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2011 BERKSHIRE HATHAWAY ANNUAL SHAREHOLDERS' MEETING

"The ideal asset in an inflationary environment is a royalty on someone else's sales where all you get is a royalty cheque every month."

- **Warren Buffett, 30 April 2011**

We made the annual pilgrimage to Omaha, Nebraska to attend the 2011 Berkshire Hathaway Annual Shareholders' Meeting. As usual the Q&A session with Warren Buffett (age 80) and Charlie Munger (age 86) lasted a marathon six hours and covered a range of topics from David Sokol and the Lubrizol saga, business valuation, how certain assets perform in an inflationary environment and nepotism.

A new record of more than 40,000 people attended the meeting this year at the Omaha Qwest Centre. We felt that the overall quality of the questions continues to improve significantly with filtering from the experienced media panel of Carol Loomis (Fortune Editor), Becky Quick (CNBC reporter) and Andrew Sorkin (New York Times journalist and author of *Too Big To Fail*).

We believe that the following notes are an accurate depiction of the meeting, however we have omitted discussions on topics unrelated to investing and business success.

We hope that you enjoy reading these notes as much as we enjoyed attending the meeting and putting them together!

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"I am Warren, he is Charlie. He can hear and I can see, that is why we work together." This is how Warren Buffett opened the Shareholder meeting.

The meeting began with the annual Berkshire Hathaway film featuring numerous celebrities including, Arnold Schwarzenegger, Former Treasury Secretary Henry Paulson and the cast of the US TV series *The Office*.

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Whilst the film contained its customary lighthearted fun and self-deprecating humour, the mood turned serious when the film cut to Warren's 1991 Congressional testimony following the Salomon fiasco [*Salomon Chairman John Gutfreund was dismissed after failing to report illegal trading in U.S. treasury bonds*].

Buffett (1991 Salomon Congressional Hearing):

"I ask every Salomon employee to be his or her own compliance officer. After they first obey all the rules I then want employees to ask themselves whether they are comfortable to have any of their actions appear on the front page of their local newspaper which will be read by their children, spouses and friends with the reporting done by an informed journalist. If they follow this test they need not fear my other message – **lose money for the firm [Salomon] and I will be understanding, lose a shred of reputation for the Company and I will be ruthless."**

Buffett's statement on reputation was not lost on the crowd and the relevance to the current David Sokol matter was loud and clear. The film provided the perfect segue into one of the most eagerly anticipated topics in the meeting's history.

David Sokol, who was widely viewed as Buffett's successor as CEO of Berkshire, recently resigned following his questionable purchase of Lubrizol stock one week prior to approaching Buffett to acquire the company. The Berkshire audit committee has since condemned Mr. Sokol's actions and the SEC is currently considering further investigation.

Buffett & Munger proceeded to spend the next thirty minutes addressing the Sokol matter – here's a summary of what they had to say.

Buffett: Before we get to the Q&A session today, I would like to discuss David Sokol's purchase of Lubrizol stock and then I'd like to ask Charlie to give his thoughts on the matter.

You just saw the Salomon film clip from 20 years ago. It was 20 years ago this August that I was elected Chairman of Salomon. One of the first actions I took as Chairman was to hold a press conference.

Somewhere early on in this press conference, a reporter asked me the question, "what happened at Salomon?" Well, I was new at Salomon at the time and didn't know all the details yet, but the phrase that came out of my mouth at the time was, **"what happened was inexplicable and inexcusable."**

It is now 20 years on and I still find what happened at Salomon to be inexplicable and inexcusable. I will never completely understand why some of the events that transpired at Salomon did transpire.

Looking at what happened a few months ago (*Buffett is referring to David Sokol's purchase of Lubrizol stock immediately prior to him recommending the company to Berkshire*) I don't think there is any question about the inexcusable fact that Dave violated the Berkshire code of ethics.

He violated our insider trading rules, and he violated the principles that I lay out every two years in a direct personal letter to all our managers.

One interesting point is that Dave, to my knowledge at least, made no attempt to disguise the fact that he was buying the Lubrizol stock.

You read about insider trading cases and people set up trusts in Luxembourg or they use neighbors who know neighbors or they use third cousins to buy the stock for them.

People who are trading on inside information usually have various ways of trying to buy the stock so that when FINRA (Financial Industry Regulatory Authority, the securities industry regulator) looks at the trading activity in the months prior to the deal, they do not see names that jump off the page as being associated with the deal.

To my knowledge, Dave did nothing like that so he was leaving a complete and detailed record of his Lubrizol purchases.

We at Berkshire are usually queried, after any public company acquisition, as to who knew about the deal prior to it being announced. We provide the regulator with a full list of people who knew about the deal, both inside and outside of Berkshire (lawyers etc.). The regulator usually also comes back to us with their own list of who was trading in the stock prior to the deal being announced and they ask us if any of those names ring a bell.

So, if you're trading in your own name and you're on that list of people who know of a deal ahead of time, the odds that it's not going to get picked up are very much against you.

But, to my knowledge, Dave did not disguise his trading in Lubrizol stock, which I find somewhat inexplicable. If he really felt that he was engaging in insider trading and knew the penalties that could be attached to it, why would he do this right out in the open?

The second fact, which is perhaps a little less puzzling, is that Dave has a very high net worth. He was paid close to $24 million by Berkshire last year - and we got our money's worth!

I would say that there are plenty of activities in this world that are unsavory, committed by people with lots of money, so I don't regard that as totally puzzling. However, I will give you one interesting example that makes Dave’s recent actions very puzzling to me.

We bought about 80% of MidAmerican at the end of 1999. Walter Scott and his family were the second largest shareholders, I think they owned something over 10%, and then two operating managers, Dave Sokol (the most senior of the two), owned or had options on a big piece of the company and Greg Abel, a terrific partner of Dave's, also had a piece.

Walter Scott came to me a year or two after we'd bought MidAmerican and told me that we ought to have some special compensation arrangement for Dave and Greg if they perform in a really outstanding manner.

