4 May 2013

2013 BERKSHIRE HATHAWAY ANNUAL SHAREHOLDERS' MEETING

"Interest rates are to asset prices what gravity is to apples… This is a situation we haven't seen before and has the potential to create significant inflation. My guess is that the Fed was hoping to have more inflation by now. The easiest way to run up nominal GDP is to print money."

- **Warren E. Buffett, 4 May 2013**

We made the annual pilgrimage to Omaha, Nebraska to attend the 2013 Berkshire Hathaway Annual Shareholders' Meeting. As usual the Q&A session with Warren Buffett (age 82) and Charlie Munger (age 89) lasted a marathon six hours and covered a range of topics from the current interest rate environment to railways to social media and living wills.

An estimated 35,000 people attended the meeting this year at the Omaha Century Link Center. The overall quality of the questions continues to improve with filtering from the experienced media panel of Carol Loomis (Fortune Editor), Becky Quick (CNBC reporter) and Andrew Ross-Sorkin (New York Times journalist and author of *Too Big To Fail*).

This year's meeting also included questions from a panel of investment analysts, including Cliff Gallant of Nomura Securities (for insurance questions) and Jonathan Brandt of Ruane, Cunniff & Goldfarb (asking non-insurance questions). Joining the panel for the first time was an analyst asking questions with a bearish perspective on Berkshire, Doug Kass of Seabreeze Partners Management.

Due to the poor weather in Omaha the crowd was ushered in an hour earlier than usual. In one of the first questions an audience member thanked Warren & Charlie for the early entry.

Buffett: If we owned a company that sold rain coats we would have left you out there longer! [Laughter]

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 putting them together!

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The meeting began with the annual Berkshire Hathaway film produced by Susan Buffett Jr. (Warren's daughter) featuring Arnold Schwarzenegger, Jon Bon Jovi, the cast of TV series *Breaking Bad*, and a cartoon rendition of Warren and Charlie dancing "Gangnam Style" on *Dancing with the Stars*.

Q&A Session

After the introduction Warren and Charlie got down to business, taking their positions on stage for the Q&A session.

Q: How do you expect Berkshire to perform against the market going forward?

Buffett: Certainty is not assured in the future.

If the stock market continues to behave as is, the increase in our book value over a five year period is likely to fall short of the S&P 500 (including dividends) return.

As we have always pointed out, we are likely to do better in down years versus up years.

I should point out that we use book value per share as it is a useful tracking device because it is easily calculable and should approximate growth in intrinsic value, although there is a significant gap between book value and intrinsic value which is why we feel we are conservative using this measure. For example, if we add a million policies at GEICO by the end of this year, that adds a significant amount to intrinsic value but not a dime to book value.

This gap is why we feel comfortable buying back shares at 1.2x book value because we think that is below intrinsic value.

Distortions do exist but in the end we have to do better for you than an index fund if we want to earn our pay. Over time we will do better, but not every year, as we have seen over the past few years. Charlie?

Munger: I confidently expect that Berkshire will do quite well over the long term. I don't know if that is over three years, five years or thirty years.

We're slowing down but I think it will still be pleasant.

Buffett: At 89 years old Charlie is not really concerned about the stock price year to year. He worries about the long term!

Munger: I am just making sure I am ready for old age which might come at any time.

[Laughter]

Q: What are your big worries and what do you think can go wrong at Berkshire when you are no longer here?

Buffett: This is something we think about all the time. That is why the culture of Berkshire is very important and the businesses we own are very important.

I am confident that the current managers will keep running these businesses and customers will still be calling the day after I die. There is no question about that.

The key is preserving a culture and having a successor that has more passion and more brains than I do.

It is the number one subject that we discuss at every board meeting. We are all in agreement as to whom that individual should be [but they do not say].

Charlie what are your thoughts on this?

Munger: My thoughts on this topic are very simple. To the many Mungers in the audience, don't be so stupid as to sell any Berkshire shares in the future.

[Laughter]

Buffett: That goes for the Buffetts too!

Q: A recent column stated that Berkshire was getting a better deal than 3G Capital in the Heinz transaction and that the 8% preferred dividend is where you will make the real profits, with the common equity being "dead money". Is this true, and does the structure of the deal indicate your low expectations for the stock market?

Buffett: No, that is totally inaccurate. This is an absolutely fair deal. I didn't have to change a word in the term sheet or governance arrangement proposed by Jorge Paulo Lemann.

Charlie and I actually paid a bit more for Heinz than we would have if were doing the deal ourselves. This is because we think Jorge Paulo and his associates are extraordinary managers and unusually good. So we stretched a little because of that fact.

The design of the deal is such that if Heinz does very well, 3G's $4bn equity stake generates higher returns [on a percentage basis] than our overall $12bn [$4bn equity, $8bn preferred debt]. 3G wanted to be more levered and we provided that leverage on what they and we regard as fair terms.

If anyone thinks that the common equity is dead money, they are making a mistake. I guess we will find out over the next five years.

We have more money than operating ability at the parent company and 3G have plenty of operating ability and wanted to maximize their return. In five years' time I think 3G will generate a higher return on their $4bn of equity as will we on our $4bn.

Anything to add Charlie?

Munger: The report you mentioned is totally wrong!

[Laughter]

Buffett: Ha, that will teach 'em!

[Laughter]

Q: Should the GEICO insurance company adopt usage-based driving technology for determining premium levels?

Buffett: Insurance underwriting is an attempt to work out the likely propensity under a number of variables of an individual having an accident.

Life insurance is a particularly obvious one. If someone is 100 years old and you don't know anything about them, the likelihood of them dying within the next year is higher than that of a 20 year old.

When you get into auto insurance there are many ways that companies can assess the likelihood of people having an accident. Clearly, if you are a 16 year old male you are more likely to have an accident than I am. That doesn't mean I am a better driver than he is, but he probably is driving ten times as much as I am and is trying to impress the girl sitting next to him and that doesn't work for me anymore…

[Laughter]

Our ability to sell insurance at a considerable discount to our competitors and at the same time earn a significant amount of underwriting profit indicates that our selection process works well.

If your selection process is wrong and you charge a 16 year old male the same as a 40 year old female who doesn't drive very often, you are going to earn terrible underwriting results. Our criteria, which has been developed over decades, has become quite useful at predicting risk.

Charlie, I didn't give you a chance to comment.

Munger: I have nothing to add.

