Adam Blum's 2017 Berkshire Hathaway annual meeting notes
May 6, 2017

Friends,
Here are some of the notes I took on my phone at this year's Berkshire Hathaway annual meeting, held today in Omaha. As always, the meeting was an unforgettable experience.

Thanks,
Adam
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Pre-meeting video

-Almost the exact same as the video shown over the last few years except with clips interlaced from the Buffett documentary that recently aired on HBO
-Paul Anka and Warren Buffett sing a song to the tune of Anka's "My Way" - some lyrics:
"To our owners, so devout, like Michael Sam, you all came out."
"Such a crock, to pay with stock."
"Deb [Bosanek] does it all, except for Dallas."
"Failures few...you must not know of Dexter's Shoe."

Introductory Comments

Warren on he and Charlie: "You can tell us apart, because he can hear, and I can see."

"The realized investment gains or losses in any period really mean nothing. We don't really think about the timing at all, except in relation to our intrinsic value." Over $90B in unrealized gains is in the company. They have a slight preference for taking losses as opposed to gains for the tax effect, mainly this year as they're taxed on gains at 35% and also get tax benefit on losses. There's some chance that their corporate income tax rate will be lower after this year, meaning losses would have a smaller tax benefit in the future.

It was a wonderful period at GEICO, because competitors have intentionally cut back on new business. New business brings significant acquisition costs in the first year, and there's a higher loss ratio on new versus renewal business. Out of fear of missing earnings, GEICO's publicly traded competition didn't want to pay the penalty on first-year loss and originated fewer policies. "Of course, that's made to order for us, and we just put our foot to the pedal."

Float increased $14B to $105B year-over-year in the first quarter of 2017. It's nice to have that. And that's one reason cash is so high. Warren feels very good about the quarter even though operating earnings are lower. "One quarter means nothing as long as we build value."

Special recognition of Jack Bogle (Vanguard Group): "Jack has done more for the American investor than anyone in this country. Index funds wouldn't have happened without him. It was not in the interest of Wall Street to develop these, because they brought down fees dramatically. They have delivered for shareholders a result better than Wall Street professionals as a whole, in part due to low costs. Jack at a minimum has saved investors tens of billions without hurting them, and those numbers will be hundreds of billions over time - happy birthday, Jack (88 on Monday) - I've got good news for you, Jack. In only 2 years you'll be eligible for an executive position at Berkshire, so hang in there, buddy."

Q&A

Q1 - Wells Fargo's decentralized structure gave too much autonomy to community banks. How is Berkshire Hathaway not exposed to this same risk?

"We have a more decentralized plan than any company remotely near our size and count more heavily on principles of behavior than loads of rules." Warren shows the Salomon Brothers testimony at every meeting and issues very few communiques to managers - once every 2 years – he tells them that they have all the money they need but don't have any reputation to lose - better than a thousand-page guidebook. With 367k employees, people are always doing something wrong. The real question is whether managers are worried about finding and correcting bad behavior and whether that gets to Omaha.

Wells Fargo had three big mistakes, but one stands out. The incentive system there was built around cross-selling and the number of services per customer. This incentivized bad behavior. Undoubtedly, people were paid and promoted based on this number. "We have made similar mistakes in designing the system, but at some point the CEO gets wind of it and has to act." The Salomon CEO (John Gurfreund) found out Paul Mozer was "flimflamming the US Treasury" on April 28th, and right then he had to report Mozer to the Fed Board. Gutfreund didn't do this, because it wasn't the pleasant thing to do, and then on May 15, at another US Treasury auction, Mozer the pyromaniac lit another fire, and then it was all over. It had to stop when the CEO learned about it. The last mistake was that that Salomon totally underestimated the impact of what they had done when it came out; the total fine was small, and so management measured the seriousness of problem by the size of the fine. The main problem is the CEO didn't act when he learned about it. At Berkshire Hathaway, the main source of info for Buffett of anything done wrong at any subsidiary is the internal audit hotline - they get about 4,000 alerts a year - most are frivolous, but anything serious has led to action. It's a good system but not perfect. Buffett assumes a lot of communications came in like this at Wells Fargo and that it was a huge error if the complaints went ignored or were sent to be addressed back down below.

Munger: "Put me down as skeptical when some law firm thinks they know how to fix something like this. If you're in a business like Wells, you need a huge compliance department, but doesn't mean everyone should solve problems with compliance - entrusting good managers is a better system."

"An ounce of prevention is worth more than a pound of cure."

"Gutfreund described his problem at Salomon as a traffic ticket"

Q2 - autonomous technology - Driverless trucks are a lot more of a threat to BNSF than an opportunity. Driverless cars being pervasive would mean that they're safe and would cause harm to the insurance industry. If they make the world safer, it will be a very good thing but not for insurers or railroads.

Charlie: "I think that's perfectly clear."

Q3 – investing sweet spot – "You know it when you see it." It's a business that they can look out 5-10-20 years and see a decided competitive advantage that would last over the period with a trusted manager that would fit in with and was eager to join the Berkshire Hathaway culture. Then it's a matter of price; they're willing to lay out a lot of money now based on what they think an asset will deliver over time. The higher the certainty, the more comfortable they are with the price. In 1972, the question was, "would folks in the future want to buy high end candy?" To date they have taken out $2B pretax from See's Candy, so that was a "yes." "It doesn't work very well if you go to your wife or girlfriend (I hope they're the same person) and say 'here's some candy, I bought the cheap one,' so See's did have a bit of a moat"

Charlie: "We were young and ignorant then; Now we're old and ignorant."