So I scribbled something out on a yellow pad. It didn't take me five minutes. And it provided for a very large cash payout based on the five-year compounded gain in earnings. The base earnings we used for this formula was high, in other words this compensation formula did not start from any depressed earnings level. We set a figure that no other utility company in the United States was going to come close to. However, if that figure were achieved, we were going to pay $50 million to Dave Sokol and $25 million to Greg Abel.

Once Walter and I had settled on the earnings targets (16% compounding for five years), I had Dave come into the office and I showed him what Walter and I were thinking. Dave looked at the targets and resulting compensation for just a very short period of time and he said, Warren, this is more than generous. But he said, there's just one change you should make.

And I said, what's that Dave?

And he said, you should split it equally between me and Greg instead of being $50 million for me and $25 million for Greg. It should be $37.5 million each.

So that day I witnessed Dave voluntarily transfer $12.5 million, getting no fanfare or credit whatsoever, to his junior partner.

I thought that was rather extraordinary, and what really makes it even more extraordinary today is that $3 million (the profit David Sokol made on the Lubrizol trade), ten or so years later would have led to the kind of troubles that it's led to.

Twenty years from now Charlie will be 107, and we won't mention what I'll be, but I think 20 years from now I will not understand what causes a man to voluntarily turn away $12.5 million dollars to an associate without getting any credit for it in the world and then ten or so years later buy a significant amount of stock the week before he talked to me.

When Dave called me on Lubrizol he said nothing about his contact with Citigroup or anything of the sort and I told him that I didn't really know anything about the company.

He told me that I should take a look and that it might fit Berkshire.

I said, How come?

He said, I've owned it and it's a good company. It's a Berkshire type company. I obviously made a big mistake by not saying, well, when did you buy it, but I think if somebody says I've owned the stock, you know it sounds to me like they didn't buy it the previous week.

So there we are with a situation, which is sad for Berkshire, sad for Dave, still inexplicable in my mind, and we will undoubtedly get more questions on that. We'll be glad to answer them. Charlie do you have any thoughts on this?

Munger: I think it's generally a mistake to assume that rationality is going to be perfect even in very able people. We prove that pretty well regularly.

Buffett: Do you have any explanation for the irrational?

Munger: Yeah. I think hubris contributes to it.

Buffett: Well we've gotten quite a bit out of him today folks (referring to Munger). [Laughter]

Buffett then went on to provide a detailed analysis and timeline of the Sokol affair. So as not to take away from the rest of the meeting notes we have included this detail in the Appendix.

Q&A Session

Q: Whenever you talk about the future of the US economy your remarks are always positive despite the severe problems we are currently facing. Many people wonder if we are not entering a time of national decline?

Buffett: I don't see how anybody can be anything other than enthused about this country. If you look back to 1776 it has been the most extraordinary economic period in the history of the world.

I was born on August 30th 1930 - if somebody had come to me in the womb and said let me tell you what it is like outside now, the stock market has just crashed, 4,000 banks are going to fail, the Dow Jones average is going to get down to 42 (it was 381 back a little bit before you were conceived) and we're going to have 25% unemployment - it would be like in that Woody Allen movie where he says "go back go back!"

Since all of this happened in 1930 the standard of living of the average American has increased 6 for 1. Absolutely incredible! I mean you look at centuries where nothing happened to the average person. So we have a system that works magnificently and it will always have troubles from time to time.

There will always be negatives. This country will always face problems. This country went through a civil war, it's gone through all kinds of things, but what happens? We have a few lousy years from time to time, I mean we've had 15 recessions since the country started and we will always have a list of 10 or 15 things at the start of the year that will tell you why this country can't possibly work well.

All I can tell you is that it doesn't work in a straight line, but the power of capitalism is incredible. That is what is bringing us out of this recession. Monetary and fiscal policy have some utility and certainly in the Fall of 2008, but if you look at the history of the United States, probably half of our recessions have occurred when people didn't even know what fiscal or monetary policy was.

What happens is that the excesses would build up in the system and then eventually come crashing down. The resuscitative powers of capitalism would then set the country back onto a stronger growth pattern. That's happened time after time after time and the game isn't over – it's not like the potential of America is used up. I will tell you that over the next 100 years you are going to have 15 maybe as many as 20 lousy years but we will be so far ahead of where we are now that we will be unrecognizable (applause). Charlie?

Munger: Well I could go back a lot further than that. Europe survived the Black Death where a third of the population died. The world is going to go on.

Buffett: You've got to be a little more encouraging than that Charlie. [Laughter]

Q: Could you give us an insight into the current state of the U.S. housing / real estate market given many of Berkshire's businesses operate in this market?

Buffett: Well, the immediate is that it is terrible. It has been flat lining for a long time now. It affects many of our businesses. There has been no bounce, but you see that in the housing start figures.

This country over time, will build houses at a rate overall commensurate with household growth. I think you are going to see considerable household growth in the coming decades, and I believe our companies are well positioned to make significant money when we get to a more normalized growth in new housing.

I said in the annual report that I thought we would be seeing the upswing by year end. I have seen no evidence of this since I wrote the annual report two months ago. There has been no improvement I have seen so far. If it doesn't, then maybe it will be a year later. I don't think anyone really knows the answer to that.

If I had to bet one way or another, I would bet that it will turn up by year end. It really doesn't matter though whether it is this year or next.

Munger: One advantage of buying these cyclical businesses is that a lot of people don't like them because their earnings are lumpy. What difference is it to us if the earnings are lumpy as long as it is a good business? We also have the advantage of purchasing businesses which nobody wants.

Q: If you were going to live another 50 years and could add one additional sector or asset class to your circle of competence what would it be?

Buffett: That's a very good question, and I particularly like the preamble. [Laughter]

I would say it would have to be something in the tech field. I think that would be terrific but it isn't going to happen. It's going to be a huge field. There are likely going to be a few winners but a lot of disappointment so that the ability to pick the winners in technology is going to be disproportionately more difficult than picking the winners in, say, the major integrated oil industry.

