Private & Confidential

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2014 BERKSHIRE HATHAWAY ANNUAL SHAREHOLDERS' MEETING

“Change is inevitable so how well you adapt is terribly important.”

- **Charles T. Munger, 3 May 2014**

We made the annual pilgrimage to Omaha, Nebraska to attend the 2014 Berkshire Hathaway Annual Shareholders' Meeting. As usual the Q&A session with Warren Buffett (age 83) and Charlie Munger (age 90) lasted a marathon six hours and covered a range of topics from intrinsic value to capital allocation to succession.

An estimated 38,000 people attended the meeting this year at the Omaha Century Link Center. Another record, with all overflow rooms filled.

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 included questions from a panel of investment analysts, including Jonathan Brandt of Ruane Cunniff & Goldfarb, Jay Gelb of Barclays, and Greggory Warren of Morningstar. Buffett was unable to find a bearish analyst or investor to join the panel.

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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As per recent years, the meeting began with a Berkshire Hathaway film produced by Susan Buffett Jr. (Warren's daughter) featuring Warren singing a version of *I Did It My Way* with the song's writer Paul Anka, characters Vince Chase and Ari Gold from TV series *Entourage*, and a cartoon featuring Team Berkshire, including Warren, Charlie, Bill Gates and Mrs. See (See's Candies), beating the Russian Ice Hockey team at the 2034 Winter Olympics in Omaha. The film also included a number of advertisements of Berkshire's investments including Coca-Cola, Heinz, GEICO and Berkshire Hathaway HomeServices.

<u>Q&A Session</u>

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

Q: Why did you not publicise your opposition to the Coca-Cola stock option program prior to the shareholder vote and why did you abstain rather than vote against it?

Buffett: The proposal was made by a long-term shareholder [David Winters, Chief Executive of Wintergreen Advisers, LLC] who was opposed to the option program. His calculations of dilution were wildly off and we didn't want to get into a discussion about them. I did talk to Muhtar Kent [Coca-Cola Chairman and CEO] and told him that we'd abstain.

We admire Coca-Cola and their management but we thought the compensation plan was excessive. Immediately after the vote I announced that we had abstained. I think that in terms of having an effect on the Coca-Cola compensation practices and other companies' compensation practices, this was the most effective way of behaving for Berkshire.

We made a clear statement but at the same time we didn't want to go to war with Coca-Cola and did not have to endorse and join forces with someone whose calculations we didn't agree with.

I don't think going to war is often a very good idea. And when you join forces you have to be very sure who you join forces with. We'll see what happens with compensation between now and our next meeting with Coke. Charlie?

Munger: Warren, I think you handled the whole situation well.

Buffett: And Charlie gets to remain Vice Chairman. [Laughter]

Charlie is the only person I talked to about the plan beforehand and we agreed on the course of action.

Q: Berkshire typically doesn't change businesses that it acquires, however your partner in the Heinz deal [3G] is far more hands-on. Could you use the 3G management processes to improve Berkshire subsidiaries in the future?

Buffett: I don't think the two blend very well. 3G does a magnificent job running their businesses but it's a very different style than Berkshire.

I do think we'd be likely to jump at future opportunities to partner with 3G. They're marvellous partners who are more than fair. We're very likely to partner with them, perhaps in things that are very large. But I do not think that a blending of the two would work very well. We have a system that works well for us, with managers joining a company that's unlike any other. That's a huge corporate asset for Berkshire that continues to grow and we want to maintain that clear message.

Munger: I don't think we've ever had a policy that encouraged overstaffing our businesses. [Laughter]

Buffett: At least not in our home office. We have not enforced a strong discipline on every subsidiary. Most are overwhelmingly managed on a lean basis, but that's not true of every one we've been involved in or will be in the future. We encourage it by example but not by edict.

Q: Steve Wynn [Chairman and CEO of Wynn Resorts] has been quoted as saying "Obama is the biggest wet blanket to the economy." Can you get Obama to change the direction of the economy?