"We would be very wise to buy at a slightly higher price but wouldn't have done it then. We looked a lot smarter than we were. Charlie would've bought it for more, but I was unwilling."

The founder's grandson wasn't interested in the business. He was more interested in girls. But he almost changed his mind and didn't want to sell. Rick Guerin said Charlie spent an hour talking to the kid about the merits of girls and grapes to convince him."

Their early experience of fixing unfixable businesses was a benefit. They couldn't make a purse out of a sow's hair and had to rub their noses in bad businesses to learn what they didn't want to do or couldn't do.

Q4 - Berkshire Hathaway major stock holdings are businesses Buffett likes. Being the largest holder of the four largest airlines isn't much more than just industry thought. All businesses have some problems; they didn't buy them with the idea that would never have competition. The largest holdings are in strong hands, and Buffett likes their financial policies and position. Where do they have durable competitive advantage? A good business will have several new competitors, but investors must judge the ability of management to ward off competitors.

A good company is an economic castle. The moat around it protecting it, and there's a knight in there warding off marauders. The marauders will never go away. Coke in 1886 Amex and 1852, were founded and had lots of challenges past, present and future. Insurance has them too. They paid $8mm to purchase National Indemnity in 1962, and now their insurance holdings are tens of billions of dollars. There will always be things to do that really intelligent management and a decent distribution system can do to ward off marauders; Buffett reviews the stock portfolio every single day.

Charlie: "I don't think I have anything to add there either."

Q5 - confidence in retroactive insurance of AIG being profitable

"At the time we do every deal, I think it's smart!" AIG transferred to Berkshire Hathaway 80% of the excess of $25B up to $20B limit; Berkshire Hathaway got $10.2B for that. "Ajit has made a lot more for you than I have." Ajit and team have come to conclusion that they will pay out less money and at a slower rate than the $10.2B received. Ajit does 99% of the thinking and know they may be wrong but they're conservative. They were wrong on one transaction in the past like this but have done ok overall. Warren was interested in the $10.2B, but it's hard with $90B+ in cash earning peanuts. "Earning peanuts" is not an attractive use for the capital. They need to have a use for it, and they will.

Charlie thinks this transaction is intrinsically dangerous but there are no two better people in the world to assess it than Ajit and Warren – "get me in a lot more of these businesses, and I'll accept that worry."

Berkshire Hathaway is the only business in the world who'd have taken on that business in a way that AIG would've accepted.

Q6 - for Munger - memorable negotiation - What did the most good was his learning experience with See's Candy, seeing the power of the brand and the unending flow of ever increasing money with no work. He wouldn't have bought Coke if he hadn't bought See's. "A life properly lived is just learn, learn, learn all the time." Every time they appoint new person who hasn't had capital allocation experience, it's a roll of the dice – "if we had stopped learning, you [shareholders] wouldn't be here - you'd be alive, probably, but you wouldn't be here – there's nothing like the pain of getting into a lousy business to find a good one - the first rule of fishing is to fish where the fish are, and the second is don't forget the first."

They bought a department store in Baltimore in 1976 with risk of competitors coming into this new market and both failing. They learned over time which things to avoid. "Experience is like eating cockleburs – it really gets your attention."

Q7 - tech companies; When they bought IBM 6 years ago, they thought it'd do better than it has; Apple is much more of a consumer products business in terms of analyzing the moats around it; wrong on first but will find out on second – "not apples and apples but not quite oranges."

They avoided tech companies, because they didn't want to play where others were better. Their mistake was seeing Google and being impressed but never investing in it. They were close to it and seeing the impact of it with the pay per click stuff but never pulled trigger. Munger added that Walmart was a total cinch, but they didn't figure it out and blew that one too.

It's harder to predict winners and price competition in tech.

It's remarkable where one person has built extraordinary economic machine in two different industries simultaneously like Jeff Bezos – if a CEO in his industry had a silver bullet and could get rid of one of his competitors as Intel's Andy Grove used to hypothesize, competitors on both sides would be pointing at Jeff in the cloud and in retailing; Jeff has been involved in the business execution, not just bankrolling it, so it's even more impressive.

Munger: "We are sort of like the Mellons - old fashioned folks who've done right, and Jeff Bezos is a different species."

Q8 - airlines – Their investment has no connection with the railroad business or any other business. Long term, one couldn't pick a tougher industry ever since Orville went up. "If anyone had ever been

thinking about investors, they would've had Wilbur shoot him down." Hundreds of airlines have gone bankrupt. Buffett said the dumbest things he'd ever done was buy USAir, but he made money off it, then the company went bankrupt twice. A number of factors make for terrible economics. The question is if it's suicidally competitive. The industry has been operating at 80% or better of capacity (seat-miles), and they can see visibility into deliveries. It will be at higher capacity than it was historically, but will they do suicidal things with pricing? It remains to be seen. Today the airlines are earning higher returns on invested capital than FedEx or UPS, but that doesn't mean it will last when someone cuts prices or fuel prices go up. The conditions have improved, as there's more labor stability having been through bankruptcy, and now the airlines have an industry pattern of bargaining.

Munger: "The Investment world has gotten tougher. Maybe now we have small statistical advantages when before was like shooting fish in a barrel. It's ok to have things get a little harder when you're filthy rich."

Even if airlines are worth a little less than today, the investments will do well in fived years just from stock repurchases.

Railroads were a terrible business for decades, and then it got good.

They bought all four airlines, because it is hard to distinguish who will do best. Revenue-passenger miles should be higher in 5-10 years, but the question is what the companies' operating ratios are, and will they have fewer shares outstanding from buybacks?

Q9 - protestor on a rant

"That's marvelous."