The degree of disparity of results among large tech companies in the future is likely to be very dramatic. If I had the skills where I could pick the winners there I would do much better than if I had the skills to pick the winner in the major integrated oil industry.

Q: What about the Lubrizol business attracted you?

Buffett: Yeah, it struck me as a business I didn't know anything about initially. You know, you're talking about petroleum additives. I never would understand the chemistry of it, but that's not necessarily vital. What is important is that I understand the economic dynamics of the industry. Are there competitive moats? Is there ease of entry? All of those sort of things. I did not have any understanding of that at all initially.

I now feel I have a good understanding of industry dynamics and how the business has developed over time, specifically, the role of oil companies in relation to chemical additives.

The oil companies are the biggest customers. They sell base oil to Lubrizol, but they are also the biggest customers, and they have gotten out of the business to quite a degree.

So this industry has consolidated over time. I looked at the question of ease of entry. You know, every time I look at a business - when we bought See's Candy in 1972, I said to myself if I had a hundred million dollars and I wanted to go in and take on See's Candy could I do it. And I came to the conclusion, no, so we bought See's Candy. If the answer had been yes, we wouldn't have done it.

I asked myself that same question about Coke, can I start a soft drink company and take on Coca-Cola if I have a hundred billion dollars? Richard Branson tried it unsuccessfully some years ago in something called Virgin Cola. The brand is supposed to be a promise. I'm not sure that's the promise you want to get if you buy a soft drink. [Laughter]

In any event, I felt after my conversation with Dave, subject to a second conversation with James Hambrick (CEO of Lubrizol), that it's not impossible at all for people to enter this business. However, in terms of the service and the relatively low cost of what Lubrizol brings to the party, and in terms of people trying to break into a market and take them on, I decided there's probably a good size motor on Lubrizol. They've got lots and lots of patents, but more than that they have a connection with customers. They work closely with their customers when new engines come along to develop the right kind of additive.

Charlie and I have come to the conclusion that Lubrizol is the No. 1 company in terms of market share, the market share is sustainable and that it's a very good business over time. It helps that they are helping engines run longer and run smoother. When metal is acting on metal, the lubricants are very important and this is always going to be the case so they're always going to be around. I think Lubrizol will be the leading company for a very, very long time - and that's the conclusion I came to.

Q: Do you think Berkshire is currently overvalued?

Buffett: If Charlie and I had to stick a number in an envelope right now telling us what the intrinsic value of Berkshire was neither one of us would stick a figure in, we'd stick a range. It would be ridiculous to come up with a single specific number which encompasses not only the value of the businesses we currently own but what we're going to do with the excess capital. Even our ranges will differ slightly and my range may differ tomorrow depending on how I feel, but not dramatically.

We've signaled in the past that we'd buy the stock where we thought it was trading below our conservative range of intrinsic value. The only reason we will buy our stock is because we think it is cheap. That is not the standard practice in corporate America at all. In fact corporate America to some extent purchases their stock more aggressively when it is high than when it is low, but they may have some equation in their mind that escapes my reasoning.

We do not think that Berkshire is currently overpriced. We recently had a very large international company that may have been interested in doing something with Berkshire. It's a very nice company but bigger than we could handle unless we used a lot of stock. We won't use the stock - we believe that our shareholders would come out behind if we used stock to fund an acquisition at these prices. It is a wonderful company and it would make a lot of headlines but in the end our shareholders would be poorer because your stock is a currency and unless it's fully valued it's a big mistake to use it as a currency.

When you trade away your present business for some other business, you are either saying your own business is fully valued or that the guy who is selling to you is making a hell of a mistake.

Q: **Do you believe that companies with very high return on capital like See's Candy are the right companies to own in an inflationary environment?**

Buffett: A company with a high return on invested tangible capital is superior. If you have a wonderful consumer product that requires very little capital to grow, that is a very wonderful asset to have in an inflationary environment.

Businesses such as utilities, like MidAmerican Energy generate bond like returns. You have to spend capital to build a new plant but all you are going to get is a fixed return. Since yields on bonds go up due to high inflation, you aren't going to do that well in an inflationary period with bond like investments.

In fact, See's Candy was doing close to $30 million of revenue annually when we first bought it and now it is doing a little more than $300 million of revenue. It took $9 million of tangible assets to run it when it was doing $30 million and it takes around $40 million of tangibles at $300 million. So we only had to retain $30 million in the business which made us around $1.5 billion in free cash over that period. If the price of candy doubles, we don't have any receivables to speak of, our inventory turn is very fast and the fixed assets are small. So that is a much better business when you are going to have a lot of inflation. Charlie?

Munger: Well, the funny thing is that we didn't always know this.

Buffett: And sometimes we forget it. [Laughter]

Munger: But it shows how continuous learning is absolutely required to have any significant achievements at all.

Buffett: Yeah and we experienced this in a huge way back in the 1970s. The ideal asset in an inflationary environment is a royalty on someone else's sales where all you get is a royalty cheque every month.

Q: Is there a point in the future where Berkshire shareholders can expect a dividend payment? What conditions will be needed for Berkshire to pay a dividend?

Buffett: There is an argument that if we payout a dividend than really we should payout 100% because what it really means is that we have lost the ability to find ways to invest a dollar in a manner that creates more than a dollar of value for shareholders. Every dollar that has been reinvested in Berkshire has created more than a dollar of market value.

It's much more intelligent for people to leave the money in and sell off a little bit if they need the cash. There will come a time, who knows how soon, when we do not think we can lay out $15 billion to $20 billion a year and get something that's immediately worth more than that for our shareholders. When the time comes where we are getting 90 cents in value for every dollar spent we will stop spending the dollar and return it to the shareholder. Charlie?