Buffett: I think I'll let you communicate with him [Obama] directly. [Laughter]

I disagree with some of the things you've said. We have a different opinion on politics and I won't convince you and you won't convince me.

American business is doing extraordinarily well. Anyone who thinks American business isn't doing well should look at corporate profits. Anyone who thinks corporate taxes are too high should look at corporate taxes versus GDP since World War II. Earnings on net tangible assets in America are the envy of the world.

For much of mine and Charlie's lives taxes have been much higher than they are now.

But I don't want to try to convince you since I don't want you to try to convince me.

Munger: I'm going to avoid this one.

Buffett: And people complain about me abstaining. [Reference to the Coca-Cola option plan abstention] [Laughter]

Q: You've said that the yardstick of performance versus the index should be any 5-year period. You just underperformed for a 5-year period but didn't address it. Should we infer that you are changing the yardstick?

Buffett: We're not changing the yardstick. But we did point out in the 2012 letter that we usually do worse in strong market periods and that if in 2013 the market would do well we would underperform on the 5-year mark. Last year was a very strong year for the stock market and that resulted in us having an underperforming 5 year streak.

We will underperform in very strong up years, we will likely more or less match in moderate up years, and we will outperform in flat or down years. Over a full cycle I think we will outperform, however there's no guarantee of that.

Munger: Warren's yardstick is increasing Berkshire's net worth after corporate taxes, and the index doesn't pay taxes. Warren has created a ridiculously tough standard. If this is failure I want more of it. [Laughter]

Q: What can you do to narrow the gap between Berkshire's intrinsic value and its market value?

Buffett: We said we'd be eager to buy stock at 120% of book value. At that price we think we are getting a bargain. The 120% is a loud shout-out for a figure that we think is significantly below intrinsic value. We only want to repurchase shares if it's at a significant discount to intrinsic value. Other companies, including Coca-Cola, buy back shares to negate option dilution. That's actually not the best reason to repurchase stock. If you're buying a dollar for ninety cents you're doing the shareholders a favour, if you're buying one for $1.10 you're destroying value.

Q: How do you gain the trust of the owners of companies that sell their businesses to you?

Buffett: We've kept our word. We have to be careful what we promise. We can't promise, for example, that we won't have layoffs. We can promise that we won't sell the business if it turns out to be disappointing.

We make a promise and put our economic principles in the back of our shareholder letter every year so owners who sell us their business can count on us. And if we behave differently, word will get around.

We've only had to get rid of a few businesses, including our original textile business. We promise our managers they can keep running their businesses.

Munger: Obviously we behave the way we do because we like doing it. It's worked very well and we're unlikely to stop.

Q: Your son Howard is on the Board of Coca-Cola and voted for the pay proposal that you've come out against. You said Howard will succeed you as Chairman. How can we count on Howard to defend the future and culture of Berkshire?

Buffett: I've voted for unsavoury pay plans and acquisitions as a director of corporations before. The nature of boards is that they're part business organizations and part social organizations. People behave in some ways with their business brain and some with their social brain.

In 55 years of being on corporate boards for 19 companies, I don't think I've ever seen a compensation committee report come in and get a dissenting vote. The social reason is that the board splits up its work and assigns these tasks to the compensation committee. It's almost unheard of to question that activity.

Bear in mind that the so-called independent directors on that board are getting $200,000 to $300,000 in fees per year. They may be independent by SEC standards but believe me they're not really independent. They want future positions like that.

On my 19 boards, I was put on the compensation committee exactly once. They're looking for Cocker Spaniels, not Dobermans.

Don't judge Howie too hard. My son Howard and my other children have a deep regard for the Berkshire culture. His job as non-executive Chairman won't be to set compensation or pick the CEO. His job is to facilitate a change in the unlikely case the Board decides a change is needed.

Munger: When Warren was on the compensation committee at Salomon Brothers they asked what the hell he was doing. How could he vote down compensation on Wall Street?

Knowing Howie I don't worry that he'll go foolish or soft and just shout his approval.