Q: Now that you're on Twitter, and the SEC is now allowing public disclosures through social media, what are the implications for Business Wire? And by the way, what are you doing on Twitter?

Buffett: I haven't figured the last one out yet…

[Laughter]

I think public disclosure through social media is a mistake.

The key to disclosure is to be accurate and simultaneous. We want to be sure that we get accurate information at the same time as everyone else. Business Wire does an excellent job of that.

Investors shouldn't have to refresh the webpage of say Wells Fargo regularly to get the latest news and hope they're not ten seconds behind somebody else. Business Wire allows for global disclosure that's both accurate and simultaneous. That is the key to disclosure. I don't think anything has come close to that. I think that Business Wire will do well, I couldn't be happier and we will not sell it.

Berkshire puts out its disclosure aftermarket to allow people to digest all the information and disclosure. Anything important from Berkshire or any of our companies is going to come out via Business Wire.

Charlie?

Munger: It is hard to comment on Twitter when I have been avoiding it like the plague.

[Laughter]

Buffett: He sent me out to test Twitter and see if anything bad happens to me.

Question from the appointed short seller: Thank you for providing me the opportunity to be here and play the role of Daniel in the Lion's Den in front of 35,000 of your closest friends and admirers...

Buffett: Don't worry you can bring your own crowd next time!

[Laughter]

Warren, you have said that size matters…

Buffett: It does.

[Laughter]

My question is in relation to Berkshire paying higher multiples for businesses today than it has in the past and also purchasing more mature businesses. The relatively high prices paid could potentially result in a lower return on invested capital. You used to hunt for gazelles and now you hunt for elephants. The recent buys (BNSF & Kraft) look like preparation for your legacy creating a more mature slow growth enterprise. Is Berkshire morphing into a stock that has come to resemble an index fund for widows and orphans vs. a stock which delivered differentiated and superior returns?

Buffett: There is no doubt we cannot do as well as we did in the past and size is a factor.

It also depends on the nature of the markets. There will be times when we run into bad markets and size can actually be an advantage as we saw in 2008. Our size has allowed us to do deals that others can't.

Even in the past we have paid up for businesses. I think we paid over 20x earnings and a modest multiple of book value for GEICO which was still cheap in retrospect.

We have paid up, partly at Charlie's urging for great businesses, more than we would have 30 or 40 years ago. But it is tougher as we get bigger and we have always known that would be the case. I still believe our returns can be satisfactory going forward.

There are companies we should have bought 30 or 40 years ago that looked expensive then but we now have realized that paying up for an extraordinary business is not a mistake.

Q: Do you think the US Dollar will lose its status as the global reserve currency?

Buffett: The US Dollar will be the world's reserve currency for some decades to come. I think China and the United States will be the two economic super powers but I don't see any reason why the US Dollar will lose its status. It is extremely unlikely any other currency will supplant the US Dollar anytime soon.

Munger: There are certain advantages for any country that has its currency as the world's reserve currency. If you lose that, you lose some of that advantage. England had a better hand when it had the world's reserve currency.

It's in the nature of things that sooner or later every great leader is no longer the leader. Over the long run we're all dead…

Buffett: Thanks Charlie, this is the cheery part of the day!

[Laughter]

Munger: Every great nation in history is no longer. I am confident that the US Dollar will still be the world's reserve currency 20 years from now, but that doesn't mean it will be forever.

Q: Will corporate profits remain above 10% as a fraction of GDP as they are now?

Buffett: This level is unusual. Particularly when considering the economic backdrop.

Corporate income tax as a percentage of GDP in the United States is 50% what it was 40 years ago despite Corporate America frequently complaining about the corporate tax rate. Profits are at an all-time record of GDP.

American business has done extraordinarily well at a time when inequality has widened based on net worth and income.

It will be interesting whether these levels can be maintained. Business has come back very strong in terms of profits but employment has not come back the same way. That is going to be a subject of a lot of public discourse which you are currently reading about.

If I had to make a guess, corporate profits as a percentage of GDP will come down because GDP will increase - this doesn't mean absolute profits will have to come down.

Charlie, do you feel that the corporate tax rate is too high?

Munger: I think that if the rest of the world continues to bring tax rates down, we are at a disadvantage if we are much higher. I rather like Warren's idea that people like us should pay more.

Q: Warren, you currently have a lot of business unit managers reporting directly to you. Would this structure be too unwieldy for your successor?

Buffett: My successor may organise it a bit differently… but not too differently. I think they would leave in place the principle that our CEOs are still running their businesses in all of the important ways except for capital allocation.

I have actually delegated a few units to an assistant of mine and my guess is that my successor may do something similar.

I have grown up with these companies one by one over time and am very familiar with them. So it is a lot easier for me to communicate with dozens of managers than perhaps a new successor would be able to.

A fresh leader will have to understand the major units but may be better served with fewer direct reports, particularly for those smaller companies.

The real money will be made in the future by the big operating businesses and the insurance businesses within Berkshire.

Charlie?

Munger: Of course it would be unwieldy to have so many businesses, particularly small ones, if we were trying to run them through an imperial headquarters system dominating all the details. But our system is totally different. If your system is decentralization almost to the point of abdication, what difference does it make?

Buffett: It works pretty well now and it will work pretty well after us too.

We are trying to make acquisitions of businesses with at least $75 million in pre-tax earnings. The best acquisitions for us are the bolt-on acquisitions which are operationally easiest in terms of the burden on headquarters.

Munger: If it was all that difficult, what we are doing now would be impossible – and I can assure you that it isn't.

Buffett: hmmm, I'm going to have to think about that one Charlie.

[Laughter]

Munger: Warren, if 20 years ago someone said that you could manage a company of this size with 10 people and all these people would come to Omaha to listen to you. You would have said they were ridiculous….it's happened…and it works!

Q: What are the long-term risks from the Fed's quantitative easing policy and how will it be able to stop this policy without negative implications?

Munger: I don't know.

[Laughter]

Buffett: I have nothing to add…

[Laughter]

Munger: It certainly is going to be difficult.

Buffett: We're in unchartered territory. As many people have found out, it's a lot easier to buy things sometimes than to sell them.

There is all this liquidity that has been created and is just sitting there. Believe me the banks want to provide loans. Wells Fargo is not happy with leaving reserves at the Fed. They want to provide loans on the proviso they get more in return than they give out.