Munger: Well there is nothing wrong with selling a little Berkshire stock and buying some jewellery if you are in the right place. [Laughter]

Q: Please explain why you haven't invested more heavily in commodities? Given Bernanke continues to print money and doesn't look like he's stopping anytime soon isn't it right that gold should continue to appreciate?

Buffett: If you think about it there are three major categories of investment. You ought to think very hard about which category you want to be in before you start thinking about the choices available within that category.

The first category is anything denominated in a currency, it can be bonds, deposits in a bank or a money market fund. If you reach into your pocket and pull out your wallet *[Buffett reaches into his coat pocket]*, now I don't like to do this, you're watching an historic event here. [Laughter]

[Buffet pulls out a $1 note from his wallet] If you look at this, I might add this is a one, on the back of it, it says 'In God We Trust.' That's really false advertising. If Elizabeth Warren were here, she'd say, 'In government we trust.' God's not going to do anything about that dollar bill if the government does the wrong thing.

Almost all currencies have declined in value over time. As a class, currency-related investments, whether they be in the U.K. or the U.S. or anywhere else doesn't make much sense.

The second category of investments regard items that you buy that don't produce anything but you hope someone will pay you more for it at a later date. The classic case of that is gold. If you take all of the gold in the world and put it into a cube, it will be a cube that's about 67 feet on a side and 170,000 metric tons. You could get a ladder and get up on top of it and think you're king of the world. You could fondle it, polish it, you could do all these things with it but it isn't going to do anything. All you're doing when you buy gold is that you're hoping someone else in a year or five years from now will pay you more for something that can't do anything. You're betting on how scared people will be two years from now.

Keynes described this phenomenon in Chapter 12 of his book *The General Theory of Employment* when he talked about this famous beauty contest where the game was to pick out not the most beautiful women among the group but the one that other people thought was the most beautiful.

There is no question that rising prices create their own excitement. So when people see gold go up a lot they like to get in. Over time that has not been the way to get rich.

The third category of assets is something that you value based on what it will produce. You buy a farm, you expect a certain amount of corn to come your way every year. You decide how much you would pay based on how much you think the asset will deliver. Those are the assets that appeal to me and Charlie.

If you buy that farm and you really think about how much corn you can produce and at what cost, one can make a rational decision, and the success of that investment will be determined in your own mind about whether it meets those expectations. Logically you should not care whether you get a quote on that farm a day later, a month later or even a year later.

We feel the same way about businesses. When we buy Iscar or when we buy Lubrizol we look at the underlying business. I would bet on good producing businesses against something that doesn't do anything over any period of time. Charlie?

Munger: I certainly agree with that. Besides, there is something peculiar about buying an asset that will only really go up when the world goes to hell. [Laughter]

Buffett: One thing about gold also, in addition to this 67 foot cube, more gold is being produced every year. So you have to have buyers not only to offset sellers in the normal course of events but you have to absorb something like $100 billion worth of added items of no utility. It's really interesting, I mean you think about it, they dig it out of the ground in South Africa, they ship it over to the Fed and the Fed sticks it back in the ground. [Laughter]

I might mention that the value of that cube at today's prices is about eight trillion dollars. There are roughly one billion acres of farmland in the United States and that's valued at something over two trillion. You take ten Exxon Mobils and you get up to somewhere around four trillion. So you could own all of the farmland in the United States, ten Exxon Mobils and you would have about one trillion dollars in your pocket for walking around money. You could have your choice of that or your 67 foot piece of gold that you could fondle – that may seem like a close choice to some people, but not to me.

Q: When you were initially raising your investment funds how did you go about attracting investors?

Buffett: Sounds to me like a man who is about ready to start a hedge fund. [Laughter]

In my case, I moved back here from New York in March 1956 and a few members of my family said that they would like me to manage some of their investments. So I told these seven members of the family that if you would like to join up in partnership I'm not going to tell you what is going on, but I will tell you that I will be doing with my own money what I will be doing with yours.

From there it was a very slow process, we just stumbled along and for almost six years I operated out of my house with no employees, kept all the books and filed all the tax returns myself.

When Charlie came along in 1956 I told him that law was a great hobby but it's no place for a man of his intellect to be spending most of his time. [Laugher]

Charlie, what are your thoughts on raising money?

Munger: Well it helps if you conduct yourself in a way so other people trust you. Then it helps even more if other people are right to trust you. So the formula is quite simple.

Buffett: Unfortunately with the current fee structures just attracting money rather than performing can be very lucrative. The skill of attracting money in the short term may be a more important quality than being able to manage money. Neither one of us ever charged a fixed fee of any kind. [*The Buffett Partnership did charge a performance fee ranging from 16.7% to 33.3% of gains*]

Q: One hundred years from now what would each of you like to be remembered for?

Buffett: Old age. [Laughter]

Munger: He wants them to say at his funeral "that is the oldest looking corpse I have ever seen".

Buffett: If I were to be serious about it, probably a teacher. I really enjoy teaching a lot. I was the benefactor of some fabulous teachers in my day from my Dad to Ben Graham to Tom Murphy.

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Q: The U.S. Dollar has been depreciating against other currencies and the U.S. Government continues to run a zero interest rate policy. What is Berkshire doing about the risk of further U.S. Dollar weakness given the company's assets and operating businesses are denominated in the U.S. Dollar?

Buffett: I think that there is no question that the purchasing power of the U.S. Dollar will decline over time, the only question is at what rate. I also think that the purchasing power of almost all currencies around the world will decline. Of course a short position is just a bet on which one will decline at the faster rate. I don't have a strong conviction on that, I have some mild convictions about it but not enough where I want to back it up with a lot of money.

We do own some businesses; let's take Coca-Cola for example, where 80% of the business is denominated in non-USD currency. We've got exposure in various other ways but we are unlikely to make a big currency bet, although I do think that the purchasing power of the U.S. Dollar is likely to decrease and I do have fears of it declining at a rapid rate. Now, Charlie has pointed out to me that the dollar of 1930 is worth 6 cents now in terms of depreciation and as he points out we have both done pretty well. So inflation does not destroy us. I hate inflation but we've adapted to it pretty well over the years and we have not had the total runaway hyperinflation that can really be upsetting to a society, yet. But I do think it's something that you always have to guard against.