Buffett: If you're in any social situation and you keep belching at the table you'll end up eating in the kitchen. [Laughter]

Q: What do you think Berkshire's cost of capital is and how is it evolving? Is it becoming harder as you have grown to earn returns exceeding this hurdle rate?

Buffett: There's no question our size is an anchor to performance. We cannot earn the same high returns on capital with a market cap of $300+ billion [as when we were smaller]. Archimedes said he could move the world if he had a long enough lever. I wish I had that lever.

Our cost of capital is what could be produced by our second-best idea, so our best idea has to exceed that. I've heard so many nonsensical discussions on cost of capital.

Munger: I've never heard an intelligent one. [Laugher]

Buffett: The real test over time is whether the capital we retain produces more market value over time in present value terms.

We bought a Canadian company the day before yesterday [AltaLink power transmission from SNC-Lavalin] and spent close to $3 billion and thought it was the best thing we could do with the $3 billion on that day.

What I do know is I've never seen a situation where the CEO wants to do a deal and the CFO didn't come in and say its returns exceeded the cost of capital.

We think we can evaluate businesses and we know the capital we have and which things we can sell or buy. We constantly think about opportunity cost.

Munger: A phrase like cost of capital means different things to different people and often means silly things to people who teach in business schools. We just don't do it. We look at whether a dollar retained results in more than a dollar of shareholder value. That's not what they teach in business schools. We're right and they're wrong. [Laugher]

Q: How were you able to purchase Nebraska Furniture Mart at such a wonderful price?

Buffett: The $60 million we paid for the business was a multiple of 11x to 12x earnings at the time. Sales were about $100 million, pre-tax margins were around 7%, so around 4.5% after-tax, ballpark. It was not a bargain purchase. It was a great business and a wonderful opportunity. The Blumkins are as fine a family as I've ever met.

There was actually another company, from Germany, that was trying to buy them at the same time. Believe it or not, and I didn't know this at the time, Erskine Bowles [of the Simpson-Bowles Commission] was representing them.

On my birthday in 1983 I gave Mrs. B the contract that's in the annual report. She didn't read it but her son told her what was in it. I never asked for an audit of her financials. I asked her if she owed any money and whether she owned the building.

But it was not a bargain purchase. If you want a bargain purchase, you should go shopping at the Nebraska Furniture Mart. [Laughter]

It's a remarkable organization.

I'd like to put in a plug for the Dallas store. It's over 40 acres. I predict it will do more volume than any home furnishing store in the world by a factor of at least two.

Q: In your will you've given instructions to put 10% of your wealth in short-term government bonds and 90% in a low-cost S&P index fund. Why are you advising the trustee to invest in an S&P fund instead of Berkshire shares? Are you expecting the S&P to outperform Berkshire?

Buffett: When I die all the Berkshire shares will go to five different foundations, every single share. They will be distributed over the ten years after my estate is closed, so I figure over twelve years. I'm telling the trustee to not sell any shares until they have to be sold. So my view over at least twelve years after my death are as bullish as they can be.

As far as my wife is concerned, it's not a question of maximizing capital. It's a question of peace of mind. It's not designed for her to get an ever larger amount of capital.

On the part that I care about maximizing I've instructed the trustees not to sell a single Berkshire share until they have to be sold.

Munger: Warren is peculiar in the way he distributes money in the family and he's entitled to do as he damn pleases. He is very meritocratic and is quite extreme in giving money back to the civilization from which it was earned. I like being associated with that. [Applause]

Q: Has there been any discussion at Board meetings of a replacement for Charlie Munger?

Buffett: Charlie is my canary in the coal mine. Charlie turned 90 and I find it very encouraging how he is handling middle age. [Laughter]

I think it's very likely that whoever replaces me as CEO will have developed someone they work with very closely over the years. It's a great way to operate. Berkshire is better off for the two of us having worked together than if there were just one of us.

We've seen it with Roberto Goizueta and Don Keough at Coke. We saw it with Tom Murphy and Dan Burke at Capital Cities. They're both magnificent companies. In both these cases they've accomplished far more because they had two incredible, complementary people working together.