We really are in unchartered territory. I have a great deal of faith in Bernanke. I don't know if he is impacted by the term of his employment though. He may just hand over the baton to the next guy and say here is this wonderful balance sheet, all you have to do is reduce it by a few trillion…

[Laughter]

This is a situation we haven't seen before and has the potential to create significant inflation. My guess is that the Fed was hoping to have more inflation by now. The easiest way to run up nominal GDP is to print money.

When the markets get any kind of signal that the buying is ending or the selling is beginning, it will be a shot heard around the world. That doesn't mean the world will come to an end but it will certainly mean that everybody that owns securities, driven to them by extremely low rates may re-evaluate their hand rather quickly and markets will follow.

Munger: Generally speaking I think that what has happened macro-economically has surprised all the people who thought they knew the answers, namely economists. Who would have guessed that interest rates would have stayed so low for so long, or that Japan would have 20 years of stasis after using all the tricks in the economist's bag.

Given this history, I think economists should be a little more cautious in believing they know the consequences of printing money in massive amounts.

[Applause]

Buffett: It is a huge experiment.

Munger: I suspect the next century will be harder, not easier, than the past. I'm not going to be here to see it but I predict that we'll have more trouble than we now think.

Buffett: Charlie says he won't be here to see it but I reject such defeatism.

[Laughter]

Q: How has the Fed's zero-interest policy affected Berkshire's various businesses?

Buffett: It's helped.

Interest rates are to asset prices what gravity is to apples. Lower rates mean a lower pull on asset prices. We have seen that play out.

People make different decisions when they can borrow at extremely low rates.

Interest rates power everything in our economic universe.

We can borrow money today at far cheaper rates then in the past and that obviously helps. This will change at some point. This is like watching a good movie, because I don't know the ending – that's what makes it a good movie.

We will be back here in a few years and I will tell you I told you so and hope you have a bad memory.

[Laughter]

Charlie?

Munger: I don't expect interest rates will stay this low for extended periods of time. Everyone has been surprised with the current situation.

Buffett: Of the cash securities on our balance sheet, they are invested in short term treasuries. We never stretch for the yield such as commercial paper for an extra 10 basis points - we don't want to count on anybody. Obviously in a high interest rate environment we would earn substantially more interest income which we do not earn today, but of course it would have a lot of other impacts to our other businesses.

Q: What are your thoughts on unregulated digital currencies such as Bitcoin?

Buffett: Charlie I hope you know something about this?

Munger: I have no confidence in such a currency whatsoever.

Buffett: I don't know much on the topic but of our $49 billion we haven't moved any into Bitcoins.

[Laughter]

Q: Has Bill Ackman's public accusation about Herbalife's multilevel marketing plan had an impact on Pampered Chef's [a Berkshire company] multilevel marketing plan?

Buffett: Pampered Chef is not a scam. It is about selling to the end user. We have thousands and thousands of parties a week where end consumers are buying product and we are not making money by loading our sellers with product. This is a distinguishing factor in terms of regulation. You have to look at the cases where thousands of people got their hopes up to make a living and invested their life savings in buying a product they didn't need themselves. Those people subsequently abandon all hope of selling the product and the parent company is still selling to millions and millions of people.

Munger: There's likely to be more flimflam in selling magic potions [referring to Herbalife] than in selling pots and pans.

[Laughter]

Buffett: Given our age we are actually on the lookout for magic potions.

[Laughter]

Q: Recent Berkshire returns appear to be based on Warren's reputation and access. Will a successor be able to deliver these?

Buffett: A successor will have more capital to work with and be part of a culture that's willing to commit. From time to time they will have capital when markets are in distress. Few people at this time will have capital and be willing to commit. I know that my successor will have capital during turbulent times and be able to invest with conviction. Do not worry about our successor being willing to deploy capital during these times. Berkshire has a reputation as the 1-800 for financial emergencies, and we get calls others don't.

If the tide goes out and you see who is naked, substantial businesses in need of financing will call Berkshire. Berkshire's reputation will solidify its role to provide capital when people are frozen. When I am not around it will become more about the Berkshire brand and not something attached to a single individual.

Q: What's your key to influencing people to sell their businesses?

Buffett: Sometimes the company is put up for sale when people simply do not want to run the business anymore.

Munger: We've never bought anything from an unwilling seller. We bought a lot of Berkshire on the open market, and found big blocks when we could. We don't convince people to sell their stock and there's been very little convincing on our part.

Q: How would you explain the Berkshire business model and long-term competitive advantage to a 13 year old?

Munger: We've always liked to stay sane when others go crazy…

[Laughter]

As we've gotten bigger, we've learned the golden rule: we ensure that we treat subsidiaries as we would like to be treated if the situation were reversed.

Business owners want to come to Berkshire as a result. We always try to be a fair partner - this leads to rare opportunities.

Buffett: Berkshire provides a permanent home. We had someone come to us who wanted to sell his business. He wanted to put to bed the question as to what would happen to his company when he died. He thought about it for a whole year, as to what to do. He considered his competitors, but they would come in and put their people in charge. They would come in and conquer. He also considered selling to a private equity firm but they would load it up with debt and lever it up to strategically sell it a couple of years later. This would lead to the destruction of his life's work. He then told me "Warren, you're the only guy left standing to sell to".

Berkshire treats its subsidiaries well and sellers have peace of mind. So our competitive advantage is that we have no competition.

We also have a different shareholder base than most companies. We look to shareholders as partners.

Q: Are BNSF's coal-related assets fungible? Can delivering crude oil by rail continue despite the building of pipelines?

Buffett: In terms of oil, there will be rail usage for a long time yet. Contrary to perception, oil moves faster by rail than by pipeline. With the change in market prices, there's a lot of flexibility in terms of the transportation. The whole country is producing five million barrels of oil a day - that's a lot of oil to transport.

Q: The Harley Davidson 15% senior unsecured notes come due in 2014. What will you do about it?

Buffett: We would prefer to just have them continue to pay us 15% and not answer their mail. But that's not viable.

[Laughter]

We were able to get unusually good terms from Harley Davidson as the corporate bond market was shut at that time. We won't see anything like that for a while. We wish the five year deals had been 10 year deals. These deals occurred during a special time in the market in 2008. We did not think that Harley Davidson would go broke. Any business that has its customers tattooing the logo onto their body parts can't be all that bad.