Munger: God knows where the world is heading. I just think one way or another the world pulls through. I'll tell you of a really God-awful culture and that's modern Greece. [Laughter]

I don't think there is anything wrong with the Greeks in their family life but the way they manage money and pay their taxes is just awful. One of the main industries in Greece is tourism and they are closed most the time during the tourist season - very dysfunctional. Yet there it is, the people of Greece are surviving.

Q: What factors would you look at in comparing an investment in Berkshire Hathaway stock versus a mutual fund?

Munger: Well I like Berkshire a lot better and I would be very unhappy owning an index fund. I don't think the average return of a skilled investor over the next fifty years is going to be as good after all factors, as the preceding fifty years. So I think reduced expectations are the best defence mechanism an investor has.

Buffett: Charlie's big on lowering expectations.

Munger: Absolutely, that's the way I got married. My wife lowered her expectations. [Laughter]

Buffett: And he lived up to them. [Laughter]

Q: In light of the Dave Sokol issue, could you discuss compliance issues at Berkshire?

Munger: If you look at the greatest institutions in the world, they select very trustworthy people, and they trust them a lot, and it's so much fun to be trusted, and there's so much self-respect you get from it when you are trusted and are worthy of the trust that I think your best compliance cultures are the ones which have this attitude of trust and some of the ones with the biggest compliance departments, like Wall Street, have the most scandals.

So it's not so simple that you can make your behavior better automatically just by making the compliance department bigger, and bigger, and bigger. This general culture of trust is what works.

And, you know, Berkshire hasn't had that many scandals of consequence, and I don't think we're going to get huge numbers either. [Applause]

Q: The US economy seems to be in the middle of a sluggish recovery whilst most foreign economies are showing solid growth numbers. What policies do you think need to change to get the economy growing strongly in the U.S.?

Buffett: We really have our foot to the floor on both monetary and fiscal policy. You've seen it on the monetary side with effectively zero interest rates and actually with the Chairman (Ben Bernanke) saying just the other day that this was going to go on for an extended period. Then they asked him what an extended period meant and he said an extended period [Laughter].

It's hard to imagine pushing any harder on monetary policy.

We have a huge fiscal stimulus program going on right now and it's called taking in 15% of GDP and spending 25% of GDP. That's extraordinary.

I think the natural resuscitative powers of capitalism will be the biggest factor in taking us out. You've seen that over the last two years and we are still seeing it month by month.

Pretty much all of our businesses with the exception of those that are related to residential housing are getting better. We have a biodiversity of businesses with more than 70 listed companies and over 100 businesses in Berkshire itself - we are a cross-section of the American economy. In the first quarter, which has really been the case since the lows of 2009, these businesses have really been getting better and better month by month. There is no exception to that in the first quarter of 2011.

I would say that residential construction has flat-lined at around 500,000 per year or so. When residential construction does come back I think you are going to see more of a pick-up in employment than you might think by looking solely at construction workers.

We own Shaw carpets, I'm sure their employees are not included in the construction jobs numbers, but we have thousands fewer people working at Shaw because construction is weak. So I think there are a lot of indirect, as well as direct, reservoirs of jobs that will be drawn upon when residential comes back. I don't think I'd measure it on just the number of construction workers that are being employed currently versus say four or five years ago.

While our pace coming out of this recession has been slow, compared to the hit that we took in 2008, when the American economy was paralysed, it's come back quite a distance. We see that in our businesses. Charlie?

Munger: The one place that I view we are making a huge mistake is not learning enough from the big mess that came from wretched excess in our financial system. If you look at all the panics in the United States they all came from financial collapses usually preceded by asinine and greedy behavior. I think a lot can be said to taking an axe to the financial sector and pulling it down to a more constructive size. [Applause]

Buffett: Tell us more about how you would use that axe Charlie? [Laughter]

Munger: I hate the idea that 25% of the best engineers are going into the financial sector. [Applause]

I think it's crazy that people want to get into the financial sector after the disgraceful stuff they got us into, it's perfectly awesome.

It makes Dave Sokol look like a hero.

Buffett: He's getting warmed up [Laughter].

Munger: Hedge fund operators in the United States pay much lower tax rates than the best people in physics. This is demented! [Applause]

Q: Has oil reached its peak? Is it a bubble? What are your sentiments regarding oil?

Buffett: We actually did take a position in oil a couple of years ago.

Munger: A long time ago.

Buffett: Sorry, a long time ago.

Munger: At $10 a barrel. [Laughter]

Buffett: It wasn't that long ago. That was in the 1990s. It was a lot cheaper than that. East Texas oil sold for a dime a barrel in 1932.

In answer to your question, we really don't know.

Obviously, you're dealing with a finite source. I think the world is up to 88 million barrels a day. That's a lot of oil taken out of the ground every day. And of course, there are new frontiers which have been found but we've stuck a lot of straws in the earth and it is a finite number… so, one thing I can promise you is that oil will sell for more someday.

If we could make money sitting in a room trading oil, we would do that. At Berkshire parent level, we don't hedge any commodities. Some of our subsidiaries do, that's fine, as they are responsible for their businesses.

There are very few commodities where I would know what direction they were heading in over the next six to 12 months.

I really think that an intelligent person can make more money over time thinking about productive assets rather than speculating on commodities or fixed-dollar investments.

That may be my own bias.

Munger: If we had done nothing but oil since the very beginning, I am confident that we would not have done nearly as well as we have. I think what we've done is much easier.

Buffett: We like easy.

Munger: We don't need to make it any more difficult than we have to.

Buffett: I really don't know how to have an edge in that field.

Q: What are some of the most important things you have learnt over the past year?

Buffett: I'll let Charlie go first.