"I've been eating things I like to eat all my life. I drink about five Cokes a day. It has about 1.2oz of sugar in a can. I happen to believe that I like to get my sugar this way, and it's enjoyable."

"If you told me that I'd live one year longer by only eating broccoli and asparagus as my aunt suggested, I'd rather eat what I enjoy."

"Coca-Cola has been a very positive factor in America and the world for a long time."

Munger: "I solved my Coke problem by drinking Diet Coke, and I swill the stuff like other people swill I don't know what. I have breakfast with Warren, and he has nothing but Cokes and nuts."

Buffett: "It's pretty damn good. There's something in longevity about feeling happy in your life."

Q10 - intrinsic value can only be calculated in retrospect – It's the cash to be produced between now and judgment day discounted at a reasonable rate. The last 10 years, their stock has compounded about 10% - it is impossible to achieve this return continuing in this interest rate environment - in Japan their interest rates sustained for 25 years, so one can't just assume rates will change. The chances of a terrible result are as low as one can find and same for sensational result. Buffett's best guess for the stock in future is a 10% return, assuming some higher interest rates.

Munger: "In the future, with our present size, in terms of rates of return, will be less glorious than the past. We keep saying it, now we're proving it. But it is still a collection of businesses on average that has a better investment return than S&P 500."

They have more shareholder orientation than the S&P. Their culture is one where decisions are made as a private owner would make them. This is a luxury that other companies don't have that have other pressures. Buffett asks CEOs of other companies "what would you be doing differently if you owned it all yourself?" The answer at Berkshire Hathaway is they would be doing exactly what they are doing.

Munger: "A lot of other people are trying to be brilliant, and we are just trying to be rational. Trying to be brilliant is very dangerous, particularly when gambling."

Q11 - lower tax rates will pass through to customers in utilities businesses – Buffett says that all returns are calculated after tax; for deferred taxes on unrealized gains on securities, they will get the all the benefit - for some other businesses some tax benefit will be competed away and some won't be – he has seen it in action - some will inure to shareholder benefit and some will be competed away - company-specific – but the $95mm off deferred taxes ($9.5B x 10% tax rate reduction) is real.

Munger: "If things go to hell in a handbasket and then get better later, we will do better than others. We are good at navigating through that kind of stuff."

"When the rest of world is fearful, we know America will come out fine. We won't put the company at risk. We'll grab all the opportunities we can without losing sleep."

Q12

Sold his used Cadillac for $100k plus to benefit Girls Inc - the buyer didn't have any license plates on the car but was pulled over. Cops were skeptical of his story, but Buffett had signed the dashboard, and the cops saw that and asked if the driver got any stock tips; Buffett can't recall ever selling a used car at a profit other than that time.

Q13 – why did Buffett advise his wife to invest in index funds versus into Berkshire Hathaway? She won't be selling to buy an index fund - every single share of Berkshire Hathaway will be going to philanthropy - so far 40% has been distributed - for someone who's not an investment professional, what's the best investment where there's less worry than anything - big thing is money to not be a problem – there's no way that there will be an issue absent a nuclear attack if she invested in the S&P; Buffett's aunt Katy, whose husband used to employ Charlie and Warren, worked all her life and died at 97 with a few hundred million dollars, because she was in Berkshire Hathaway. She'd write Buffett and say she hated to be a bother but was curious if she would ever run out of money. Buffett told her that she'd run out only if she lived 986 more years. There will be people who come around with various suggestions on what to do with the money he leaves his wife, and there's a chance she won't have as much peace of mind only owning one stock as owning the index.

Munger: "The Mungers are different - I want them to hold the Berkshire. The S&P algorithm is very hard to beat, but I an just more comfortable with the Berkshire Hathaway"

Buffett: "It's the family business ."

Munger: "If you protect your heirs from stupidity of others, you may have some good system, but I am not much interested in that subject."

Q14 - would've invested additional $15B each with 3G in Kraft-Heinz if there was a friendly deal to be had with Unilever.

Q15 - how to spread value investing philosophy? Keynes wrote about the propensity of people to speculate - when it gets rampant and "social proof" that some speculation worked recently, it gets more widespread. "There's nothing more agonizing than seeing your neighbor who has a lower IQ getting richer than you are." Early on in development of markets, there is more tendency for speculation than markets that have been around a few hundred years. The casino aspect of markets comes into play with people seeing others doing well. China being a newer market with widespread participation is likely to be extreme.

Charlie certainly agrees. "The Chinese will have more trouble. To the extent you're working on it (teaching rational value investing), you're on the side of angels, but lots of luck."

"Fear spreads like you can't believe, unless you've seen it." $175B flowed out of money market funds in three days during the crisis. If they think there's easy money, people will rush to it and create new converts until the day of reckoning comes.

Munger: "We've done a lot of preaching to not much effect."

Buffett, implying that they've capitalized on no one being rational: "And that's probably good for us!"

Q16 - impact of investment tax credit – Tax issues do not enter into calculation of an investment or portfolio allocation at all at the Berkshire Hathaway level. It's true in wind and solar that they're dependent on the tax law (government wants to move people's energy preferences against what the market system is doing), and they wouldn't have been done without subsidization. But changing depreciation schedules won't impact what they're going to do on the railroad to make it safer and more efficient. They can't recall in all the years saying "do this because tax laws are being or might be changed;" it'd be useful if the chairs of the House/Senate tax committees would flag the effective date of the changes.

Munger - nothing to add – "I wouldn't change anything at the railroad over a tax jiggle."

Q17 - coal declines - It will die over time. The specifics of any given year relate to natural gas prices - demand is up for coal from last year because gas is higher-priced; the speed of the decline is unknown, but people don't create generation plants overnight.