[Laughter]

Q: Do Todd Combs and Ted Weschler check with Warren before buying a stock?

Buffett: I usually don't know that they are looking at a particular stock until they buy it. They don't check with me before they buy. I see a monthly portfolio sheet but they are in charge of their own investments and I leave them alone.

Todd & Ted can do what they like, including putting all of it in one stock or in 50, with small regulatory limits (can't buy any more of AMEX to avoid being a bank holding company, etc.). When I managed money, I wanted to be a free agent. Once I had the money, I wanted free reign. That's exactly what we have with Todd and Ted now.

Q: How do you prioritize your days?

Buffett: Charlie and I live simple lives. We know what we enjoy. Charlie likes to design buildings. We both like to read a lot.

I never make lists. I can't recall making a list in my life, maybe I'll start!

[Laughter]

Munger: We didn't know that consuming caffeine and sugar and being well-rested is ideal for human cognitive function. We have been on autopilot in terms of our day to day habits. We just stumbled on that. Warren is never tired, he sleeps soundly all the time. He has never made a decision tired. He doesn't waste time considering what to eat; he just eats.

We don't waste time with daily decisions. We just have a lot of habits.

Buffett: Yeah, they put fudge up here for us and I eat it.

[Laughter]

Q: Why do you buy newspaper publishers?

Buffett: We'll get a decent rate of return. Most of these companies we bought, they have been partnerships usually. They have a structural advantage. We can write off the intangibles. As an after-tax return that would be at least 10% and is unlikely to be significantly lower.

Our newspapers are now earning ~$100 million a year. It won't move the needle at Berkshire. We would not have done this in any other business. It doesn't require an extra ounce of effort by me or Charlie. We will get a decent return and we like newspapers.

We will provide annual updates on how our newspaper returns are going. We are buying them at low rates relative to earnings. This makes sense as earnings are declining.

Munger: Warren, what you are saying to me is, it's an exception and you like doing it.

[Laughter]

Q: Why not follow Henry Singleton's example of breaking up Teledyne in 1999 and break up Berkshire?

Buffett: I do not anticipate any major changes at Berkshire. Charlie knew Henry Singleton, he has a good perspective on what he did right and wrong. Breaking it up would produce a bad result.

Munger: Singleton was a genius; he could play chess blindfolded. Just because Singleton was a genius doesn't mean we're wrong. He managed those companies on a way more centralized basis. At the end, he wanted to sell to us. He was ill and really wanted to sell to us. We said to him, we love you but we don't want to issue Berkshire stock.

Buffett: Singleton played markets better than we do. He was incredible at that and made a fortune doing that. To some extent, he looked at the shareholder group as someone who could be taken advantage of. We have not played this game.

Munger: He was enormously talented but I like our system better.

Q: What's the impact of tax rates and the trade deficit on U.S. competitiveness?

Buffett: The U.S.'s number one problem is overspending on health care costs, irrespective of public or private payer. The U.S. spends 17.5% of GDP on health care while competing countries spend 9.5%-11.5%. All signs point to the fact that this is an issue. The big issue is the cost, we have a big disadvantage in cost versus the rest of the world. Overall the U.S. has done very well since 2008. Our system works but our number one issue is the cost of healthcare.

Munger: The number two problem is a grossly swollen securities and derivatives market. I agree with the point on healthcare but find this more revolting.

Buffett: Charlie is very Old Testament but he's right.

[Laughter]

Q: Did your success just come from being lucky with timing?

Buffett: I was lucky with timing. I was lucky to have been born in the United States and male. During my lifetime, the U.S. has been an incredible environment. I would not have had the same chances if I was a female. I was conceived in November 1929, so I find myself lucky that the crash came along. It provided more than a decade where people were turned off stocks. Also in the past decade, a lot of people have been turned off by stocks.

I envy the baby born in the U.S. today: probabilistically they will be the luckiest individuals ever. These kids will do very well in terms of their probability. There are huge opportunities in the investment field. A young person who has a passion for investing today will do very well over the next 20 years.

Munger: Competition has changed over time. Sure we had some advantages over time. Now we have too much money and too few ideas.

[Laughter]

Q: How did you change over the last 50 years and what advice would you have for yourself 50 years ago?

Munger: Stay rational, keep chugging along, and work where you're turned on. Find what turns you on. I have never succeeded where I didn't like what I was doing.

Buffett: We found the things we liked to do very early in life and then pushed for doing it. We have had so much fun running Berkshire it's almost sinful. I was lucky that my Dad happened to be in a business he didn't care much for but I did.

Q: How can insurance pricing at Berkshire be rational yet you still gain insurance share?

Buffett: Berkshire is in an unusually rational place. We know what we want to accomplish. We have the benefit of being a controlling shareholder. It should be conducted as a rational activity. Others have pressures driven by Wall Street to increase premium volumes.

If we do something stupid, it's because we did something stupid, not because of external factors like Wall Street. We love having no external factors; it's a great way to operate. If you own less than 1% of a company, it's hard to resist the pressure from Wall Street. We don't have to do anything stupid in insurance; we get a lot of these opportunities.

We used to underwrite disaster insurance seven years ago but the price is not right anymore so we don't sell them. We haven't left the market, the market has left us.

Munger: There are pressures on other people that we don't want and don't have.

Buffett: It's like stocks in the late 1990's. There were a lot of smart people around you making a lot of money. This creates a social proof where it works for a while. This is the danger.

What starts as scepticism turns into a problem. People look to them and wonder why their friends and colleagues are making more money. We have no pressures, we don't give a damn. We are not smarter; we just understand not to follow them. We are not envious of those day traders who make money; we don't want to just do it to make short-term money.

Q: Is Berkshire too big to fail? [asked by Andrew Ross Sorkin, author of *Too Big To Fail*] How do you feel about Dodd-Frank and how does it impact Berkshire's insurance businesses or stakes in Goldman Sachs and Wells Fargo?

Buffett: I don't think it has affected the insurance businesses to my knowledge. I don't think we are too big to fail. The higher capital ratio requirements for larger banks compared to smaller banks obviously mean lower ROEs going forward. The capital ratio at Wells is not as high as they would be for Citi or JP Morgan. This higher capital ratio means a lower ROE.

The banking system in the Unites States is stronger than it has been in the last 25 years. Capital is higher, and a lot of the troublesome loans are gone. The new loans are far better. The banking system is in much better shape in the U.S. than in Europe. I would not worry about the banking system being the cause of the next bubble. It could be something else. We will have bubbles. We are human. We don't usually get them in the same way as before.