Munger: I hate to admit that I have ignored tech most of my life, but I have recently read a book called 'In The Plex' about Google. I found it a very interesting book. Here I am in my advanced age, and I find it interesting how people have created engineering cultures which are peculiar to me and nothing like what we have at Berkshire.

Will I ever make any use of this? I doubt it [Laughter], but I certainly enjoyed learning it.

If I enjoy learning it, then I regard it as important, because that is what we are here for… to go to bed every night a little wiser than when you got up.

Buffett: I am just trying to hold my own actually. [Laughter]

I am going to let Charlie write the next press release. [Laughter]

Munger: Warren, I approved that damn press release with no objections. Berkshire shareholders would be in terrible trouble relying on me to pick your errors. [Laughter]

Q: Do either of you believe we might be heading down the same path years from now where tax payers will have to bail out firms which are 'too big to fail' again? If so, have we done anything to avert that?

Buffett: There are institutions around the world that I think governments should probably have to bail out. Although, I don't think that is the right word choice. What I mean is stock holders should not be saved, managers should not be saved, but certainly the institutions in some cases should not be allowed to collapse.

Right now, in Europe, they are deciding if countries are 'too big to fail'.

I think for that reason, you have to do things to reduce the propensity to fail. Among those things, I think you have to have rules in place for the CEO and to some extent the board. I think that any institution that requires society to come and bail it out for society's sake should have a system in place that leaves their CEO and his or her spouse dead broke. [Applause]

There will be 'too big to fail' institutions ten years from now. Right now Freddie Mac and Fannie Mae are 'too big to figure out' [Laughter]. And that's ok, because it is more important to come up with the right solution than the immediate solution.

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Munger: The past panics and depressions, when it started on Wall St, they tended to involve great waves of excessive speculation and bad behavior from people who were profiting from those waves including salesmen, promoters and market makers.

I think it is really stupid for a country to have allowed this. Partly, the failure is not one of evil but it's one of stupidity and part of this stupidity is on the great economic institutions.

This shouldn't happen. Finance and economics are not hard sciences. Finance really attracts people who should have gone into snake charming. [Laughter]

Buffett: If there is anyone we have forgotten to insult? [Laughter]

Q: As an Australian investor, should I be worried about a weak US dollar eroding value of my Berkshire stock? Can I be confident over the long term, any fall in the dollar will be offset by the rise in the value of Berkshire stock in addition to the intrinsic growth in the underlying business?

Buffett: The answer is no! [Laughter]

It would be a lot easier if the Australian Dollar would go down.

The Australian Dollar is one of two currencies that contributed to our $100m currency profit last year.

I cannot tell you what policies will be followed in the United States and what policies are going to be followed in Australia, what they will be and how they will affect the relative valuation of those two currencies ten years from now. I think they can be quite dramatic, and dramatic in either direction… that's why I don't know what to do.

What Charlie and I focus on doing every day is trying to increase the earnings power and intrinsic value of Berkshire. And to the degree we increase it, or decrease it, the shareholders will share in exactly the same proportion as Charlie and I. We are 100% aligned.

Luck to some extent will determine how well we do in the future; we know we can't do remotely as well as we have done in the past. There is no way we know to compound the kind of sums we are working with now at the rates anywhere close to what we were able to do when we were working with much smaller sums.

We will do our best efforts.

Munger: Australia has these fabulous open pit mines. And demand for metals in Asia is booming. I can't tell you how Berkshire stock is going to perform compared with mines in Australia. What I can tell you is that I think Berkshire will do pretty well compared to companies here in the United States.

Q: The importance of Berkshire's equity portfolio has diminished over the past few decades. Where do you see the equity portfolio going over the next 10 years, and has it become an afterthought in your investment decision making process?

Munger: We will always have a fair amount of marketable securities because of our insurance subsidiaries.

As we get pushed by our size to buy bigger and bigger stocks, of course we are going to do less well than when we had a bigger universe of practicable things to consider.

Buffett: A lot less well. We are buying securities where we are putting in billions of dollars in one stock and that is not the field that is under-researched by other analysts. It is impossible to have a big edge, but we do think we have a small edge.

Munger: On the other hand, when we were doing so well in marketable securities nobody called us and said I have a wonderful business and you're the only boys in the world where I would want to transfer it. Now that happens a couple of times a year, at least. I really prefer in some ways this part of the game than the other game.

It is more fun to create permanent partners and doing constructive things than outsmart other people shuffling little pieces of paper. [Laughter]

Buffett: I like to do both actually. [Laughter]

Q: If either you or Charlie had a child in the next five years, how would you provide them with incentives to work hard and reach their full potential? How will they compete with driven youth in emerging markets?

Buffett: I thought you were going to say, "How would you have kids?" [Laughter]

I think, certainly that if you are very rich and you bring up your kids to think that they are more important in society and that they have some special privilege purely because they came out of a certain womb, then that is just a mistake. Charlie has raised eight children who I know quite well, and I don't think any of them have that sense. If you are going to raise your kids to think that other people should do all the work for them and they will be entitled to sit around and fan themselves for the rest of their lives, you will probably not get a good result.

Both Charlie and I were rich when our kids were growing up. I certainly didn't want to give them the idea that they were special purely because their parents were rich.

The one thing I don't think you want to give them an incentive to do, is to try and outdo their parents in a field their parents are good at.

If you are rich and your kids turn out with no incentive to work hard, I don't think you should point the finger at them, I think you should point it at yourself. Charlie?

Munger: My advice to you, is lose this fight as graceful as you can. [Laughter]

Q: How do you look at various investments at different points in time?

Buffett: Deals done at different times have different market conditions and opportunity costs. You need to ask yourself, what can I do today with this amount that is better than this deal or transaction? Past deals that we have done don't make a difference to our decision making process. Some people make the mistake in comparing deals or transactions that are put in front of them, with the best deal that they have made in the past. It doesn't work like that. These people often take themselves out of the game.

