidence. It is possible that at some point in the future we will find out that MasterCard is able to adapt to technological change because of some small acquisition it did in the past — it is entirely possible, but I do not see any evidence of it. In the past, for the most part the deals the company has done have been so small that they have had a nonmaterial impact on the financial progress of the business. This year that has changed a little bit. MasterCard did a couple of deals that were pretty meaningfully dilutive to its earnings so that the company is going to have the slowest rate of earnings growth it has had this year since we have owned the stock and since it has been a public company — we have owned it for its entire life as a public company. A lot of that is foreign exchange, which is a real headwind this year. Part of it is those acquisitions, which are detracting in a meaningful way from the earnings.

**Bob Goldfarb:**

As to why we bought MasterCard rather than Visa, we bought MasterCard in the first few days that it went public. We should have kept going, as John said. Visa went public later and it was priced off MasterCard, which was selling at a significantly higher price at that time than when it went public.

**Question:**

Would you please comment on the prospects for Tiffany and Richemont?

**David Poppe:**

I will talk about Tiffany and Saatvik can talk a little bit about Richemont. I will give you the high level view. The high level view we have is that Cartier and Tiffany are two of the great jewelry brands in the world. We have owned Tiffany not consecutively but for most of the last 14 or 15 years; so we feel like we know it pretty well. What I would say about Tiffany is it has grown the topline at about 7% over the last decade, which is good, not great but good. But it is still immature in a lot of parts of the world. Except for Japan, Tiffany was very late to Asia-Pac, very conservative about expanding in Europe. American luxury — I think a lot of Europeans do not believe in it, and Tiffany was conservative about enlarging the store base there. But in the last few years, Tiffany has opened a bunch of stores in Europe including one on the

Champs-Élysées in Paris, and done very well. The company has gotten more aggressive in the last few years about opening stores in China, and not only are those stores doing really well, but the engagement ring custom is catching on there as it did in Japan, I want to say in the '70s. It seems like that is going to become a custom for people all through Asia as well, which is good for Tiffany since the company has a strong position in higher-priced engagement rings.

Tiffany managers have been very good stewards of the brand and very good store operators, although not as financially sophisticated as they might have been in some cases. So we think there is good operating margin potential for Tiffany. The tax rate is an American tax rate, even though over half the sales come from outside the United States. So there should be good opportunity to manage the tax rate. The company is talking about getting it from 34% – 35% to 30%, which is a good opportunity for earnings growth.

If I think about a sustainable 5% – 6% – 7% – 8% revenue growth rate, operating margins that could be higher, and a lower tax rate, I feel pretty good about Tiffany. Again, the bigger picture is it works everywhere. The comps right now... the earnings this year will be tricky because currency is so much against you when you do a lot of your sales outside the United States, and Tiffany makes a lot of the product in the States. So it is probably going to have a difficult earnings year in 2015. But longer term, branded jewelry is taking share from unbranded jewelry at a rate of something like a point a year. Cartier and Tiffany ought to be two major beneficiaries of that trend.

**Saatvik Agarwal:**

Richemont is actually more of a watch business than a jewelry business. Its largest and best known brand is Cartier. But Cartier generates more revenue from watches than from jewelry. Plus, Richemont owns a collection of other Swiss watch brands including IWC, Jaeger-LeCoultre, and Piaget. On the jewelry side, branded jewelry has only a 20% market share, and, as David mentioned, it is increasing that by about a point a year. But jewelry sales for Richemont have grown better than 10% a year for something like ten years. More generally, I would say the high end luxury goods business will benefit from the world getting wealthier.

One thing we worry about with Richemont is the dependence on the Chinese and the Asian consumer. We have all heard about the crackdown on gift-giving in China, and gift-giving is in fair part really a code word for corruption in China. Swiss watch sales had gone backwards by about 30% in China. But given the quality of its brands and the quality of the business, we think Richemont has a long runway of growth in front of it. Historically, the business has done a lot better than 6% – 7% revenue growth.

**Question:**

Could you update us on Precision Castparts? I know that the stock underperformed in 2014. I know it was kind of slowing down. And in 2015, it preannounced a couple quarters back to back. I was wondering if you could update us on that and if you still see compelling value there.

**Greg Steinmetz:**

We do see compelling value, but it has been a disappointment. It was supposed to earn \$16 a share in the fiscal year that we just started. Instead, management is guiding to something like \$13. The difficulty has been confined largely to the forged product segment, which is a very high fixed cost business. So when volume goes against you, you really feel it in the margin. We saw a 900 basis point drop in the margin of that segment last quarter. Furthermore, the oil & gas market has gone against Precision. Management had big plans for the oil & gas business, making very large diameter pipes that are highly resistant to corrosion. Precision is the only company on earth that can make that kind of pipe. Management thought that whatever happens with the oil & gas market, the company would be ready, and it would still be able to sell this pipe because of its compelling value. That did not happen, and the company was late to restructure that business and cut costs. The restructuring is now completed; so things should get a little better. Management was expecting \$400 million in revenue out of that pipe business last year and only got \$200 million, and it will probably be similar this year.

Another thing that has hurt is that Rolls-Royce is aggressively trying to take inventory out of its system. Rolls had too much inventory because managers were worried about not being able to meet delivery schedules and overdid it on inventory. Now they are cutting back the other way. There have been some other issues. Precision makes a lot of parts for the military. Military spares are down 35%. That was

not something that the company foresaw happening in the current fiscal year.

That \$16 a share was a number that was derived three years ago and as recently as six months ago management was still talking about \$16 a share for this year. But lately management recognized that the world had changed and decided to throw in the towel. In addition to the restructuring I mentioned, the company also wrote down some inventory. This year, Precision thinks it is going to make about \$13. I think that is a conservative number. Time will tell.

What we like about Precision and why we are keeping it is, as I mentioned, that it is the only company in the world that can make these large diameter highly corrosive resistant pipes. Precision is also far and away the leader in making powdered metal components that are used in large jet engines. It is the only company that can make certain large structural castings, and there are some other things that only Precision can supply. That gives the company a lot of leverage over its customers. Management is not afraid to use it. So it has a very strong competitive position. We also have what should be a growing market for aerospace.

I was with Boeing management this week — the company is talking about raising the monthly unit deliveries of the narrow body 737 from 42 a month now to 47, and then to 50-something. That could even go to 60 because the backlog is so big, and there is still an enormous appetite even in China — which, as you know, has a soft economy — to get these planes and get them now. The 787 has gone from 10 a month to 12 and that is going to go to maybe 14. So there is growth there. Precision is seeing that in some of its segments. The company will not see it in other areas because of de-stocking at Rolls-Royce. And the build rate for the 747 is being dialed back. Also there is a transition going on from the old models of the 737 and the Airbus narrow body, the A320, from the current generation to a re-engined version. Precision has had to absorb a lot of development costs along the way as that transition has taken place. But now it is coming to an end.