Munger: "Over the extremely long term, all hydrocarbons will be used, including all the coal - they're huge resource for all of humanity and have no good substitute. I am all alone on this one, but I want to save them for the next generation. We will use every drop sooner or later even as chemical feedstock. I expect natural gas to be short in supply eventually."

Storage is a real problem even if they have the capability of producing a lot of energy from wind or solar.

Q18 - would love to find capital-light companies - Buying a high return-on-assets company with low capital intensity beats the hell out of a similarly growing capital-intensive business. The five largest US market cap companies are $2.5T, close to 10% of whole US market. One could run them with no equity capital at all. "It's a very different world than Carnegie's steel mills and Rockefeller's tank cars – you literally don't need any money to run the top five companies in the country." Buffett owns a few businesses like this, but they don't grow - if he could find them in a field that grow, they would be at the top of the list.

Munger: "The world has changed a lot, and people who've gotten into these businesses have done very well."

Buffett: "A lot of people chasing that are receiving a lot of money from venture capital. It's a wonderful field, but not everyone is going to win big."

Q19 – Abdication/delegation of management duties to subsidiaries enable businesses to run better than if the subsidiaries were part of the S&P 500 and were targets of activists looking for a jiggle in the short term. Their structure frees up at least 20% of the time of a CEO who otherwise would have lot more responsibilities at a public company in terms of meeting with analysts, etc. The CEOs at Berkshire Hathaway can spend all their time improving their businesses.

Munger: "We are trying to be a good example in the world. No one would be here at the meeting if we didn't set a proper example and weren't honest."

Q20 - structured settlements - they issue these for insurance companies to give folks a lump sum against the payment stream from injury settlements - Berkshire Hathaway has a preferred position because they like the longer maturity situations. The assumption that they can earn more money than is inherent in the cost of these injury settlements; people trust them more than others to make the payments - if interest rates continue at present levels, will have some losses though; have to make sure the original claimant is still alive as they can't count on relatives of the deceased to "turn off the faucet."

Q21 - held equity in USG through asbestos bankruptcy – because it was very cheap. The business was disappointing, because the gypsum business was disappointing. Managements of gypsum businesses got too optimistic each time the business rebounded, and supply exceeded demand over the years.

Q22 - impact on insurance of Ajit leaves - He's irreplaceable, but there's a terrific operation in insurance outside of him, which is terrific-squared with Ajit. A lot is institutionalized and extraordinarily able management is there. They bought Guard Insurance in Wilks-Barre, PA, and it's been a gem with brilliant management. The same goes for other businesses Ajit bought. Medical Protective with Tim Kenesey was the same story. Buffett thinks without Ajit, they'd still have world's best P&C insurance operation.

Munger: "A few years ago, California changed the workers comp law, and Ajit just took $10B out of the air - he saw it when no one else did."

Producing underwriting profits while someone is handing them over float is the best business. This gives them hundreds of billions they can earn on, as if someone handed them $104B and paid them to hold it. Now with all the investment managers doing reinsurance offshore for permanent capital, it's gotten more competitive, but it's still a wonderful business.

"I've just been handed something Kraft-Heinz came out with - some of the members of the audience may not approve - it's a 'create your own cheesecake' concoction, and it's a 170 calorie one - I've had three of them - I will let someone else eat the broccoli but I will eat five of these."

Q23 - succession plan – It's still the same as it was before. They have never had more good managers than they do now. The managers have the jobs they want in life, which is a lot better than having a lot of folks who want to run Berkshire Hathaway one day.

Q24 - where to go fishing for the next 3-5 years? They don't discuss sectors of interest much nor the macro environment. Instead, they're purely opportunistic and look at all sorts of businesses all the time almost as a hobby. They have a bunch of filters and know in first five minutes or less "can we really ever know enough about this to make a decision?" It's getting harder to anticipate consumer behavior than they thought in order to project returns on present and prospective capital. But they still reading signals from people in the first meeting with the other side.

Munger: Some subsidiaries do bolt-on acquisitions that make sense, but the general field of buying companies is competitive with all these leveraged buyouts ("and don't call it private equity – that's like a janitor calling himself chief of engineering"). Leveraged buyout people can get to a decision within a week with shadow banking and all. "We do well, because people don't want to sell to those guys." A 61-year-old business owner with all the money he needs told Buffett that all he's worried out on his drive to work is that he doesn't want to leave his wife stuck with the business. He can't sell to a competitor who will dump employees. He can't sell to leveraged buyout firm that'll leverage it to the hilt and then resell it. "It isn't because you're so special, there just isn't anyone else who I want to buy the company - if you're ever proposing then don't say that!" They will lose a lot because of the cheap money out there. "If all an owner cares about is getting highest price, we are not a good call. We can offer happiness to a person who sells us the business. He will have lots of money and be doing what he loves doing while leaving family and employees in the best possible position. This is not the equation of many people who buy businesses borrowing everything they can and resell after dressing up the accounting."

Q25 - successor compensation Buffett allegedly said he'd think about and address at a future meeting: "At my age, I don't have to worry about things I said that I would do later." He hopes for someone already very rich who's been working a long time and is not motivated by 10x or 100x the money they think they need. He hopes to find someone who may even set the example of taking less than what market value is. They'd pay a very modest amount with an option that's increasing in strike price annually assuming there are substantial retained earnings each year (why reward a manager for keeping money?). They'd maybe even make the options exercisable only a few years into retirement.

Munger: "I have avoided compensation consultants all my life. I hardly can find the words to express my contempt."

Buffett: "If the board hires one after I go, I will come back."