The goal is not to make a better deal than you have made before, the goal is to make a satisfactory deal which is the best deal you can make at the time.

Charlie is going to relate this to marriage and I'll let him explain that. [Laughter]

Charlie?

Munger: Of course we are going to make different deals at different times with different opportunity costs. There is no other rational way to make deals.

Q: What can you recommend to improve reading speed?

Buffett: There is hardly anything more pleasurable than reading and reading and reading. Charlie and I do a lot of it and we continue to do a lot of it. I don't do it as fast as Charlie though.

Munger: I think speed is over rated. I had a roommate at CALTECH and he had a very distinguished mind. You see I could do problems faster than he could, but he never made a mistake. [Laughter]

Could you pass the peanut brittle Warren. [Laughter]

Q: What would be the impact if Congress did not lift the debt ceiling on Berkshire Hathaway and the U.S. economy?

Buffett: It would probably be the most asinine act that Congress has ever performed, except that one time in 1890 when in the state of Indiana a Bill was submitted to change the definition of π (the number *pi*) to 3.0 to make it easier for school children to work with. [Laugher]

That is the only bill that I think would give competition. It is extraordinary.

It's extraordinary, that with our deficit running well over $100 billion a month… having that debt ceiling to start with is a mistake. The United States of 2011 has a different debt capacity than the United States in 1911. We are a growing country so we will have a growing debt capacity. That doesn't mean that I think it is a good idea to have debt growing as a percentage GDP.

One thing I am certain about is that we will not have a debt crisis as long as we issue notes in our own currency. The difference between having to borrow in your own currency and having to borrow in another currency is that the only thing we need to worry about is the printing press and inflation.

If you are a member of the European Union you can't print your own money. You have to get your co-members to help you out.

Believe me, when it is time to pay somebody back and you are forced to pay in someone else's currency versus paying in your own, it is an entirely different process.

Munger: It seems to me that these days both parties in Congress are competing to see who can be the most stupid. [Laughter]

Q: When you think about forecasting long term cash flows do you think about growth or just look at certainty of the cash flows?

Buffett: Growth is part of the investment equation and obviously we love profitable growth. We would love to figure out a way to take See's Candy, grow it geographically and do whatever to grow profitably. Coca-Cola has successfully done it for the past 120 years. Some products just travel way better than others.

When we look at a business and we are looking out into the future, obviously if we see growth in that picture and its growth which produces a high return on incremental capital, we love it. But that does not mean that we will rule out companies which have no or little growth in the future, if the price is attractive.

It is a factor in every investment decision we make - what is the future earnings power of the business and what are its future capital requirements. We think plenty about the potential growth of a business. Sometimes we are right and sometime we are wrong.

Munger: In our country, the business schools teach students to make projections way into the future and they use computers to project them out. They then use this data in the decision making process.

I always believe these projections are more harm than good. If we get these reports from investment bankers we throw them away.

You get an enormous false precision in forecasting using computer programs. Warren and I make rough projections in our head all the time. The fact that data is written and comes out of a computer makes some people think they are significant.

Buffett: I have never seen an investment banking analysis where earnings don't grow over time. It is the old story, don't ask a barber if you need a haircut. You do not want to ask an investment banker what earnings will be in five years. You can be sure that they will be higher than they are today.

As Charlie said, we are doing projections in our head anytime we look at a company or stock. We make projections but we also have a mental model where we determine how way off we could be in our projections.

Q: Where does Berkshire hold its cash?

Buffett: We keep our cash in U.S. Treasuries. While it is irritating that we don't currently get paid for parking our money there, we know with certainty we can use it when needed.

Munger: I think it is really stupid to earn a few extra basis points on short term money, especially when you are like us who try and make opportunistic gains.

Buffett: If Ben Bernake and Paris Hilton run off to South America together, we want to make sure that our cheques get cleared. [Laughter]

One of our advantages is that we can make large acquisitions quickly.

Q: What would you recommend the youth to do to improve their chance of success as entrepreneurs?

Buffett: I used to do it by doing a lot of reading. I practically lived at the Omaha Public Library for three years around the time I was nine or ten. Anything you do to improve your own skills is good. You never know when it is going to pay off in the future. I have only one diploma hanging… I have a couple of others… but the one that is hanging up is one I got from a Dale Carnegie course, which cost me $100 back in 1951. It is incalculable how much value I got from that $100. There is nothing like working to improve your own skills, and I would say communication skills are the first area I would work on to enhance your value throughout life, no matter what you do. If I had stayed in the same position I was in, in terms of communicating, back in 1951, my life would have turned out differently.

I think you get lucky if you find your passion early on, but you want to work for something you are passionate about and you want to improve your skills in that area.

If you do both of those things, you are likely to do very well.

Prepared by

VGI Partners

Omaha, Nebraska, 30 April 2011

Appendix

Q: When you found out about Dave Sokol's stock purchases of Lubrizol I do not understand your reaction. Surely you knew the actions would damage Berkshire's reputation, something you had said repeatedly you would be ruthless in protecting. Being ruthless meant you would probably have fired Sokol on the spot but you didn't do that. Then you put out a press release that a majority of Berkshire shareholders I have spoken to found to be totally inadequate. You have always been direct in your dealings; you were not direct in that press release. Why were you not incensed - if you were - why did you not express your anger. Why did you handle this matter in the inadequate way you did? (Applause)

Buffett: Bear in mind his first conversation when he said he owned the stock was January 14. In between January 14 and March 14 [the day the deal was announced], Dave gave no indication that he'd had any contact with Citigroup of any kind and as we learned later, they met in maybe October or something like that and talked about possible acquisition candidates for Berkshire. He told me at one point, he said Evercore and Citi represent Lubrizol. One of them represents the directors and one of them represents the company, and not a word about any contact.

On March 14, when the deal was announced in the morning, I got a call from John Freund. John works for Citi in Chicago, and has handled the great majority of our business in equities for decades, and I've got a direct line to him. I talk to him frequently and he called and said congratulations and aren't you proud.