One thing that I think worries people is that, okay, aerospace is going to be a growing market, but is Precision losing share? We all know that because of Precision's arrogance in the way it treats its customers — raising prices and making demands on them — they would like to cut Precision down to size. So is there a case of customers taking market share away from Precision and giving it to Alcoa and

others? I have looked under as many rocks as I can think of to try to get to the bottom of this and I am not finding the evidence. Maybe I am looking under the wrong rocks, but the fact that I have not turned anything up and the fact that the customers buy under long term contracts which they are locked into, and the fact that competitors are not giving me any examples of how they have taken share from Precision make me think we are okay on the market share question.

If Precision can preserve market share in a growing market, we should be okay, which is why we are still holding the stock. Plus at its current price it is not expensive. It trades at a discount to some other of the big names in aerospace. Before it always traded at a premium.

**Question:**

I had a question on Fastenal — your thoughts on its net margins as the company pushes into non-fastener products and larger customers. And then maybe a little bit on Fastenal versus Grainger.

**Chase Sheridan:**

I will start with the margins. There has been a lot of discussion around gross margin because Fastenal's average customer size has been ... its large customers have been growing faster than the rest of the business; so the gross margins have been coming down a little bit. Fastenal has gross margins north of 50%, which is almost unheard of in industrial distribution. Fastenal's operating margins are north of 21%, which is also highly unusual. I expect the gross margins to come down over time. But I expect the operating margin to rise over time. That is because it is more efficient to serve these larger customers. Management makes that argument on a quarterly basis when it reports its result. Management always tries to talk about how its average revenue per store is growing.

When we first bought it, Fastenal was growing the store base rapidly. In its early days, Fastenal was growing its store base by over 30% a year and it was still growing by 14% when I joined the firm in 2006. That growth rate is now zero. So the company does not have a lot of low volume new stores depressing its margins. As a result, as the existing store base grows in terms of the average sales per store, those stores become more efficient.

The second part of the question was how do we think about Fastenal versus Grainger. We like both businesses. We follow Grainger closely. It is an excellent business with a wide moat. Jim Ryan at

Grainger has done a very good job. It is tempting to say we could own both of them. So far, we just own Fastenal, though.

**Question:**

Do you find it more difficult today to find good stocks? Because it is lucky if you find one good stock a year. A Picasso sold this week for something astronomical. Why is it that wealth cannot find a good home in a stock and instead goes into art? It is harder and harder, it seems, to find — absent technology stocks — a good investment today. Am I wrong?

**David Poppe:**

Yes, it is definitely harder to find good stocks today. The market has gone up, has compounded 14% a year for the last five years through April 30. I think we are up about 17% a year over that time. That is roughly a doubling in stock prices. You cannot say that it is probable that we are going to compound at 17% over the next five years. No one knows how we will perform. But we are in an environment where more modest returns going forward are more likely than what we have seen in those five years.

**Question:**

Can you give me an update on Idexx?

**Arman Kline:**

The company had a wonderful 2014. It made a big decision to go to direct distribution. Historically, Idexx distributed the consumables for its instruments and its rapid assay tests for companion animals through a network of distributors in the US. Overseas it was a little bit more direct. It made a decision to go direct here, and the reason it made that decision is that it felt as the market leader with a dominant market share introducing new technology, new products, it needed a sales force that could encourage the adoption of those products more than it needed the help of distributors to penetrate the market. We think that management made the right decision.

Earlier this year, you may have noticed in the first quarter, Idexx had a little bit of a hiccup as a result of that move to direct distribution. A competitor came out with a lower priced product and distributors picked it up because Idexx was no longer selling through them. The competitor was very aggressive, and, as the CEO of Idexx said, there is now a rapid assay price war going on in the industry. The business is still growing very nicely, but the

stock was priced for perfection — last year it was trading for a high 30s multiple of forward earnings. Most of you have probably noticed we have sold down our position as a result of that valuation. We are still large shareholders. We still believe in the business. We think it is unique. We think it has a long runway. We think it will continue to dominate that space. We remain excited about the future there and believe in its direct distribution model. Do you want to add anything, Greg?

**Greg Steinmetz:**

Idexx is responsible for at least 75% if not more of all of the R&D spending in veterinary diagnostics. It can earn a nice return on that because this megatrend of the humanization of pets is showing no signs of stopping. People will spend anything on their animal if the veterinarian gives them a credible reason why they should. And it is a lot more than just rich people. It is a broad swath of pet owners. Idexx, to its credit, is a great believer in veterinary diagnostics. Management sees it as a very long-lived opportunity. It has really been paying off. Despite the issue with rapid assay this year, we are still going to get 10% organic growth. International is going gangbusters, and there the humanization of pets is just getting started. Even in China — where they are boiling Tibetan mastiffs, if you read the story in the *Times* two weeks ago — people are starting to treat animals more like humans. It is an opportunity that Idexx is going to benefit a great deal from.

**Question:**

What is the weighted P/E of your portfolio on 2015 GAAP earnings? Two, in terms of Valeant, it has no R&D, I think. Given that any drugs that it has on patent will eventually go off patent, what is Valeant's moat?

**David Poppe:**

I do not think we actually know the weighted average P/E on GAAP earnings. For companies like Valeant, I am not sure it would be a relevant number anyway. On the rest of it we will bring Rory up and put him on the spot.

**Rory Friday:**

Valeant does spend on R&D. I think the company is going to spend, adding Salix and the legacy Valeant businesses, about \$300 million. We met with Mike a few weeks ago and he was telling us how with \$300 million, you can get an awful lot done. Mike can get a lot done with very little. Jublia is a good example. Jublia is a toenail fungus drug

that Valeant just launched last year. It spent \$30 – \$40 million developing that drug over the last few years, and it is probably going to do more than \$300 million in sales this year.

Valeant has a number of other compounds in the pipeline, especially on the dermatology side. It bought Dow Pharmaceuticals early on in Mike's reign at the company — he paid \$285 million. Valeant has gotten Acanya out of it, which was a \$70 – \$80 million drug, and it is getting Jublia now. Valeant has six or seven drugs that it expects to launch over the next eighteen months. One of them, Vesneo, for glaucoma, management thinks could generate as much as \$1 billion in sales globally. I think Mike said the company is going to spend less than \$100 million on that program, in total. With an R&D budget of \$300 million, Valeant can do quite a bit in terms of building its pipeline.