Munger: "There's a lot of mumbo jumbo in this field, and I don't see it going away. What consultant will ever get another assignment if he recommends the CEO payment be in the 4th quartile. It produces an inconsistent result with how representors of an owner should be."

"Capitalism is golden goose we all live on."

"The only excuse I won't take is that everyone else is doing it - just like in stock compensation not being viewed as a cost. It's worse than Galileo. I would hope that my successors would already be wealthy."

No Berkshire Hathaway director is in it for the money. They have bought all their stock in the public market.

"How can a director who hasn't shelled out a dollar for stock be counted on to do what's best for owners?"

Q26 - intermodal will do very well, but car loadings peaked in 2006. Trains have big advantages over trucking in many respects. It's not a volume growth business but still is a good business. He likes the West US better than the East US for rail. They can't expect aggregate car loadings to increase though.

Q27 - any potential successor with proven capital allocation abilities will be at the top of the board's mind. Capital allocation is incredibly important. The company has $280B of shareholder equity, and in the next seven or eight years, we will have to allocate $400B or more. Berkshire Hathaway will be an aggregation of businesses in ten years with more allocated capital in that period than in the entire prior history of the company. This capital allocation needs to be very close to the successor's main talent. If the successor hasn't done it but has other talents that cause his career rise, it's like getting to Carnegie Hall by playing violin and then walking on the main stage and being given a piano to play. People have to have a money mind. They can be very smart but make very unintelligent money decisions; their wiring works that way.

Munger: "Also there's the option for the successor of buying in stock (stock buyback), which is not hopelessly unintelligent."

Buffett: "A money mind will know what needs to be done. It's not complicated when thinking straight about it."

Q28 - value of money managers - would Buffett pay a fee to Munger for his counsel? There are maybe a dozen people he has known who he'd have predicted or did predict that the person would beat the average over the long term. Charlie is one of those. "Would I pay financial advisors as a group? Not a good question. I'd have paid $100K for Babe Ruth to come over to the Yankees from the Red Sox in 1919 but not for many other players. If you hire an obstetrician, they will do a better job than someone off the street. In all the professions, there is value added by professionals. But in the investment world, it isn't true. They can't do better in the aggregate than the person who just sits tight. Active guys here and there will outperform, but how do you find them?"

Munger: "It's even worse. An expert who is really good at money management suffers terrible performance problems when he gets more money in. The investing world is a morass of wrong incentives, crazy reporting and a fair amount of delusion."

None of the 12 folks Buffett would have invested with would even beat the S&P 500 with $100B, only with moderate sums. It's a interesting profession when hundreds of thousands of folks are compensated by selling something that can't be true. "Salesmen will always make huge money by selling something magical." In any other field, 2% management fee on a poor performing fund would be viewed as tragic. "We pay Combs and Weschler $1mm a year plus what they do to beat the S&P, and this just doesn't happen with other money managers. They charge 2 and 20, because they can't get 3 and 30."

Q29 - Precision Castparts - made 2 bolt-on acquisitions already because they have an extraordinary manager and are in a terrific position in the aircraft field. They will make more bolt-ons over time. The only big purchase adjustment is the amortization of intangibles of $400mm. Buffett doesn't regard the asset as actually being diminished at that amount over the period. He's also not tremendously worried about the 3-D printing of aircraft parts. "Can anyone do it better or cheaper?" Overall, he feels very good about it – the company has long term contracts and is viewed as a trusted supplier. Reliability in that space (aircraft engines) is incredibly important.

Munger: "It's a very good business purchased at a fair price but no bargain like we used to see in the old days - but that's ok."

Buffett: "On the topic of adjustments, starting in 2018, there will be an accounting nightmare, because we will have to mark publicly held equities to market through the Income Statement. This will confuse the heck out of GAAP earnings. Berkshire Hathaway is not a Wall Street securities firm, so this is just a big distortion. Accounting is not supposed to describe value but can be useful in specific situations for estimating value."

Munger: "You can blame the auditors for that one - that was really stupid."

Buffett says they will do their best to explain what to use and ignore in coming to a judgment in valuing the Berkshire. Holdings.

"What can be silly this year will become absolutely ludicrous next year."

Q30 - probability of duplicating track record in China - Charlie says it's like determining the order of precedence between a louse and a flea. The stock market there is cheap and has a bright future, but there will be growing pains. He has an opportunistic way of going through life and doesn't have any rules about what to look at.

Q31 - 3G cost-cutting - They believe in having a company as productive as possible - and all gains in this world have come from productivity; they have been doing that in every industry since 1776. Buffett prefers to buy companies that are already running efficiently, because don't enjoy the process of getting more efficient. And there are political consequences that do hit businesses from cost-cutting, but 3G focuses on product improvement and innovation. "If you had the cheesecake at lunch then you'll agree with me." They have been through the process of buying a textile business that went out of business or a department store that went into oblivion. It's not much fun cutting jobs.

Munger: "There's nothing wrong with increasing productivity. But just because it's right doesn't mean one should always do it. It can be counterproductive from the bad publicity."

Q32 - raising share buyback threshold from 1.2x book value – When the time comes that they can't put the money out at a rate of return that is justified, they will repurchase cash or issue dividends. At the moment, they're still optimistic about deploying capital, so Buffett wouldn't move the price threshold much closer. It's already a narrow spread to the market price. The last thing they want to do is own something at 100x earnings if the business can't grow. They shouldn't use shareholder money that way. But they're sure that sometime in next decade, there will be markets where they can do intelligent things on a big scale; "We can't come back in three years with $150B in cash and think we've done something brilliant."