It's a great way to operate if you can. You can't will it, but I would be very surprised if there wasn't a similar enhancing relationship within a few years of a new CEO taking over. But so far nobody has brought up any successor to Charlie in the meetings and I have a lot of trouble thinking of anyone who could be a successor to Charlie.

Munger: I don't think the world has much to worry about. Most 90-year old men are gone soon enough.

Buffett: The canary has spoken. [Laughter]

Q: If you had to invest your entire net worth in one company other than Berkshire, what would it be?

Buffett: Great question but it won't get an answer. Charlie?

Munger: I think that's the right answer.

Q: Please don't move the meeting to Dallas or some other place [as had been speculated].

Buffett: We won't. [Applause]

Q: How do you and Charlie manage your relationship? Do you ever argue?

Buffett: Charlie and I have never had an argument. We met when I was 29 and he was 35. We've disagreed on a lot of things since but it has never led and never will lead to an argument. We argue with other people.

I called Charlie on the Coca-Cola vote and asked what he thought, and we think alike.

Munger: Most of the time we think alike. That's one of the problems.

Buffett: There's no question that if you look at the really bad mistakes, I've made, I've been a little more inclined to action than Charlie.

Munger: Well, you once called me "the Abominable No man". [Laughter]

Q: What are your weak points and what could be done to address them?

Buffett: A clear weak point of mine is that I'm slow to make personnel changes. I like the managers we have. Charlie and I have a wonderful friend who couldn't have been a greater guy, and we were slow to make a change there. We loved the guy and it wasn't killing us in the business.

We will be slow and there will be times when because of our lack of supervision over our subsidiaries we'll miss some things. Something will happen and it wouldn't have happened if we had the same procedures as other companies. But on the positive side we've achieved a lot more because we gave people leeway.

We don't have a general counsel office or human relations department at Berkshire. It's not always a 100% benefit but on balance it's definitely a positive.

Munger: By the standards of the rest of the world, we over-trust. So far, our results have been excellent because we have carefully selected people that can be over-trusted. A lot of places would work better with a culture of deserved trust. I think our modern culture where things are just about internal controls can do more harm than good.

Q: Since 1999, profit growth at See's Candies appears to have stalled. Why hasn't it grown anymore since then after growing so well in the 1970s and through the 1990s?

Buffett: The boxed chocolate business is basically not growing any more. Boxed chocolates have lost position dramatically, primarily to salted snacks. See's has done far better than any other chocolate company in the country. But we can't do much to increase the size of the market. We've tried to move See's out of our strong geographies multiple times and found that it doesn't travel that well.

Munger: Sometimes it travels well and sometimes it doesn't and you figure out where it can travel to by trying it.

Buffett: See's certainly opened my eyes to the power of brands. We made a lot of money on Coca-Cola because we bought See's. I understood brands to some extent but there's nothing like owning one to see the strengths and limitations of a brand. In 1972 we bought See's and in 1978 we bought Coca-Cola, and I would have been very surprised if we had bought Coca-Cola without having bought See's.

Munger: Its main contribution to Berkshire was ignorance removal. What we knew originally wasn't enough. We were just smart enough to buy See's. If there's any secret to Berkshire, it's that we're very good at ignorance removal. The nice thing is we have a lot of ignorance left to remove. [Laughter]

Q: What are the current prospects for NetJets?

Buffett: It's a perfectly decent business but not a big grower. Its new unit volume peaked more or less coincident with what happened in the stock market. Hedge fund managers and others gave us quite a boom in sales but when their contracts ran out in 2011 and 2012, a lot of them did not renew. Until the last 6 to 8 months, jet ownership in the U.S. was declining slightly.

It's a large size business, we're 60-some percent of the industry and we're the premier product but it's not a big growth market. I don't see the market doubling or tripling in size.

We'll go to China soon but that's a very long-range plan. Europe is also slightly down.

Recently, however, flight hours are up again so the owners we have are using it more. I wouldn't classify it as a big growth opportunity but it's a satisfactory business.