In terms of the pharmaceuticals and Valeant's exposure to patents, one of the things the company has tried to do is go into areas where the company has durable products. Valeant has a lot of branded generic drugs overseas, which are off patent drugs. Valeant has contact lens solutions and OTC pharmaceuticals. It has CeraVe, which is a moisturizer. And Valeant has a lot of drugs that are not going off patent. The key in the pharma game is always, once you have the distribution, once you have a sales force in the ophthalmology space or in the dermatology space, how do you source innovation? You can do that through R&D or you can do that through buying things. Mike is making a big bet that it is cheaper sometimes to buy things, to source that innovation when you have the distribution. So it seems like that model is working. The business is growing right now pretty nicely.

**David Poppe:**

Mike Pearson believed that he could build a large and successful pharmaceutical company without taking the risk of expensive R&D that most large, successful pharma and biotech companies had taken. He would instead do it by focusing on specialties that did not require these risks through lean R&D, zero-based budgeting, minimal taxation, and high returns from the get-go on numerous acquisitions. He would target companies of all sizes in product and geographic areas in which big companies did not compete and in which there was minimal reimbursement risk. By avoiding all of those other risks, he would be able to take some risk by leveraging his balance sheet to generate very rapid

growth and high returns on total capital and spectacularly high returns on shareholders' equity.

**Question:**

My question is about Google and your opinion of its capital allocation strategy. And maybe more specifically products like Google Glass and driverless cars. Is Google on the right path?

**Chase Sheridan:**

Great question. When people ask me about risks to Google, hubris is one of the primary risks that it faces because the core business is so good. Management is investing really, really heavily in being the aggressor in a lot of areas — the opposite of a milker. Some people milk their businesses. Google is putting the milk back in the cow. With its capital allocation strategy, I will start by looking backwards and saying I thought that Google overpaid for YouTube at the time. I thought that Google overpaid for DoubleClick at the time. Looking back, those were both great acquisitions. I would certainly advise Google to do them again.

Android was a very insightful acquisition. The acquisition and development of Android were spearheaded by Larry Page, who was very involved in the project. Android has become an enormous asset for the company. I will say that second guessing Larry Page has proven to be a humbling experience. Management is extremely farsighted when it comes to the direction that technology is moving. That said, I think the reason we did not put on a bigger position in Google at the time we bought it was that we perceived — I think a lot of investors perceived correctly — that shareholders are not first in line when it comes to the buffet of cash flow that Google produces. Larry Page has very large ambitions and the joke around here is Google generates more cash than its managers know what to do with, and the fear is that Larry Page is going to use it to colonize Mars. I think Google will start paying a dividend ten years after Larry Page's death. I do not want to second-guess management, but I really cannot handicap very well what the company's investments now are going to look like in ten years.

I will say this: A lot of the products that get a lot of press are really not material to Google's overall results. If you look at Google Fiber, if you look at Google's recent moves in the wireless industry, these are points of leverage that Google is finding to pressure the rest of the ecosystem to invest, to improve access to the Internet for all users, which ultimately benefits Google. It does not require

very much money and Google is actually getting responses from folks like AT&T speeding up fiber access. So I do not think that these projects that we are reading about like driverless cars — they are interesting, but I do not think that the resources that they consume are significant in the context of Google's overall earnings power. When I look over the next five years, I think that Google could create \$100 billion of profits. So I am going to give management the benefit of the doubt for now. But it is a good question and I do not have a great answer for it.

**Question:**

Going back to Valeant, I believe it is almost 20% of the portfolio. Could you shed some light going forward?

**Bob Goldfarb:**

It is actually more than 20%. We are always reevaluating it in terms of the risks and the rewards. To date, we have always believed that the rewards outweighed the risks. That said, the company has been operating in a fairly benign environment despite the risks that we consider. I think particularly of the risk that the low interest rate environment could change unexpectedly. But Valeant has been able to borrow money at very reasonable rates to fund acquisitions. As Rory mentioned earlier, the company has used equity very sparingly. The second risk would be Mike Pearson's health and longevity. So far so good — he is 55 — the mortality tables would suggest that the risk there is relatively low at this juncture.

A third risk would be changes in drug pricing by the government and/or the payers, the pharmacy benefits managers and the HMOs. A fourth risk, which the company lived with in the earlier days of our ownership, was genericization. But at this point in time the portfolio is less subject to genericization within the foreseeable future. In terms of the opportunities, management has guided to earnings of about \$11 a share this year and it has given a number for EBITDA that translates into about \$16 a share of earnings for next year. So the company certainly sees the very rapid growth continuing into 2016 and I think the market is beginning to accept that number and price it into the stock to some extent.

One major change since we met a year ago was that the organic growth has really accelerated. It is double digit this year and we would expect a continuation of double digit organic growth next

year. So Valeant has really transformed its portfolio. After the merger with Biovail in 2010, organic growth was not very good for several years. But due to some very smart acquisitions since then, Valeant has rejiggered the portfolio so it is now geared for substantial organic growth.

**Question:**

I thought somebody should offer a compliment to Jonathan Brandt, who was one of three analysts questioning Warren Buffett and Charlie Munger two weeks ago at the annual meeting at Berkshire Hathaway. I have read some of your comments that were extracted by Morningstar, but I would like to hear some of your insights from the Q&A two weeks ago.

**Jon Brandt:**

I am not sure I have a great answer to that question. My principal insight is that they do not really like my questions. There are so many issues that get bandied about, and none of them really is going to change my valuation of the company. On certain questions, they cannot really be as open as maybe you would like them to be because there are sensitive issues, competitive issues and such.

It is fun and it is interesting. But there are just so many different divisions of Berkshire. The railroad is significant, and the insurance company is significant. Heinz would be another big one now that it is merging with Kraft. It will be publically traded, but he thinks of it as partially owned. But I spend a lot of time looking at all of Berkshire's businesses. The format of the meeting is not one that lends itself to a change in valuation. Some people have talked about whether he should put the leaders of the various businesses up on stage to talk about their businesses. I think that would be an interesting thing to do. But each incremental insight is not going to change the valuation in a material way. A lot of people complain that there is not enough disclosure in the annual report. A huge business like Lubrizol, which is on its way to making \$1.5 billion pretax, might get two sentences about it in the annual report. But I am not sure if there were five pages about Lubrizol that my valuation of Berkshire would be any different, which is his point for why he does not spend more time disclosing information.

**Question:**

In the annual report, you mention and discuss trends towards more passive investing versus active investing and the impact it has on relative

performance. Could you share some more insights on your views on that topic?