Munger says the answer is "maybe."

Q33 - CTB subsidiary - makes equipment for poultry growers – Buffett can't address their rights violations but will put the gentleman in touch with people who can fill him in. Buffett is pessimistic on weapons of mass destruction, though nuclear isn't as likely as biological or cyber. It's the number one problem of mankind.

Munger: "I don't think we mind killing chickens, and I do think we are against nuclear war."

Q34 - Todd and a Ted manage a proportion of Berkshire Hathaway capital that's similar or higher than when each one started – it's tougher to run $10B than $1-2B. The hiring decision has been terrific. Each has made more money than Buffett would've made and has been a terrific help beyond just money management. They're smart, have money minds, are good at investment management and absolutely fist class human beings. Charlie gets credit for Todd and Warren for Ted.

Munger: Shareholders are very lucky to have Ted and Todd, because both think like shareholders.

Buffett: "It's hard to find young, ambitious talent who don't put themselves first; giving them another $30B each won't improve their lives or performance."

Munger: "It's a lot harder now (with $90B in cash to deploy)."

Q35 - A shares voting rights diminishing? Are they thinking of buying back A Shares on the private market? Depends on the price. Buffett has given away $2.8B of A shares each of last two years. This is immaterial - 7/10ths of 1% of the company's market cap. They bought a block of 12,000 shares of A in 2012 off-market, because it was offered at a discount to the intrinsic value. Buffett said he was comfortable buying it up to 120% of market value. Ture, the foundations he donates to may build up a position over time as they accumulate Berkshire stock before selling it, but they will have to sell it as they spend on their causes. Buffett likes the idea of a fair number of votes being concentrated with people who believe in the culture. If they can buy A shares back at an intrinsic value discount, they will do it again.

Q36 - Do you know any eligible bachelors in NYC area? Joking. BofA warrant with option to convert into common stock - if the price >$7, whether or not they keep the stock, they will exercise it before expires. The income from the investment increases if BofA paid $0.11 per quarter dividend (>$300mm a year), so if they get to that level of dividend, they will exercise since the common dividend would exceed the $300mm. Would they want to keep the stock? As of today, he would use the warrant to convert and keep the common stock. Who knows in 2021, when they can sell.

Munger: "It's very wise for a woman who owns Berkshire Hathaway and is good looking to put her picture up like that."

Buffett: "We might actually start selling ads in the annual report."

The BofA purchase came to him in bathtub, and he spent a lot of time there ever since, and nothing's come to him, so he may need a new bathtub.

Q37 - 3G question - 80% of the US population worked on farms 100 years ago. Any industry tries to get more productive. If one can do business with fewer people, that's what American businesses do - it's very painful but absolutely essential to become more productive as that's the only way to have more productivity and consumption per capita.

Munger: "We don't want to go back to subsistence farming. I had a week of it and hated it growing up. I also don't the miss elevator operator sitting there with a crank. Why would we do it (fire people)? We had to in the past when businesses were dying. There's some political fallout but nothing that isn't moral."

Buffett remembers the old story of seeing a bunch of men working digging a trench by hand with idle digging machines in the background. Someone asked why not use machines to do the men's job? The answer was "well, that would put them out of work." The questioner said, "give the men spoons at least."

Q38 - buying power – They won't come close to hitting their $20B cash floor. They could use debt for something that lit their fire, which is unlikely today. They could do a very large deal if they thought it was sufficiently attractive. They spent $16B when they were much smaller over a three-week period in 2008 and never got to a problem where they weren't sleeping at night.

Munger: "$150B is probably too big for us."

Buffett: "We both would do a very big deal."

Munger: "We don't have to agree perfectly."

Buffett: "If we found a deal that makes compelling sense, we would do it."

Munger: "Now you're talking."

Q39 – 3G's Jorge Paulo Lemann as a Berkshire board member or successor – It would complicate things. Buffett loves being their partner and will do more with them. The board may not change in next few years, and his successor is likely to have been with Berkshire Hathaway.

Munger: "My back hurts, and I come to this meeting to indicate to the shareholders that they probably have seven good years to get out of Warren."

Q40 - Fruit of the Loom hasn't been hurt by online so far, but anyone who thinks they're insulated from it is incorrect. The furniture operation is also setting a record this year; it's hard to see the effects from online (outside of their own online operations). There are a lot of things they didn't see ten years ago that then materialized, that said. Nebraska Furniture Mart's online business is now at 10% of total volume, but a significant amount of the online buyers still go to the store to pick out the furniture. There are no illusions that ten years from now will look anything like today. One hundred years ago, department stores offered incredible selection and a big, exciting experience of variety, decent prices and streetcar accessibility and then along came the shopping centers followed by the discount stores and now the Internet, where transportation has been taken care of entirely. They are much expanded in assortment, more convenient and have lower prices. A lot of questions in retail are very interesting to watch.

Munger: "It would certainly be unpleasant to be in the department store business. We are fortunate ours failed so badly that [Berkshire director] Sandy Gottesman talked us out of it. We got lucky."

Q41 - book value has a lot less relevance than it used to because of so many private holdings at Berkshire. The best method is to calculate intrinsic value, but they can't be precise. The probability is exceptionally high that 120% of book value understates intrinsic value. If Berkshire were all public securities, 120% would be too high, but there are so many private holdings with unrealized value.

Munger likes it when marketable securities go down and owned businesses go up.

Q42 - "You've only tweeted 4 times" - "it was either going that or going to the monastery." They made a large investment in IBM which has been a significant laggard and expect to end up being 1-2 vs 0-2, but will find out (Apple). Buffett makes no pretense of being on intellectual level of some 15-year-old into tech. He does have some insight into consumer behavior, though. And he will make some mistakes in marketable securities. "You can't bat 1.000 no matter what industry you are in. We've lost money on insurance. I've gained no real knowledge of tech since I was born."