The next boom won't be a housing boom. I feel very good about our investments in banks. They are pursuing, in my view, sound practices. They will be decent investments over time.

Q: Have you lost any passion for the business as you've grown wealthy? Are you digging any less deep?

Buffett: I don't think our passion has gone away. I think you can't separate the game from the scorecard. Nothing's more fun for me than finding something new for Berkshire. That was true 40 years ago and is true now.

Munger: Well, when we bought American Express for the first time, we didn't know anything about it so you had to do a lot of work. The second time was a lot easier.

Buffett: When I learned about the Salad Oil scandal at American Express, I saw an opportunity and did a lot of research. I talked to a lot of restaurants and they told me they couldn't get rid of accepting American Express despite its fees, so I knew it was a great company.

It's not like the investment universe is changing that dramatically over time. Once I've learned something I don't need to relearn it.

Today, I already know a lot about American Express so I need to do less research.

We can't buy any more in American Express because of the banking holding company laws but in a sense they're doing it for us through repurchases. Coca-Cola, Wells-Fargo, IBM, most of our companies do the same and our ownership share goes up every year.

Q: What are your top five quantitative metrics for buying stocks?

Buffett: When we're looking at the aspects of a stock we're looking at the aspects of a business. It's very important to have that mindset. We're buying businesses, whether we're buying 100 shares of something or the whole company, we're always buying businesses.

So when Charlie and I read about something in Value Line or in the paper we don't use one metric for all companies. Different numbers are of different importance for different industries. If you were a basketball coach and someone who is 5'4" was asking you to be on the team, you'd probably turn him away even if he was the one player out there for whom it could work. As a coach you'd rather look for 7 footers and then worry whether they're athletes or can keep in school.

We see certain things that shout out to us "look further." And over the years we have accumulated a lot of knowledge about various kinds of industries such that we can make an intelligent analysis about all kinds of businesses. Usually some facts emerge that make it compelling.

It was mentioned that I got the idea to make an investment in Bank of America in the bathtub. The bathtub was not the key factor, I can assure you.

[Laughter]

I read "Biography of a Banker" more than 50 years ago and have followed Bank of America and other banks since then. So we have certain things we think about in banks that are different than when we're buying newspapers.

So we don't have one size that fits all. For example some brands travel well, like Coca-Cola, and some brands don't travel well. And we just keep learning about things like that and every now and then some opportunity, like Bank of America in 2011, comes up.

It's not because I'm calculating some precise P/E ratio or P/B ratio. It is because I have some idea what the company will look like in ten years and some reasonable amount of confidence in that assessment.

Munger: We don't buy stocks just based on financial figures. We need to know how a company functions. Any computer can do screening. We don't use a computer for screening, do we?

Buffett: No, I don't. I don't know how to. Someone needs to explain it to me.

[Laughter]

We need to know what a company will look like 10 years from now, and for a lot of companies we just don't know the answer to that. For example, we don't know which auto company will be successful in 10 years and which one will be hanging out. We don't know how to foresee the future well enough on something like that.

Munger: People with high IQ's, are financially driven, and who are good at math naturally want to think about the math.

Q: Bill Gross expects low future returns for the next few decades because of the macroeconomic outlook. What do you expect?

Buffett: Charlie and I don't really pay attention to macroeconomic forecasts. I can't remember a time for stocks when the economic outlook was certain.

We don't think there's a precise way of figuring out the future of the economy. So why try to value something you know nothing about?

I have a general feeling that America will continue to work well. For my adult lifetime, there have always been near-term concerns.

What we do know is that BNSF 10 years from now, 20 years from now, will be carrying more freight loads than today. There will be no substitute for the service that they provide. There will be two important railroads in the West and two important railroads in the East, and they will have an asset that has incredible replacement value.

It's not very complicated, and to ignore what you know because of predictions about what you don't know and what, in our opinion, nobody knows, is foolish.

We don't have anything against people talking about "the new normal" but my own guess is that America will do very well. Charlie?

Munger: Of course, when we have money, we have to do something with it. If you're a surgeon and you're debating whether to work a couple more years before you retire, I'd personally advise you to keep on working.

It's quite conceivable that the next decade will be worse than the past decade.

Q: How is Fruit of the Loom dealing with competition from Gildan?

Buffett: You keep your costs down, constantly work on brand building, and try to keep your main customers and in turn their customers happy. Gildan has certainly hurt part of Fruit's business in the last 10 years. But we turn out first-quality products with a low price and strong brand recognition.

As a note, Gildan pays little income tax being based in the Cayman islands.

I think, five or ten years from now our market share in men's and boys' underwear will hold up. Gildan of course is a competitive threat, Hanes is also a competitive threat. Fruit isn't a Coca-Cola, but it's not an unbranded product either. I think we'll do reasonably well.

Munger: You can't win every skirmish or battle.

Q: What 10 books influenced you the most?

Munger: I couldn't name 10 books. There are too many, they all blend together.

Buffett: *The Intelligent Investor* changed my life. I had read all the books on investing in the Omaha Public Library but this one changed my philosophy and taught me how to think about a stock and about the stock market. If Ben Graham hadn't written his book, which he had no financial reason to, my life would have turned out very differently.

I was also influenced by Phil Fisher's book [*Common Stocks and Uncommon Profits*].

The philosophy doesn't change, you just need to apply it to different times. But I have not found any aspect of this philosophy that's flawed.

Charlie has probably read more biographies than anyone.

I really enjoy biographies as well. I just read the Joseph Kennedy biography [*The Patriarch,* by David Nasaw], that was very good.

Q: Given the recent consolidation and resulting profitability in the U.S. airline industry, do you think double-digit profits are sustainable?

Buffett: Airlines have consolidated, but in some businesses you can only have two competitors and they still beat each other's brains out and end up competing very stupidly. This is what happened with Freddie Mac and Fannie Mae which had a huge advantage over everyone else but still, in an attempt to report higher earnings each quarter, went places they shouldn't have gone.

So you do see certain industries where two or three companies do extremely well and you see other industries where there are only two companies and they don't do well. It's very industry-specific.

Airlines have little incremental costs, huge fixed costs, are labour intensive and commodity-intensive and sell a commodity-like product. The temptation to sell the extra seat can be too great and it can be difficult to differentiate between that last seat and every other seat.