**Bob Goldfarb:**

I have been surprised that this trend has not continued into 2015, and year to date, a much higher percentage of active managers is outperforming the indices. I have been surprised because usually when you see a trend like that, it tends to go on until it gets so extreme that it ends, and it ends with a bang, not with a whimper.

**Question:**

Just a quick question from an operating perspective. I am wondering if you can comment on how Sequoia interacts with some of the other funds within the firm. It is probably wrong — but if you check Bloomberg it says the firm owns 30 million shares or so of Valeant but ten million shares are in Sequoia. So it raises a couple questions like how do you guys share ideas between funds, and then when you are building up a stake, how do you determine which fund, if you are going to put it in multiple funds, gets the first or the best price?

**David Poppe:**

We have Sequoia as a client. We also have separately managed portfolios for several thousand clients. Ideally, everybody has the same portfolio. When we buy a stock, it is allocated pro rata to all the clients. Because everybody has different cash flows in and out of accounts, the percentages over time can be off from one account to the next. One client might be taking withdrawals and over time that account will look different. Another client is putting money in. But we do not run tailored portfolios. We own 34 million shares of Valeant and 11 million are in the fund, but pretty much every client who was with us at the time we first started buying Valeant should have the same basis, or within pennies. That is true for all the positions.

**Bob Goldfarb:**

When we buy or sell a stock, we buy or sell it pro rata across all of the accounts so each gets its fair share at the same cost. The result of that is a lot of mail, which we know many of you dislike. However, we think that is the fairest way to do it.

**Question:**

I know you have a relatively small position in Verisk Analytics. Just a question on the investment thesis, the valuation, capital allocation, and more specifically the Wood Mackenzie acquisition, which the company announced in March.

**Chase Sheridan:**

I will try to be brief. Our position in Verisk rounds to 0.0% of the portfolio. So I would not consider it a real position. It is a great business. Verisk is basically becoming a platform for buying data analytics firms. Its core business in the insurance space has as big a moat as you are going to find anywhere but the returns on its expansion businesses, the jury is still out. The acquired businesses are good but the returns on those investments are not anywhere approaching the returns in its core business. It is probably not worth it to take any more time because we really do not have a material position.

**Question:**

On page three of the prospectus, there is a bar chart showing the performance. We all know that Valeant has a big effect on the total bottom line. But if you start with 2012 when the return was about 16% and the next year 35%, last year 8%, this year it is about 12% — if you backed out Valeant, what would those percentages be for the other 80% of the investments in the Sequoia Fund?

**David Poppe:**

Valeant has outperformed the S&P 500 by a substantial margin over the last three years. If you backed Valeant out, the other 80% would have underperformed the S&P, but that includes a substantial cash position at all times. The stock portfolio performed roughly in line with the S&P.

**Question:**

So on a percentage basis, what would let's say last year's 8% be without Valeant?

**David Poppe:**

About 4%.

**Question:**

Let's say the current bottom line is about 12%, right?

**David Poppe:**

Valeant came into the year at 20% of the portfolio and it is up 56% year to date. So that is over eleven points of return for the total portfolio.

Sequoia is up about 12% so the rest of the portfolio generated less than one point of return and the market has generated about 3.

**Question:**

So you are saying that without Valeant, instead of its being 12%, it would be less than 1%?

**David Poppe:**

When a 20% position goes up over 50% that works out to a lot of performance, yes.

**Question:**

If you skip last year and you go to the wonderful year of 2013 when the result was 35%, what would that have been without Valeant, about?

**David Poppe:**

Valeant was up almost 100% that year. It started the year at about 12% of assets. If Valeant went up 100% in 2013 and it was 12% of the portfolio that was twelve points of performance. We were up 35 that year and began with about 14% in cash. So, the rest of the stocks, about 74% of the portfolio, were up around 31% in aggregate and generated 23 points of return.

**Question:**

Could you please share your point of view about margins at Google and stock options?

**Chase Sheridan:**

Net margins at Google have been declining rather rapidly as the company has expanded into non-search businesses. Search is such a high margin business that nothing is going to compare. But in addition to the display business and other businesses that Google is currently monetizing, management is planting a lot of seeds elsewhere. So the margins have come down over time. If you are looking solely at the growth of net income or EPS — let's go to the EPS line — if you are looking solely at EPS growth, it does not look that compelling. That is because Google is being penalized for an enormous amount of growth investing.

However, Google trades at a very modest premium to the S&P. If you look at its enterprise value to net operating profit after taxes, which is a way that you would look at it to give the company credit for the \$60 billion of cash on the balance sheet and some intangible amortization, it is about 19 times forward looking, 2015, ballpark. The S&P is in the 17–18 range for its forward P/E. Meanwhile Google grew at 18.9% last year and the S&P in aggregate grew about 4.2%. So if you are

taking a long view, you do have to have some faith that some of Google's investments that are not currently benefiting the EPS line are going to work out. It does not have to be a lot of them but Google is planting a lot of seeds in a lot of places.

With regard to stock options, Google has a policy of compensating its employees very well. I think the intention is to try to create a place for the very best talent in the world to congregate and to avoid becoming a big stale company. I would say Google is on its way. The goal seems to be to create in the twenty-first century what Bell Labs and Xerox PARC were in the twentieth. Stock options are a part of that. They are expensed so it is already included in the math. The grants are very generous, but Google does get outstanding talent.

**Question:**

Could you talk about the attractiveness of the industrial gas market, and more specifically about Praxair, the relative attractiveness of that company versus the other players in the market?

**Trevor Magyar:**

The industrial gas business is an excellent business. It has been for decades. The industrial gas business really starts with these large air separator units that the industrial gas suppliers build near large industrial customers. The separators connect to the industrial plant and provide atmospheric gas, oxygen and so forth to the customer for a period of many, many years. The gas is sold under long term take or pay contracts. What is interesting about that is that not only are those contracts profitable, but they also give the companies, the industrial gas suppliers, an opportunity to build a business in the surrounding area. So they overbuild the air separator unit. They take some of those extra molecules, liquefy them and peddle the gas to customers within a certain radius.

The key to the whole equation is that these gas molecules are very, very cheap to produce, which means the distribution costs associated with those molecules outweigh the cost to produce them. If you are the one producing the gas in a particular region through one of these big onsite plants, you are the low cost supplier of that gas to customers in a 150-mile radius. So you truck the liquefied gas to smaller customers in the area and you make a nice profit. That is how the business has worked for a long time. It has always been a very good business. Over the past 10 – 15 – 20 years, it has gotten even better because it has rationalized. It has turned into a

global business with four large players: Praxair, Air Products, Air Liquide, and Linde. It is fundamentally a good business in terms of how it is structured.