Munger: I demonstrated my optimism by buying 25 more hours.

Buffett: He was a tough sale. [Laugher]

Q: How big of an acquisition could you make?

Buffett: Our goal is to buy really big businesses where we like the management and that we think we can grow over time. Berkshire is about adding earnings power. We don't get opportunities that often. If the opportunity were large enough and we needed to raise some money we can dip into a huge reservoir of securities and still have huge investments thereafter. It hasn't come to that but it could happen this year or ten years from now, you never know.

Munger: Our acquisitions were irregular in the past and will be irregular in the future. I do think we'll get more automatic, intelligent redeployment of capital and that's a great thing.

Buffett: What really turns us on is finding a business we'd like to buy. Marketable securities play a big part and it's a great place to deploy capital but what we're really looking for are businesses to buy.

We have Todd [Combs] and Ted [Weschler] thinking about marketable securities. We're in no hurry to sell any of our stocks that you mentioned [Coca-Cola, Wells Fargo, IBM, and American Express]. If we wanted to raise cash we wouldn't sell these stocks.

Q: Why not go out and ask for several billions in callable long-maturity bonds and make good use of it?

Buffett: If you had asked Charlie and me forty years ago if at the current low rates we wanted to borrow a ton of money, we would have said yes. But we do have a great way of raising funds outside equity, through insurance float, and we've done that to the tune of $77 billion. We like to finance the company conservatively and we don't want to change that policy.

We're reluctant to lever up much at the parent now since we have these other sources of capital. You're certainly right that if we saw a really good $50 billion deal we'd figure out a way to do the deal.

Munger: Even though your question is intelligent we'll probably not do it.

Q: Todd Combs and Ted Weschler are managing less than 10% of your equity portfolio. How much do they run now and how much do you think this will expand?

Buffett: They're managing a little over $7 billion now. We'll change that periodically but it will always be upward. They will handle more money in the future than they're handling now. They're seeing that it does get a little more difficult as the sums get larger. However it's still much better to give them money and take it away from me as time passes.

They're both terrific additions even beyond their investment skills, as they know a lot about businesses and management teams. Ted and Todd have been very helpful in doing things beyond their investment management duties and that will continue. They don't ask for extra compensation for what they're doing. They're 100% attuned to Berkshire. It's been a big plus for Berkshire to bring them on and they're more important factors as the years go by.

Q: If you ran the Fed, what would be your interest rate policy? Is there a need for a hike and on what time horizon?

Buffett: Who would have guessed you'd have rates this low for this long? I'm surprised at how well things are going. I would like to say I would have done the same thing. This is really an interesting movie because we haven't seen it before and we don't know how it ends. I think Ben Bernanke was a hero at the time of the panic and subsequently. He is a very smart man and handled things very well.

What was interesting was that when the 2007-2008 Fed minutes came out, a number of the Fed's members didn't get it. It was fascinating that a lot of them didn't understand just how serious things were. That's why I give particular credit to Bernanke because he wasn't getting unanimous support from those around him. In my opinion he did a masterful job.

From everything I've seen from Janet Yellen, I think the same way about her. And we will see how this movie plays out. I don't know but we'll see what happens when rates go to zero for a long time.

Munger: Nobody in Japan would ever have expected interest rates to go down and stay down for twenty years. If you're not confused you probably don't understand the situation we're in particularly well. [Laughter]

I will say, though, that at Berkshire we're not buying a lot of long-term bonds.

Buffett: A zero-interest policy has had a huge effect in rejuvenating the economy and raising asset prices. It has not produced a bubble. That doesn't mean it never could. It's not a bubble situation at all we're in, but it is an unusual situation.

Q: Forest River has done well and outperformed its competitor Thor. What's the difference?

Buffett: We bought Forest River, run by Pete Legal, about ten years ago. Pete, who's not an MBA-type at all, is a terrific guy. He built up a very successful but smaller RV business and sold to a private equity firm in the 1990s. They tried to tell him how to run it and he told them to go to hell, and not long after that it went broke. Pete then bought it out of bankruptcy and rebuilt it, and then came to see me one afternoon in Omaha with his wife and his daughter.