Munger: "It was a very good sign that Warren bought Apple. Either he's gone crazy or is learning. I prefer to think he's learning."

Q43 - artificial intelligence - They bet a lot will happen in AI but have no insight. This would result in significantly less employment in certain areas, and that's a good thing. Is the world better off if 1 person can do the job of 143 million people? Of course it is. It would require a great deal of adjustment, but is a good thing. Artificial intelligence is great for society but is disruptive and can have huge problems in terms of democracy. Like in trade, the small invisible benefits to consumers don't show as prominently as the harm incurred by the displaced local manufacturer.

Munger: "I give you golf lessons while you dye my hair. It's like the royal family of Kuwait. We can't have all the work so concentrated to leave so many at leisure. But a few percent per year of gain is a wonderful thing. No one ever complained about the advent of air conditioning. I am worried more about the change not being fast enough."

Q44 - solar/wind - They don't look at it in terms of capacity; they just look at what comes along. They have a big appetite for either one. They have done more wind lately but have no bias. They're well-situated, because they pay lots of taxes as a multi-pronged enterprise and can use the tax benefits better than electric utilities who often don't have enough tax money to offset with tax credits.

Q45 - Amazon – They didn't buy it, because they were too dumb to realize what was going to happen. They didn't even think about the Amazon Web Services possibility and didn't think Bezos would succeed like he has in retail. They underestimated the brilliance of the execution. "You can read Bezos' annual report in 1997, and he lays it all out. And he has done it and done it in spades. It just always looked expensive."

Munger: "It was easy. What was done there was very difficult; it was not at all obvious that it was going to work as well as it did. Other things were easier, and we screwed those up. I don't regret missing it - I do with Google. We'll miss out on more, but that's our secret - we don't miss out on them all."

Q46 - board buying back stock if the company's stock drops after Buffett dies – There have been a few times where people aggressively repurchased shares after playing games to depress the shares.

"Encouraging shareholders to sell at lower prices knowing you're going to buy back shares is reprehensible." Buffett thinks the stock is likely to go up if he dies on breakup speculation alone. People would say Buffett obstructed breaking up something where the sum of parts might sell for more than the whole.

Munger: "We might suddenly get very stupid very quickly, but I don't think board will have that problem."

Q47 - companies benefitting from stock grant accounting - not a factor at Berkshire Hathaway

Munger: "It's not a big deal"

Buffett: "There are few things in accounting we really disagree with like amortization of intangibles - unless it's material, we stay away from fighting it."

Munger: "I certainly agree with that (that stock grant accounting changes are not material to Berkshire Hathaway)"

Buffett: "Is anything less real now that Precision Castparts is now private? Then why do they have to report $400mm less in earnings? Also, for valuation purposes, depreciation accounting is very inadequate for capital-intensive businesses."

Q48 - Ratios and formulas have some degree of meaning, but valuation of a business is not reducible to any formula where you can put in the variables perfectly. Not that it's unimportant, but it's not as simple as having one or two formulas. "The most important thing in intrinsic valuation is future interest rates."

Munger: "Fish where the fish are. A good fisherman can find more fish in China; it's a happier hunting ground."

Buffett: "If you want to be a good evaluator of businesses, you really ought to figure out a way to run a lousy business for a while. You learn more than running a business so good you can't mess it up - seeing how awful it is, and how little you can do about it, and how IQ means nothing."

Munger: "There's nothing like a personal, painful experience if we want to learn, and we certainly have had our share of it."

Q49 – He can't think of anything that can harm Berkshire Hathaway in a material, permanent way, except weapons of mass destruction. They have a variety of earnings streams and asset positions and a great philosophy. They're in a strong place.

Munger: "It would take something really extreme. BP took huge loss with one well. Berkshire Hathaway subs are all independent. We would pay, but we are not one accident away from disaster. We are better protected in every way than most companies."

Q50 - Berkshire Hathaway Specialty Insurance – Its growth depends on the market. They're not interested in being a price cutter in a market where prices aren't attractive. The business is built to scale and grow a lot. It's destined to be one of the leading P&C firms in the world just as they were in reinsurance when Ajit came in at a time when they had nothing. They have people, capital and reputation. There's no stronger company in insurance. Specialty is a very important addition.

Q51 - most interesting learnings of last few years – "I am a specialized one, and Charlie does as well as I do and has a much higher general absorption rate. A lot of fun can occur when learn you were really wrong on something - what's going on in America is terribly interesting, politically and all."

Munger: "Buying the Apple stock is a good sign in Warren - now he did run around and take his ,grandchildren's tablets away for market research. Don't unlearn the new tricks. We can't solve problems by printing money and lying. Take Puerto Rico. Who would've ever guessed that a US territory would be bankrupt? I would have, because they behaved like idiots; everywhere you look in Berkshire Hathaway someone is being sensible. Combine that with being very opportunistic so when some panic or something comes along it's like playing a one-hand sport with two hands."

Phil Fisher's *Common Stocks and Uncommon Profits* describes the usefulness of scuttlebutt method. In certain cases, one can learn a lot by asking a lot of questions. They did it with Apple. If they talked to heads of ten companies in an industry and asked which competitor they'd bet on or against and why, they'd have a better fix on the industry's economics than any one executive in the industry. The problem is not in getting the new but in shedding the old.

Munger added that they would never have bought Iscar or Precision Castparts if these businesses had come along ten years ago. They're learning and still are.