We chose to invest in Praxair because it is best in class; it has the highest returns. The company is run in an incredibly lean way. When we looked at the industry, it was obvious from the get-go that Praxair was the best operator in terms of returns and cost focus. That said, while the reality is they have all done very well over the long-term, the industrial gas business has done less well over the past few years, and the reasons are pretty obvious. China, Brazil and some other emerging markets have slowed down. That has affected growth because fewer new separator units have gone up and the cylinder business has been weaker. But we still feel very confident about the quality of the business and the management team. Praxair has tended to trade at a premium to the other industrial gas players because of that quality.

Air Products, which had been a reasonably good company and a reasonably good operator, had always been something of a laggard to Praxair. It now has a new management team that has identified the opportunity to close the gap with leaders like Praxair. So Air Products' stock has run on those management changes. The valuation reflects investors' belief that improvements are going to come and they are going to come relatively quickly. We could have a debate about how reasonable that is and the time frame over which those benefits are likely to materialize. Air Products might have been the better stock to be in over the past few years, but we do not regret our choice in terms of focusing specifically on Praxair. So again, it is a wonderful business; it has a wonderful management team. Maybe the growth has been disappointing over the past few years, but we still feel confident in holding it.

**Question:**

Two questions, one on Google. Maybe some more commentary on how you think the transition to mobile is going. I know that is a tricky question, but some thoughts on that. Then on Perrigo, any comment on the current Mylan offer/bid, and whether or not that company ultimately will remain independent now that it is technically in play.

**Chase Sheridan:** I took a peek at Google's market shares and how they have changed over the last twelve months. Google's market share in mobile browsers, Chrome and Android combined, went from 37% to 48%. The company's market share in mobile

search went from 91% to 92% globally. And the market share of the mobile operating system, which is the Android OS in all of its forms, from 37% to 52%. It is worth pointing out that Google's share in mobile search is actually quite a bit higher than its market share in desktop search. The transition to mobile is fraught with all kinds of potential pitfalls, but Google was very early in emphasizing mobile with Android.

The worry for a lot of Google followers is that people tend to spend a lot of their time in apps on mobile devices; so the worry is that as apps predominate in terms of taking users eyeballs away, mobile search use may decline. As it turns out, people still do a lot of searching on their mobile phones through the browser, which is how Google makes the bulk of its mobile money. But it also has a pretty robust display business, and the company is doing what it can to maximize its presence there. I am going to pull a number from memory, but I believe that Google has something like 37% of all mobile advertising. It has a tremendously strong position. In terms of just the advertising technology stack that Google owns, there is nobody who comes close. That is sort of an unholy mess, but it is consolidating and it is consolidating into a couple of large platforms. Google will own one of them. Facebook will own one of them, and then we will see what else shakes out. But Google has a tremendously strong position in mobile. The company has navigated that transition better than I would have expected. Google saw it coming before most of us did.

**Saatvik Agarwal:**

Regarding Perrigo, Mylan made an offer for Perrigo about a month ago. The original offer was made for about \$205 but Mylan never disclosed the actual terms of the offer. It came as a surprise to Perrigo. It came as a surprise to us. Since then, Mylan has actually disclosed the terms of the offer. And it does not quite work out to \$205 a share if you use the terms Mylan has disclosed. You have to value it based on the stock price of Mylan before it made the offer, because it is a stock and cash deal, and the stock price of Mylan ran up when they made the offer partly because people speculated that it would put Mylan into play and that Teva would bid on Mylan, which is what happened — Teva made a bid for Mylan after Mylan made an offer for Perrigo. Then Mylan raised its bid for Perrigo.

We have known Perrigo and its CEO, Joe Papa, since we bought the stock five years ago, but we are

rational people and if someone offers us a really good price for one of our companies, I think we would be open to selling it. And I think that Joe Papa feels pretty much the same way. Perrigo has rejected the Mylan offer, saying it undervalues the company. So at this point we do not really know what is going to happen.

**Question:**

This year in your annual report you had very interesting insights on the UK corporate governance challenges that seemed to surprise you in terms of your investment considerations. How do you think about investing directly in companies listed in foreign countries relative to the US?

**David Poppe:**

It is interesting; Greg Alexander has been a tremendous investor in foreign companies. We have been less successful. While some of our foreign investments have performed extremely well, in aggregate if you stripped out the foreign stocks that we have owned over the last ten to eleven years, they have certainly underperformed the US stocks. Europe in general has underperformed the US. So you are fishing in an inferior pond to begin with or one that has been so over the last ten years. Maybe it will be better over the next ten years. One thing that I learned — I would be curious what Bob thinks — we are good in the United States. Bob has an encyclopedic mind on US stocks and we have a lot of expertise and a lot of hours, years spent looking at these stocks.

The UK has been interesting. Arman was just over there and he met with a prominent person there. That person said UK boards are interesting because the board tends to be very involved in trying to set strategy and telling the management what to do. In the US, the board tends to react to management's ideas about strategy. Management has to set strategy and the board holds them accountable, but is not as active. Our perspective is that boards are not going to be as good at setting strategy as the management team. They are not on the ground. They do not know the businesses well. The UK system in particular is a little bit odd because it tends to be retired CEOs who come into industries that sometimes they do not know anything about. There is that push of who is in charge. So in the case of Rolls specifically, we were very unhappy with the board setting strategy. The board installed one of its own as CEO for a time and now he is retired. We think the board has, to its credit, thought really hard about this.

So two separate things: One, although foreign markets have underperformed ours, our success has been a mixed bag. We just have not always picked the right companies and that is on us. Second, the UK, it is just different. As we go into foreign markets, even one as similar to the States as the UK or Scandinavia, we have got to be aware of those cultural differences and who is really setting the strategy for the company.

**Question:**

Would you please offer some guidance with respect to distributions for this year from the Sequoia Fund?

**Bob Goldfarb:**

We are going to have a capital gains distribution that will be paid on June 8. It should be about \$2.53 a share. The reason I say should is depending on the number of shares outstanding it can vary by a penny or so. Those are from gains that were taken in November and December of 2014 that we will be distributing. For 2015 year to date, the figure is approximately \$7.64, again based on the current number of shares outstanding.

**Question:**

Mr. Buffett always calls all of us his partners. Did anybody at the annual meeting ask — he has so much cash in the bank — why he does not pay a one-time dividend to his shareholders or as he calls us his partners, which we are not.