Essentially his words were that Citi's team had worked with Dave on this acquisition, and they were proud to be part of it, et cetera, et cetera.

And this was all news to me, so that set up some yellow lights, at least. And the next day, I had Marc Hamburg, our CFO, call Dave, and Dave readily gave him the information about when he had bought the stock and how much. Marc also asked him what the participation of Citi had been in reference to Berkshire's side of the transaction, and Dave said that he thought he called a fellow there to get their phone number, which turned out to be somewhat of an understatement.

Now, during the period when we announced the deal on March 14, Lubrizol is the one that needed to prepare a proxy statement. We were not issuing shares at Berkshire. So there was no proxy statement on our part.

The Lubrizol legal team, went to work with Lubrizol management to start preparing the proxy statement. We eagerly awaited to see the first draft of that because I was going to be leaving for Asia on Saturday, which would be March 19, and I wanted to see what Lubrizol had to say about this whole Citi matter. The most interesting part of every proxy statement is basically the history of the transaction, and it's the first thing I read on any deal because it gives you a blow-by-blow of what has taken place.

And as Marc Hamburg and our law firm can tell you, I kept urging them to get that to me before I took off for Asia.

We got that the afternoon of Friday March 18, and it had a fair amount of material in it about Dave's involvement with Citigroup. Then at that point our law firm, Munger Tolles, got involved.

Ron Olson, a Director of Berkshire and partner of Munger Tolles, was on the trip to Asia with us. So we got on the plane on Saturday March 19 and traveled over the next week until March 26. We knew at that point that his partners at Munger Tolles were interviewing Dave, and I believe that he was interviewed at least three times about both the stock purchases, the history of things with his relationship with Citigroup and they were assembling this information.

I don't have a BlackBerry or whatever it may be. Ron does. So he would get some information as we were over there, and he was getting some input but we decided that when we got back we would need to have a prompt meeting of the Berkshire Board about this matter and we would also learn what the full details the attorneys at Munger Tolles learned from their interviews with Dave.

And we got back from Asia on Saturday March 26 and on March 28 we were going to bring Charlie into it before calling a board meeting. Then about five or so in the afternoon, a letter was delivered by Dave's assistant which really came out of the blue.

And he said to me he felt he was retiring on a high point and he gave the reasons why he was retiring which I laid out and so on. I don't know whether the questioning the previous week had affected his attitude. He would say not. But in any event, we had that resignation.

That resignation may have saved us some money. If we'd fired him, the question would be whether it was with cause or not with cause, and we would have said it was with cause, but that might have very well gotten litigated and a retirement did provide, in effect, the same non-level of severance payments that a firing with cause provided.

So I drafted up a press release, which has since been the subject of at least mild criticism, and I laid out the good things that Dave had done, which he had done for the company. He'd done many good things, some extraordinary things. And then I laid out some actions which I said, based on what I knew then, it did not seem to me to be unlawful, and I talked with both Charlie and Ron about that.

Ron would have been more careful in that wording. I'm not sure Charlie would have been. I'll let him speak for himself on that.

And I ran it by Dave Tuesday morning just to be sure the facts were accurate. He objected to something I put in the statement. I had included a line that basically said that he had had his hopes dashed for succeeding me as CEO of Berkshire, and that was part of the reason for his retirement. He said that was absolutely not true, that he had no hopes of ever succeeding me and that I shouldn't be trying to second-guess what was in his mind. So I took that part out.

He affirmed all of the other facts in that letter and I sent it to him a second time to make sure that he was okay with the facts, and he said that they were accurate.

Now, in there was included the fact that Dave had no indication that Lubrizol had any interest of an approach from Berkshire. Now according to the final Lubrizol proxy, this is not the case. I have not talked to anybody except John Freund at Citigroup, so I have no idea what took place with the investment bankers at Citigroup except what I read in the Lubrizol proxy. The Lubrizol proxy now says that Dave did know that Lubrizol had an interest in being acquired by Berkshire on December 17.

Both in the two chances that Dave had to review it and then when he went on CNBC on a Thursday and talked for a half an hour, he made no attempt to correct any of the facts in the statement. Now, on Wednesday when we put out the statement, we had to have a board meeting first. The board got the release a little bit ahead of time and then we had a board meeting. We also phoned the head of the enforcement division of the SEC and told them exactly the facts regarding the stock purchases and anything else that they might have cared to know.

So I think we acted in that case, very, very promptly, to make sure the SEC and the top of the enforcement division was well-versed on what had taken place to our knowledge to that point.

So from our standpoint and my standpoint, Dave was gone, with minimal severance costs, minimal chances for lawsuits about compensation due to him and we had turned over some very damning evidence, in my view, to both the public and to the SEC.

What I think bothers people is that there wasn't some big sense of outrage or something in the release and, you know, I plead guilty to that. This fellow had done a lot of good things for us over 10 or 11 years, and I felt that if I'm laying out a whole bunch of facts that are going to create lots of problems for him for years to come, that I also list his side of the equation in terms of what he'd done for Berkshire.

And as I said a little bit earlier, you know, one thing I didn't even lay out was this extraordinary act where in effect he turned over $12.5m to a fellow employee. So that's the history of my thinking on it (Applause).

Charlie, do you want to add anything?

Munger: Yes. I think we can concede that that press release was not the cleverest press release in the history of the world. [Laughter]

The facts were complicated, and we didn't foresee appropriately the natural reaction.

But I would argue that you don't want to make important decisions in anger. You want to display as much ruthlessness as your duty requires, and you do not want to add one single iota because you're angry (Applause).

So Tom Murphy, one of our best directors always told the people at Cap Cities, **"you can always tell a man to go to hell tomorrow if it's such a good idea."** And I don't think it was wrong to remember the man's virtues as well as his error (Applause).

Buffett: I might add as an aside Charlie and I have worked together for 52 years, and we have disagreed on a lot of things. We've never had an argument.