Historically, the airline business has been a death trap for investors since the Wright brothers. An investor should have shot them down on their first flight.

Munger: Last time we looked at something like this was railroads, where we missed an early opportunity and went in much later. So we've proven ourselves to be slow learners.

But this goes into my "too hard" pile.

Buffett: We like to do things we have stronger feelings about than this. We like businesses where things don't change dramatically. Look at See's Candy, we don't see a competitor coming along and taking business.

Munger: You really couldn't create another railroad in North America.

Buffett: I sure hope not Charlie!

Munger: But you can easily create another airline.

Buffett: And people love doing it. I've received a lot of proposals to start an airline. Actually, it's quite sexy to create an airline. If you go to a CEO and talk about this new airline you get his attention, if you talk about hauling coal you don't really get any attention. Airlines are a business that attracts people and it's easy to raise money for. But the amount of bankruptcies in that field has been baffling.

Of course, we once bought US Air, and by the time the check was cashed they were already having trouble and then they went bankrupt twice. We were very lucky and ended up making money on it, but they did end up going bankrupt twice.

Q: Should 120% of book value per share represent a floor for share repurchases for all companies?

Buffett: Book value has practically no correlation to intrinsic valuation for most companies. However, for Berkshire, book value has reasonable tracking value utility and that's why we show it in our reports.

We've signalled that as long as we have a substantial cash balance left over after we took care of our businesses and there was an opportunity to buy back shares below 120% of book value, we'd buy quite a bit.

If you're repurchasing shares at a significant discount to their intrinsic value, you're buying dollar bills for 80 or 90 cents.

It's difficult for us to do it because every time we announce it the stock goes up.

Munger: People are saying that if even these cheapskates are buying it, the stock must be cheap.

Buffett: We don't really like the idea of running a company that makes most of its money by buying its partners out at a discount, but the partners want to sell and we like buying. We haven't done much buying since most of the time our stock is in a reasonable range around intrinsic value. If in our opinion, and the directors' opinion, the stock is at a reasonable discount to value, we'd buy back a whole lot. Charlie?

Munger: Nothing to add.

Q: Charlie, have you ever considered moving to Omaha to be closer to Berkshire headquarters?

Munger: The answer to that is no.

Buffett: Our partnership works extremely well. Despite being somewhat technophobic, we are using the phone. [Laughter]

After working together this many years we each know exactly how the other guy thinks. We don't even need the phone that much. We used to do a lot of calling when it cost a lot of money to phone. Now that it's cheap to call we don't use it much. But Charlie has warm feelings about Omaha, as do I.

Munger: Yes, it's great here. But they have changed so much in Omaha with new buildings and everything else. Every time I come here I feel like Rip van Winkle.

Buffett: It's important to remember though that a third of the life of this country has happened during our lifetimes, so a bit of change is to be expected.

[Laughter]

Q: What factors or sources do you use when you make judgments about industry changes?

Buffett: There's no precise math on what makes a good investment. It isn't as precise as you'd think.

If you get a chance to buy a wonderful business, which includes a reasonable certainty of earnings, an unusually high return on capital and the ability to deploy more capital at that rate of return, you should stretch a little.

You won't find great businesses a lot, so when you see an opportunity you should take it. The stock market will offer it to you from time to time.

Q: Why do you, given your reputation for thriftiness, support an administration engaged in record spending?

Buffett: I find it totally unproductive to discuss politics. When you look at Charlie and me, he's a Republican and I'm a Democrat and we actually don't disagree as much as you'd think.

I believe that the stimulus was quite appropriate given the incredible situation we were looking at. Berkshire Hathaway was getting phone calls because GE couldn't get money. Fannie and Freddie were going into conservatorship. That's quite a situation.

Now the question is how we get off the stimulus, and that's quite a problem, but it's a lesser problem than the one we prevented if we had decided to follow some austerity path in 2008.

Munger: Warren, I agree with you completely.

[Applause]

As did George W. Bush. It was bipartisan to pass the stimulus.

Buffett: In September 2008, George Bush uttered 11 of the smartest words in economic history: **"If money doesn't loosen up soon, this sucker is going down**." People aren't giving him enough credit for that. We owe him a lot.

Once we were in terrible trouble, our leaders came up with policies that were reasonably useful in avoiding a calamity.

I am disturbed by a national debt that grows faster than GDP, and wrote an op-ed piece in the New York Times[1] about this very problem back in 2009. We came out of World War II with a higher debt-to-GDP ratio and people predicted terrible things but the country has done sensationally. The current debt is not our country's toughest hour by a huge margin.

Munger: I agree with you. But I also think if you're not confused by the current political and economic problems, you just don't understand them very well.

[Laughter]

Most of the debt is not even counted. The real obligations of the United States are off the books, the present value of entitlements that likely can't be changed, are larger than the official debt.

Buffett: But Social Security is not a real problem as long as GDP grows at a reasonable rate.

Munger: That's the real problem. All of our problems are trivial if real GDP per capita would just grow 2% per year. All of our problems would just fade in significance.

Q: Would buying 20 great companies and holding them be better than buying an index fund?

Buffett: The returns will likely match closely. Of course it depends how you pick the stocks, but by and large it should closely match the index.

[1] http://www.nytimes.com/2009/08/19/opinion/19buffett.html

The real distinction, and Graham made this, is between the person willing to spend significant amounts of time on investments, and the one who wants to work on their day job. The problem with the active investor is that they may get excited about stocks and try to time the market.

Equities will do well over time and it's a matter of trying to be a professional when looking at stocks as businesses. There's nothing wrong with being an amateur investor.

Munger: Knowing the edge of your own competency is very important. It is very dangerous to think you know what you're doing when you may not.

Q: Could you read us your tea leaves on the U.S. economy and would a weak U.S. economy make you focus on international opportunities instead?

Buffett: We'll never close any options off but I am confident that we'll find most opportunities in the U.S. because it's a huge marketplace for businesses and we're better known here. We do find a lot outside the U.S but it's mostly in terms of bolt-on acquisitions.

In terms of the economy, ever since the fall of 2009 we've seen a gradual improvement of slow progress in the American economy. People were talking about a double-dip but I never believed in that happening. What we see overall is just a slow progress in the American economy.

This economy over the last four years has not been roaring but has also not folded, and I wouldn't be surprised if it keeps going this way.