**Jon Brandt:**

He has addressed the dividend issue several times, and I agree with him. As long as he feels that over time he can add more than a dollar of value for every dollar of retained earnings, it makes sense for him to reinvest the money. If it takes him a little time — the opportunities do not always show up immediately — he had a lot of cash going into the crisis in 2008, and when stocks went down he made the deal with Goldman Sachs. He made the deal with GE. He made the deal with Dow. Even though it happened shortly after the crisis, he bought the railroad in February of 2010 at a price he would not have been able to get the board to agree to in 2007.

What I have always said to people with Berkshire, if they want the cash, if they want a 3% dividend yield, why not sell 3% of your holding every year? If your Berkshire is in a taxable portfolio, you will pay less tax on that synthetic dividend, if you will — you can be an investment bank in your own home — that synthetic dividend

will have a lower tax rate on it than if Warren paid a dividend, presuming you have a non-zero cost basis in the stock. Honestly, I do not understand the “He should pay me a dividend” argument at all, given that you have this option. It does not make any sense to me.

**Question:**

I have two quick questions. I might have missed the first one, but I was wondering what you thought of Valeant going forward, if you thought it was going to perform similarly well from now to next year. The other question I had that you might have answered earlier is based on kind of an expertise thing. I noticed that given your asset allocations mostly in equities that you are probably very correlated to the S&P, and I was wondering if you had ever thought about investing in other asset classes, going into FX, commodities or anything to maybe reduce that, or not?

**Bob Goldfarb:**

I would disagree with your statement that our equities are closely correlated to the S&P. They are not. That lack of correlation accounts for much of the significant variance in performance, in both directions, between Sequoia and the S&P over 45 years. The firm has invested in bonds twice since it was founded. But given the results from this week’s auctions, maybe we should have invested in art. We did not. And we do not have any plans to diversify on that score. With regard to Valeant, we are not any good at predicting short term movements in the stock; so we are not going to hazard a guess. But I would say that it is definitely ... it is a virtual certainty that we will have significantly lower returns from Valeant in the next five years than we had in the first five.

**Question:**

My main question was then do you plan on keeping the holdings at 20% or more of your portfolio, or are you going to plan to reduce that?

**Bob Goldfarb:**

We are holding on to it. We believe that the company will continue to grow EPS at a rapid rate and that the stock should do quite well.

**Question:**

Can you comment on Cabela's please? Was it a mistake? How long are you going to hold on to it? What do you think the future is?

**Greg Steinmetz:**

Yes, it was a mistake. I thought that by now the company would be getting close to earning \$4 a share, and it will be a little over \$3 this year if all goes right. We are holding on to it because the opportunity now is the same as when we entered. Unlike a lot of sectors in retailing, the hunting and fishing apparel business has not rolled up into the hands of one or two players. The mom & pops, the independent hunting and fishing goods stores, have 65% of the market. No company we think is better positioned to enjoy the benefits of the consolidation than Cabela's. Cabela's has some really good things going for it. One is the brand. Anyone who loves hunting knows Cabela's and it is a brand that travels across the country. The sale of branded apparel with the Cabela's name is close to a billion dollars a year; so you have a quarter of your revenue coming from that. There is a much higher margin on the Cabela's brand product than on the other merchandise. What I underestimated was just how severe the hangover would be from the surge in gun sales as well as the softness that developed in some of the company's other categories of merchandise.

As you know, right after Newtown gun sales took off because everyone was afraid that the government was going to say no more buying guns. So people ran out and got guns. Cabela's benefited more maybe than anyone else because it went out and bought every gun it could. So Cabela's had a lot of guns on the shelf. That has unwound and Cabela's is feeling it. The question has come up how far are gun sales going to fall?

We have already seen the sales of what they call modern sporting weapons, which are these things that look like AK-47s, really fall off. Handgun sales, on the other hand, have held up. Why is that? The biggest reason is the legislation has gone completely in the favor of the gun industry. It used to be you could only carry a concealed weapon in ten states. Now it is 43 states. So there has been a secular shift with regard to gun legislation that facilitates gun sales. Cabela's is doing what it said when we bought the stock, which is that it is adding a million square feet of retail space a year. What management has to do is figure out how to get comps back. Cabela's comparable store sales have been negative now for

six quarters. We think later this year the comps are going to turn positive and when that happens, there is going to be more enthusiasm for the stock. At that time, we would have to think again about what we want to do with it. But right now it is priced at a point where it would not make sense to sell it.

**Question:**

Your opening remark was that it was a mistake. And then you spent the rest of your answer telling us why it is a great company. I just do not understand sometimes. For two years in a row I heard that QinetiQ was a mistake, but we lucked out with that mistake. We did not luck out with Cabela's. Why? Sometimes I do not understand why you are so reluctant. Okay, it is a mistake. So you get out. Take your losses, find something better and move on.

**Greg Steinmetz:**

We think at the current valuation, it is not a mistake to be owning it.

**Bob Goldfarb:**

If the stock were selling today at the price for which we bought it, we would be selling it. So I do not think there is any inconsistency in Greg's comments.

**Question:**

I noticed the fund has a position in IBM and there have been many questions about Google. They seem to be companies moving in two different directions. Even though IBM screens cheaply on metrics, what is your attraction to the business right now?

**Will Pan:**

If you go back a little bit, IBM in 2010 put out a plan that it called the 2015 Roadmap. Management said that by 2015 it would be earning \$20 per share. That was through a mix of a little bit of revenue growth, a bit of operating margin expansion as the mix moved more towards higher margin software and other higher margin services. And also IBM was going to cut some costs. Then there was a large component that was repurchase of shares. The plan was credible. IBM had hit one before. It seemed doable going forward at the time.

Mike Tyson says everybody has got a plan until they get punched in the face. And IBM got punched in the face a couple times — IBM did not keep its hands up the whole time. So in 2013, the company had some issues with its mid-range UNIX hardware business. Two things happened. One was Intel got

more competitive at that range of systems. Then IBM also had been seeing good growth in those types of systems overseas. With Edward Snowden's revelations about the NSA installing back doors in western vendors' hardware, suddenly all those emerging market consumers, customers, got skittish, understandably. So IBM had an issue there. Also management was not able to grow its large software business as much as it thought it might. That is an execution issue on IBM's part. Management also maybe went a little bit too far in terms of cost cutting. It was not keeping its employees very satisfied.

Finally, the last issue that caused the company to abandon the roadmap came when the dollar strengthened. IBM is an extremely global company—75% of the sales are outside the United States. With the strong dollar, the company faced a very large headwind. As a result, in the third quarter of last year, IBM decided to give up the roadmap, probably a little bit too late. There were some cracks already showing and you could see them when the company repurchased a huge amount of its stock, \$8 billion worth, in the first quarter of 2014. It was also taking increasingly large restructuring charges.