Q52 - healthcare - Going back to 1960, taxes were 4% of GDP (now 2%) and healthcare was 5% of GDP (now 18%); "medical costs are the tapeworm of American economic competitiveness." The tax system isn't crippling Berkshire Hathaway. Health costs have gone up and will go up more. The rest of the world has gained an advantage in healthcare costs with socialized medicine. It will be a problem regardless of which party is in power. The new act is interesting. The net effect on one person is a 17% drop in taxes for someone like Buffett - either the deficit will go up, or the lost taxes will get collected from someone else.

Munger doesn't like it that too much medicine gets prescribed for people who all but dead. There are all kinds of crazy things going on in Medicare. With so much vested interest it's hard to change. No rational person wouldn't think the system is crazy, and it puts manufacturers at big disadvantage with other manufacturers abroad. "Huge vested interests naturally give a terrible result, and costs will keep going up. Both parties hate each other so much that neither one can think rationally on this issue."

Regarding the competitiveness of American industry, the biggest single variable is healthcare costs, where it keeps getting more and more out of whack.

Munger: "It's deeply immoral. Doctors are feasting like a bunch of jackals on a carcass. A bunch of cardiologists in Redding got the idea that heart was a widow-maker and recommended heart surgery to everyone and got great results, because no one comes through heart surgery better than a man who doesn't need it. This department at Redding became a model for the whole system, and then a priest didn't believe it and blew the whistle (of course he didn't – a dead priest wouldn't have a widow). The doctors thought what they were doing was good for people. The delusion that comes into people as they make money and do god-awful things should never be underestimated. You'd think hospital CEO would notice heart surgery rates were twenty times higher than normal, and did they ever notice – they wanted the rest of the branches to perform more surgeries too – disgusting!"

Q53 - utility business is ok - Electricity demand isn't increasing like it was, and there are some stranded assets. He will be surprised if 10 years from now, they didn't have significantly more money in wind/solar/utilities. Berkshire is the buyer of choice with many utility commissions.

Munger: "Our utilities are not normal. They're better regarded by customers and rate-payers. It's- better to be associated with assets of that quality. If someone asked us to build a nuclear plant, we wouldn't do it."

Buffett: "We are selling electricity in Iowa cheaper privately than in Nebraska's public wind environment even with the government getting a total tax benefit But if we were putting together a portfolio of stocks, wouldn't own any utilities."

Q54 - McLane reporting – The SEC requires more disclosures of businesses based on sales. McLane has a huge sales volume - Walmart is its biggest customer. The business has a 1% pretax margin, so it is inflated based on how it looks in the financials. These kinds of businesses only work if turnover is extremely fast. It has an outsized appearance because of the gross sales volume. It's interesting that Walmart wanted to sell McLane to Berkshire. Walmart said they never had a deal that closed so fast.

Munger: "That reputation of being quick and simple and doing what we say has helped time and time again. We bought a business (Northern Natural Gas) and funded it before the regulators approved, because the business sellers needed the money. Others couldn't have done this."

Q55 – asking about Warren and Charlie having iron bladders – "we won't tell you the secret to that - no contraption, you can come down and inspect." The real question was about their legacies.

Buffett: "At my funeral, I want them to all be saying 'that's the oldest looking corpse I ever saw.'"

Buffett really enjoys teaching; that's his best legacy is someone thinking he did a decent job at teaching.

Munger: "To make teaching endurable, it has to have enough wiseassery in it. And we do."

Buffett: "We can't forget what's on Wilt Chamberlain's grave: 'Alas I sleep alone.'"

Q56 - What's your dream?

Buffett: "Let's skip the first one, Charlie (implying something raunchy)."

Munger: "Oh, to be 90 again; if you've got anything you really want to do, don't wait until you're 93 to do it."

Buffett: "Look for the job you'd take if you didn't need the job. Life must be evaluated backwards but moved forward, as Kierkegaard said. Charlie says he wants to know where he will die, so he won't ever go there. What will make you feel good, and what will keep you going there in that direction? We don't want to be like the man who died, where the minister said at the funeral, 'now is there anyone here to say something nice about the deceased?' and the only person that stepped forward offered : 'his brother was worse.'"

Q57 – Buffett wishes he'd met Charlie earlier. That's his biggest regret.

Regarding EBITDA, depreciation is an expense and the worst kind. "You- spend the money first but then have the expense." It makes no sense to remove depreciation. It's a very misleading statistic used in very pernicious ways.

Munger: "You've understated the horrors of the subject and the disgusting nature of people who brought that term to business; it's like a real estate broker who said a 1,000 square foot apartment was actually 2,000 square feet. Nobody in his right mind would think depreciation is not an expense. Now they're teaching it in the business schools - that is horror squared."

Q58 - Should businesses make decisions beyond just economic impact? Trade should be and is enormously beneficial. Greater productivity will benefit the world. It's a shame to be the textile worker in New Bedford or the shoe worker at Dexter put out of work. Prosperity is enhanced by trade - doing what one does best – but the country needs an educator in chief who has to be able to explain the overall benefits of free trade and beyond that have policies that take care of the roadkill. Don't worry about investors. They can diversify and not get killed by a specific industry condition, but the worker in many cases can't do that unless the government takes care of people like that. They need to try to hit both objectives.

Munger: "Unemployment insurance exists for that exact reason. The capitalist system always hurts some people; there's no way to avoid it."

Buffett: "A rich society can take care of those people. The new tax bill instead reduces my taxes by 17%."

Munger: "Don't start spending the money yet. Otto von Bismarck said there are two things that no one should have to watch: the making of sausage and the making of legislation."