Finally, the overhang from housing ended about a year ago so we're seeing some recovery in home prices which has a large psychological effect. And we're seeing some improvement in construction, but we really want to have more housing starts than household formation.

We keep playing the game and if we hear about something tomorrow that we can spend $15 billion to $20 billion on, in the U.S. or otherwise, we'll move in an instant. You just never know.

Sometimes, the financial markets provide huge opportunities in a crisis. Most people see four or five of these in a lifetime, probably in equity markets but maybe also in debt markets. You need to be ready for this and also have the mental fortitude to jump in when others are jumping out.

Q: How do you get people to invest in a fund without a track record? [asked by someone in their 20s]

Buffett: People should be quite cautious in investing with people, even when they have a track record.

I'd advise any young person who wants to manage money to start developing an audited track record as early as you can.

It was far from the only reason why we hired Ted and Todd, but we certainly looked at their record. And they were records we both believed and could understand.

Many records are meaningless. Imagine the coin-flipping contest between 310 million orangutans and they all flipped 10 times, there'd be roughly 300,000 who flipped successfully 10 times and they'd get quite arrogant.

You need to make sure that your record is the product of sound thinking and not just being in tune with the times.

Munger: Most people start by raising money from friends and family.

Q: Is Ajit your successor?

Buffett: Ajit will be with us for a long time. He's remarkable in many ways - one of the ways is that when people start copying him, he thinks of new ways to do business.

Munger: If Ajit wasn't with us, we wouldn't look this good.

Buffett: And that's true for a number of our managers. We have great people who are, in many cases, not doing this for the money, but enjoy just building their businesses and are in an environment where they don't need to call on headquarters all the time.

If Ajit had come into our offices in 1965 rather than in 1985 we might own the world today. Fun to think about it, isn't it.

Q: How is Warren's son Howard Buffett [sitting in first row as a Director] the most qualified to become non-executive Chairman after Warren's death?

Buffett: He's taking on the role of non-executive Chairman in case a mistake is made in hiring the CEO. I think the probability that a mistake is made with the CEO is less than 1%, but not 0%, and I've seen that mistake made in other businesses.

If a mistake is made with the CEO, having a non-executive Chairman can be a great tool. Howard has an enormous sense of responsibility about preserving the Berkshire culture and has no interest in running the business. So he can focus on whether a mistake has been made with the CEO.

When you are a mediocre, likable, CEO, not a dishonest one, but not the best one, it is very hard to remove that person if he is also in the Chairman's position. A great improvement has been the initiative in corporate America that a Board now has meetings without the Chairman a few times a year.

Boards are a social institution and it's not easy for them to act out on any doubts about whether they have the right person. That's a responsibility that a non-executive chairman could focus on.

[Applause]

Munger: You've got to remember the Board holds a lot of stock. We're very interested in having the right leadership.

Buffett: We've seen a lot of situations where the CEO is a 6 on a scale of 10 and someone else could do it a lot better, but it's tough to remove them. They say "the meek shall inherit the earth" but after they inherit, do they stay meek?

The future CEO of Berkshire may be in a position that someone might want to use as a power base. I'm not telling the newspapers we own who to endorse for President and by doing so I'm trying to box in my successor as well.

Q: What are the cash flow constraints arising from the low interest rate environment?

Buffett: There has been a staggering loss of purchasing power by people who receive fixed dollars. They're huge victims of the low interest rate policy.

I feel sorry for people with fixed dollar investments, even if they're short-term ones, and I wouldn't know what I would do if I were in their position.

Imagine having some sum that seemed like a lot of money in the past but doesn't earn much now. You know, a quarter of a percent on a million dollars is $2,500 a year, that is not what people anticipated when they were saving over the years.

For over 95% of my life it has made more sense to own businesses rather than fixed dollar investments, especially when there's a period of cheap buying opportunities.

The fallout of low interest rates has hit millions of people.

Munger: Well, they had to hurt somebody, and the savers were convenient.

Buffett: What would you do about it?

Munger: I feel bad about it, but some of them were dumb.

Buffett: You wouldn't want to be in the fixed mortgage business now. The idea of giving somebody a 30 year mortgage where if it's a good deal for you they can call it off tomorrow but if it's a good deal for them they can keep it for 30 years, that's just terrible business - but good for you if you're buying a house. I recommend everyone get a 30 year fixed mortgage for as much as you can now.

Q: What's the competitive moat on IBM?

Buffett: I do not understand the moat around an IBM as well as I do the moat around a Coca-Cola. I would have more conviction about the moat around a Coca-Cola, a Wrigley, or a Heinz, than about IBM. But I feel good enough about IBM. There is enough room for both Microsoft and IBM to be successful, which they both are. I have enough conviction about IBM's position to maintain a large position in them, but I don't feel the same conviction about that than about a BNSF.

Q: How is your strategy today different than when you were smaller?

Buffett: Well, having $1 million is an entirely different game than running Berkshire Hathaway or running a $20 to $30 billion dollar fund.

We'd be looking probably at a lot of smaller things, looking for smaller discrepancies in certain situations. The opportunities are out there and periodically they can be extraordinary. But we get $12 to $13 billion coming in every year, and that means we have to make very big deals.

Munger: Well that's a nice problem to have.

Buffett: We worked pretty hard to get there. But when we were younger we looked under a lot of rocks.

Munger: In fact, I used to make a lot of money off the float of my income tax.

Q: Will Berkshire invest more in emerging markets?

Buffett: We don't start out by looking out for specific countries to invest in. We may find things around the world, but we don't set out for investing in specific countries. We don't think that's where our strength is. We're perfectly willing to invest in China, we own some BYD now. We've invested outside the U.S. and will continue to. But if you told us we could only invest in the U.S. for the rest of our lives we would not feel that that's a huge hardship.

Munger: It's a great way to sell an investment [to brand it as emerging markets]. There's lots of action there. But how do we have an edge?

Buffett: When you hear someone talking concepts, including country-by-country analysis, we get cautious. They're probably better at selling than investing.

Munger: When someone says you should invest in Bolivia or Sri Lanka, we're just not comfortable with that.

Q: Are we creating a new housing bubble?

Buffett: I don't think we're remotely close to a new bubble in housing. In terms of what went on before, the whole country was involved. The government was a very big part in financing the housing. There were an awful lot of people doing the same thing.

And for a while, the sceptics looked like idiots as everyone else was caught in it. They see everyone else making easy money and they finally succumb.