On the other hand, the mainframe turned 50 years old recently and people have been saying it has been dead for 10–20–30 years. First mini computers came at it and then the PC came at it and now you have got the cloud. This is not lost on CIOs who have mainframes. They have not been sleeping under rocks—they have considered this. But consider what it means for the CIOs. If you are a bank and you run your core banking application on a mainframe and it has been running smoothly for 40–50 years. You pay tens of millions of dollars to IBM to maintain all that, but when you do the calculation on whether to replace that, at the end of the day, you get your core banking application on another platform. That is all you get. There is really no big ROI for that. Who would want to risk an entire career and an entire company on something like that?

As part of its roadmap, IBM has repurchased an enormous number of shares. Whether the company repurchased those shares on our behalf at a good price is going to be proven out by whether the company can take advantage of new waves going forward. One of the new waves is cloud. IBM was kind of late to the game there. But it is somewhat hard to blame the company because many enterprises

were quite reluctant. IBM really focuses on the global 2000 and if most of those customers were not really receptive, then there is only so much that you can do. You can spend a lot of money trying to force the technology but often it is really about getting the timing right. Apple tried handheld computing once with the Newton twenty years ago and it did not work. Then Microsoft tried a decade later with the tablet PC and it did not work. Only with the iPad did it work.

IBM has got a couple irons in the fire today: It is trying to seize mobile by doing a partnership with Apple and rewriting or adding new enterprise applications that run on iPads. Ginni Rometty, IBM's CEO, has been on this push for cognitive computing, which is trying to build expert systems like Watson that faced off against the Jeopardy champions. There are some other initiatives around security, which is paramount to IBM's customers. So we feel that the franchises are not going away. It remains to be seen whether the company is going to be able to capitalize on what it has got going forward. In the meantime, we paid \$130 on \$11.52 per share of earnings, and right now the stock is at \$174 on about \$16 per share of earnings.

**Bob Goldfarb:**

We have had three companies that have had roadmaps and to date they are zero for three. So beware of roadmaps.

**Question:**

Can we get updates on O'Reilly and Mohawk?

**Rory Priday:**

O'Reilly has been doing fantastic. Its first quarter comp was 7.2%, and it has been pretty terrific relative to some of its peers in the industry. It seems like the spread between O'Reilly's comps and the comps of the other companies has only increased. Every year one wonders whether the operating margin is going to go higher, and it keeps climbing higher. Management has done an excellent job. The company has moved into Florida and the Northeast. It is going to put as many as 300 additional stores down in Florida. O'Reilly added a distribution center there recently, and it has 130 stores down there right now; so that is a good growth opportunity. Management just mentioned that it is going to put a DC in San Antonio in 2016. So O'Reilly is adding about 200 stores a year. The business is comping right now in the mid to high single digits but that may well slow down at some point.

O'Reilly seems to have the strongest culture in the industry and a real focus on serving its commercial installer base. Also on the DIY side, O'Reilly has been outperforming DIY retailers in terms of comps for some time. A number of factors are driving the comps, but they all seem to be going in the same direction, and the company is firing on all cylinders.

**Terence Paré:**

We have owned Mohawk for a long time. But I feel better about the company today than I have in a very long time. There are a couple reasons for that. One, the company is practically a unique franchise. It is the only flooring company that has exposure across almost the entire globe and is in most of the important flooring markets in the world. Number two, its portfolio of brands covers just about every kind of flooring that there is. It will add sheet vinyl and luxury vinyl tile when it closes on the IVC acquisition, which it announced at the end of last year. So it will make every kind of floor covering, be in most important markets, and generally be the leader in just about every market that it is in. It is the largest ceramic tile manufacturer in the world, and ceramic tile is the largest floor covering in the world.

Somebody mentioned dividends earlier. Mohawk has never paid one. The reason the company has not paid one is that the management of the company, which I think is the best in the business, has found good things to do with the cash that it produces. Looking forward, right now Mohawk has room to grow around the world and it has room to grow in the US, not so much because the US is going to be a fast-growing market, but because the US still really has not normalized in its remodeling spending and in construction. So there is growth in the US. Mohawk has growth potential in Russia. It has growth potential in Mexico, and in different areas of Latin America. So it has a fairly long runway in front of it.

And there is M&A potential still. Even though it is the largest floorcovering company in the world, it is only \$8 billion in sales. So there are things to buy. The company will be closing shortly on an acquisition in Bulgaria, a company called KAI Group. The terrific thing about that is that there are lots of little ceramic tile companies in Eastern Europe that would benefit from the modern management and modern manufacturing that Mohawk can bring to them. And there are a lot of floors that need to be remodeled and a lot of domiciles that need to be built. Something like

two-thirds of the housing in Russia, for instance, needs to be remodeled because under the Soviet administration, nobody owned their houses. So nobody took care of them, and they did not have the money anyway. As a result, those homes are in a very serious state of disrepair. And Russia is not the only country like that.

A natural question would be — now Mohawk is in Russia, who knows what is going to happen there? What about all the currency issues that they face? Those are certainly real concerns. The company does not try to hedge the dollar against the ruble, but it does manufacture in-country a significant amount of what it sells in Russia. So although there is a lot of economic turmoil, Mohawk has a cost advantage over some other European flooring manufacturers who are competing against it in Russia.

In addition to having the advantage of a partial hedge, Mohawk has natural expansion potential because the company has a variety of methods of distribution. Mohawk has a chain of stores in Russia that it got when it acquired Marazzi last year. Part of it is franchised, but part of it Marazzi owns. It is run mainly by Russians. They have been there for ten years. The accounting can be believed. The company has been careful about that. So the business can grow both by expanding its market share through distributors, but also by expanding its retail network. There are many reasons to feel good about the future growth of the company, and it is inherently a cash generative business.

**Question:**

Could you describe what Danaher does and how it is doing?

**Terence Paré:**

Danaher is in a lot of different businesses. It started out as an industrial company making things like hand tools and engine retarders. It used to make Craftsman mechanics tools. But the company right now is basically — and in fact has reclassified its documentation with the SEC — to that for industrial instruments. Danaher makes things like oscilloscopes, mass spectrometers. It has a very significant dental business. But it still sells Matco hand tools, which are sold in vans that drive around to garages, industrial printers, medical gear, water treatment equipment, and more.

The business right now is in the headlines a lot because management recently announced that it is going to break Danaher into three pieces and it is going to acquire Pall, which is an industrial filter

company. One piece will be Pall and Danaher's instruments piece, and another will be the industrial businesses. On top of that, Danaher has a communications business. This is part of an earlier acquisition and was originally called Tektronix Communications. Without getting too far under the hood, Tektronix Communications makes gear and software that keep track of the way that the IT infrastructure works in enterprises. For example, it will track if there is some weird glitch going on somewhere in your enterprise system.

Danaher has decided to combine that piece of its business with a company called NetScout, which further complicates things because shareholders are going to be offered the opportunity to swap their Danaher shares for NetScout shares. These are very different businesses from the rest of the company. When the communications piece was in Danaher, it was fun to talk about, but it was relatively small. When it is combined with NetScout, we are going to have to make a decision about how we want to go about dealing with our Danaher stock. I am still working on this. Most of the big news about Danaher has only occurred in the past week or so. So we are still noodling over it. But like Mohawk, Danaher is one of our oldest positions. I think only Berkshire has been in the portfolio longer. Danaher has been a very good investment for us. Where we go from here right now is hard to say because we can elect to own one, two, or three pieces.

One thing I would say, and this speaks to a principle that Bob has pointed to before, and that is that there is significant insider ownership of Danaher by the Rales brothers. They will continue to serve on the boards of both companies after they split it apart. And Jim Lico, a Danaher executive vice president, will serve on NetScout's board. What is not clear to me is whether or in which entity or entities the Rales brothers are going to elect to receive a percentage of shares disproportionately higher or lower than their current ownership of Danaher. The Rales have made an awful lot of money for themselves — and they have made, relatively speaking on a percentage basis, a lot of money for us. They are not going to do anything ill-advised.

**Question:**

One source of successful investments in recent years has been corporate spinoffs. I am just wondering — there are not too many in the Sequoia portfolio, Zoetis, and if you go way back,

Praxair — have spin-offs merited your attention and do you think they will merit your attention in the future?

**Bob Goldfarb:**

We look at them and we are going to get another two with the Danaher breakup that Terence just discussed. So if they are large enough in terms of market capitalization, we will certainly take a look at them.

**Question:**

I have a question on Berkshire which I think is your second largest position. Warren Buffett now is what, 84, 85. What if he should die or get sick and can no longer manage the company? I know he has given it a lot of consideration. But how do people feel about it?

**Jon Brandt:**

Warren has the very unusual ability to have an instinctual way to find a deal — when he is in the bathtub call the CEO of Bank of America, or meet people ... Jorge Paulo Lemann from 3G on the board of Gillette 30 years ago, remember him and have a relationship with him so that when 3G had the idea of buying Heinz, 3G called Warren. Berkshire will always be a call for people who need capital for deals. That is not going to change. But Warren's unique ability to find those deals — it will be hard to duplicate that. Then the final thing is the people who manage the businesses, particularly the founders who sold to him, do they have loyalty to Warren or do they have loyalty to Berkshire? I think that will be a challenge.

That said, it is not easy for Warren to put large amounts of money to work at very high rates very often. A fellow from India visited me last week. He was comparing the more recent years' compound at Berkshire to the 50-year compound. He asked me whether I noticed that it is no longer growing at 25%, and how did I think about that? I said, "Yes, I have noticed that. It is virtually impossible." But I told Bob and David, I think if Berkshire can compound its intrinsic value at 10% over the next 10 or 20 years that would be an excellent result. My point is that the expectation has already gone down so much. It is very hard for huge companies to do 15%. And it will be hard for Berkshire to do 10%, given its size. But if the board picks the right candidate for CEO — and it already has two good CIOs, chief investment officers — 10% is still a realistic if somewhat difficult or challenging hurdle.

**Question:**

That begs the question why is it in second position, is it safety?

**Jon Brandt:**

It is a couple things. I cannot speak for Bob but it is reasonably priced. It is still at a discount to its intrinsic value. I would also say that we are not having great success in finding other things to buy. What are we in terms of cash, David, these days, in Sequoia?

**David Poppe:**

Close to 20%. In the last 10 years Berkshire's stock price has compounded at 10% while the S&P compounded at 8%. So Berkshire has actually outperformed by a decent amount over the past 10 years, despite its size. So you have to think of it in terms of it is still a decent holding; it is still ballast in a storm and Warren is still very, very good in a crisis at putting capital to work.

**Bob Goldfarb:**

I think he has done an excellent job of transforming the company or institutionalizing it with long duration assets, mainly the railroad and the utilities. I think the transaction with 3G is really driven by the operational management expertise of 3G, and that is a relationship that is going to continue for a long time. All three of these, the railroads, the utilities, and the alliance with 3G will likely consume very substantial commitments of capital. Consequently, the deployment of capital will be less of a burden for his successor than it would otherwise be. So I think there is less concern about Berkshire after Warren because of these measures that he has taken.

**David Poppe:**

We are almost at 12:30. How about one last question?

**Question:**

Your comments on Omnicom?

**David Poppe:**

Omnicom is one of four large advertising agency holding companies. The industry has really consolidated down, and there are four large ones left. We think Omnicom is best of breed, but in fact they

are all pretty good. It is a very good industry for a couple reasons. One is media is really fragmenting right now. For large corporations that have huge marketing budgets, it is getting harder not easier as advertising spending fragments to online, mobile, social, as well as TV. And TV itself just continues to fragment as there is more and more cable proliferation all the time. We think Omnicom has a good stable of creative agencies. Arguably, you could say Omnicom is the best creatively. Its agencies tend to win the most prizes, for whatever that is worth. Omnicom is also very good at the data analytics side of it as are the others. It is an area where the clients need the help; so we think it is well positioned for the future. Another tailwind is that the emerging world is really growing and global marketers want to reach those new consumers or newly wealthy consumers. And Omnicom, WPP, another big advertising holding company, these companies are necessary to reach those potential new customers.

Margins in the business reflect its necessity. The margins are quite high for everybody. I am not sure that there is room for margins to go up, but I do not think there is a lot of pressure for margins to go down, because it is a needed resource. But the last thing I would say is there is some pushback — as technology gets better, the clients will be able to buy more advertising in a programmatic or automated way. It will not be sold and the media buying agency maybe goes away over time. So far that really has not been the case. As there are more options of what to buy and how to target people more and more finely; the agency, so far anyway, seems to be just as necessary if not more necessary than in the past. Last quarter Omnicom's organic growth rate was 5% – 5.5%. That is a pretty good organic growth rate for a large company. I am not sure if 5.5% is sustainable but global GDP plus two is very sustainable, and that makes for a good business.

**Bob Goldfarb:**

We are going to bring the formal Q&A session to an end. But those of you who have unanswered questions, please come forward and we will try to direct you to the right analyst who can answer those questions. We thank you all for attending and we look forward to seeing you next year.