Overwhelmingly, most people just got caught up in a grand illusion. This has happened many times in history and it will happen again.

Munger: The main problem was that as things got crazier and crazier, the government should have pulled away the punch bowl before everyone got too drunk. Instead the government increased the proof.

[Laughter]

It's hard in a democracy for governments to pull away the punch bowl from voters who want to get drunk.

Buffett: It's almost impossible.

People will continue making the same mistakes as in the past. They get fearful when other people are fearful.

I have often thought that if I owned a bank in a two-bank town, I'd hire a hundred actors to form a line in front of the of the other guy's bank making it look like a bank run. But then you'd probably see a line in front of my bank too.

People get fearful in mass and greedy in mass too. Confidence comes back one person at a time. That's where Charlie and I have an edge. We are able, better than most, to not really get caught up. When we see falling prices, we see an opportunity to buy. It doesn't bother us when prices fall. But then we're also not buying positions on margin. We never get into a position where someone else can pull the rug out from under us.

Q: What opportunities do you see in the Eurozone? Can the ECB fix the Euro crisis?

Buffett: We're perfectly happy to look at opportunities in the Eurozone. We made a couple of bolt-on acquisitions there recently.

Europe is not going away and this might create good opportunities for us to buy businesses.

But, the major flaw in the European Monetary Union is that you have 17 political bodies and a lot of diverse cultures. It'll be tough for them. Essentially they synchronized the currency without synchronizing much else. Nature finds the fatal flaws and they found it fairly quickly with the Euro. The structure that was put in place does not work and they'll have to find something that does work, and they will eventually, but they may go through a fair amount of pain in the process.

Munger: Living in Greece under the European Union is a lot like using rat poison as whipping cream. An exceptionally stupid idea! It's not a responsible capitalistic country. Most people don't pay taxes…

Buffett: I've tried for years to have him use Country A or Country B in his examples…

Munger: Greece committed fraud to get into the Euro. They lied about their debt.

Europe has made terrible mistakes. They have politicians too.

Buffett: Do you think it'll be fine in 10 years?

Munger: I think Europe will muddle through.

Buffett: Well, even with the dire forecast, we would be delighted to invest in Europe and pay cash for good businesses.

Munger: I hope you'll call me if it's in Greece.

Q: How has social media impacted Berkshire?

Buffett: It makes a difference to GEICO in terms of marketing, using social media.

I've been amazed how fast the world has changed. I would have thought the change would only have been for younger people but internet based behavioural changes have spread throughout the entire age spectrum, not just young people.

Munger: I don't understand social media because I avoid it like the plague. I hate the idea of the teenagers in my family documenting for all time the three dumbest things they ever said by age 13.

Buffett: We would have been in big trouble, Charlie, if that had been around back then.

Munger: I think there's a time when your ignorance and folly ought to be hidden.

I also think that when you multitask like crazy like the young people do, none of the tasks are likely to get done well.

Q: How do you identify frauds?

Buffett: Some you can say with 80% or 90% certainty that they're frauds. People give themselves away a lot too. In poker they talk about "tells."

Charlie and I have looked at a lot of businesses, and it's very important when we buy those businesses to assess the individuals we are buying from, because in the end they hand us the stock certificates and we hand them a lot of money and we're counting on them to run the business with as much enthusiasm as they did before. So we are assessing people.

Similarly, when looking at financial statements… For example, in the insurance field, we've seen some frauds. You'd see companies where one or two years before they offer stock to the public the reserves would be down very suspiciously, thereby boosting accounting profit.

There's a million different ways, but I've seen enough situations over the years and you can spot certain people who are in one way or another playing games with the numbers. They give themselves away, but I can't give you a checklist of 40 items or so to look for.

Munger: Sometimes it's pretty obvious. Once we were looking at a fire insurance company in an Eastern European country, I can't remember the country, and they told me it was like taking candy from babies. We only write fire insurance on concrete homes that are under water level.

[Laughter]

Buffett: When you get into accounting, there are so many things you can do to cheat. Financial institutions in particular do this.

Munger: Sometimes the business owner is not deliberately fraudulent, just deluded. They believe what they're saying.

Buffett: If you've got doubts, forget it.

It's interesting, accounting is trying harder and harder to make good disclosures, but I find financial statements less useful today than they were 30 years ago.

[Applause]

Munger: I think financial statements at big banks are way harder to understand than they used to be. They just do so many different things, and have so many footnotes, and there's so much gobbledy-gook. They're not my grandfather's banks.

Buffett: Well we should know because we own some. We bought General Re, and they had 23,000 derivative contracts and Charlie and I could have spent 24 hours a day with the help of 50 math PhD's and we still wouldn't have known what was going on. And it cost us about $400 million to find out.

Q: Would you invest in Sub-Saharan Africa (excluding South Africa) under today's conditions?

Buffett: I might not know enough about it myself but if it was attractive enough we wouldn't totally preclude it.

Munger: The University of Michigan hired an investment manager in London specializing in Sub-Saharan Africa. What he did was he bought all the African banks trading on the pink sheets in Africa. He did well, so it is possible.

Buffett: It is possible. If we were poorer we might think about it.

Munger: I don't think so.

[Laughter]

Q: How much money is the right amount to give your kids so they "can do anything, but not do nothing"?

Buffett: Kids are more ruined by parents' behaviour than their money.

Your children learn about the world through your actions and words from the moment they're born. It is a very important and a serious job and the amount of money is not as important as what they see through you. I've loosened up a bit. Every time I redo my will, my kids are happy about it.

And I do something else, which I think is an obvious thing, but most don't do it. Your children will read your will someday. It is crazy to have that be the first time after you're dead. If they have questions about your wishes or why you made certain decisions, if they review it while you're alive you can talk to them. Also, if they think there's anything unfair, they should be able to express it.

I wouldn't recommend this when your kids are 14, but certainly by the time they're in their mid-thirties they should read it. I rewrite my will every 5-6 years and my children read it. They should be participants. My kids will be wealthy but I don't believe in dynasty building. Most of the money has far more use to society than it would have for my children.

Munger: If you are having your children read the will, make sure you're not giving them different shares.

Buffett: There could be cases where children get different types of assets and you want to make sure they understand your definition of fairness.

[Applause]

Q: Should Berkshire do a stock split?

Munger: Don't hold your breath. [Applause]

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