We bought the business and he made me a couple of promises that day and we lived happily ever after. I've never been to Forest River. I hope it's there, he just sends me figures. [Laughter]

Pete does a terrific job running it. We made a deal on compensation that afternoon in Omaha when he came to sell it to us, he's never tried to change it and I never tried to change it.

I have probably had 3 or 4 phone calls with him during this entire time. It's his company and he does a sensational job. I don't know about their competitor Thor and the competitive dynamic. I just think it would be tough to compete with Pete in any business.

The important thing is that it's his company. I couldn't run an RV company and we have nobody at HQ that could run one. It's a tough business and you work on narrow margins. It runs with maybe 11%-12% gross margins and 5%-6% of SG&A so you're in the 6%-7% margin range.

Most of our shareholders probably don't even know we own Forest River but I wish we had 20 more like them. It'll do $4 billion in business this year, it's a leader in its industry and the industry won't go away.

Q: Can you talk about some of your mistakes.

Buffett: You’re not going to make a lot of good decisions without some mistakes along the way.

Charlie and I bought a department store in 1966 in Baltimore and there was nothing dumber than buying a department store in the mid-1960s. There were four department stores on the same intersection we were on and none of them are there anymore. The number one store there went broke a bit later than our store. Fortunately we were able to sell that before any real loss.

So you do have to be very alert to what is going on in your industry and business – this is something we want our managers to think about.

Munger: I spoke earlier about the desirability of removing ignorance piece by piece. Scrambling out of your mistakes is also good. Imagine Berkshire, a textile mill about to go broke and a failing department store…out of this comes Berkshire Hathaway. I would hate to think about what we would have done if we'd had a better start. [Laughter]

Buffett: My great-grandfather started a grocery store business in 1869. And my grandfather brought in my uncle to run the business in 1929. And in 1929 they said that “the day of the chain store is over!” [Laughter]

That is why we ended up with only one grocery store, which went out of business in 1969.

You really have to face the facts around you.

Q: What is Heinz’s current normalized earnings power after the substantial restructuring of the business and what do you anticipate it could be one day?

Buffett: Heinz will be filing its own quarterly reports. Its first quarter will be due soon. Heinz was a reasonably run food company with about 15% pre-tax margins and that’s not unusual for a food company. I believe the margins of Heinz will be significantly improved from those historical figures.

Bernardo Hees and his associates at 3G have restructured the business model with the brands being as strong as ever, and the cost structure will be improved. I don’t want to put a number on it but it will be significantly improved.

Q: Can you please explain how you compare investment opportunities. When there is a chance to buy more of your favourite names like Coca Cola and Moody's as in 2008 and early 2009?

Buffett: I spent a considerable part of our cash reserves too early looking back at the 2008/2009 panic. The bottom was reached in early March 2009 and was quite a bit lower than when we spent $16 billion in September and October 2008 buying stocks.

We did fine on the investments that were made during this period but we obviously did not do remotely as well as if we had kept all the powder dry and spent it all at once at the bottom.

We have never really figured out how to pick the bottom and we are never going to be able to do that in the future.

On the other hand, even as late as fall 2009, when the economy was still in the dumps, we were able to buy BNSF, which will be a huge part of our future.

So overall we did reasonably well during that period, but looking forward we can always do better.

Munger: For a great many of the early years, we had more in common stock than the value of the company, and now of course the private companies are worth more than the stock portfolio. I would guess that this will continue.

Buffett: When we are right about stocks it shows up in market value or net worth. When we are right about private businesses it shows up in future earnings power, which you can see but it doesn't jump out at you the same way changes in stock values do.

Munger: If you are investing moderate amounts of capital you are able to buy at attractive prices in the middle of the panic. But when we buy these businesses we buy huge chunks. We couldn't have bought much more of Moody's anyway.

We are forced by our own past success to buy more of these bigger positions in private companies.

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

Buffett: If it does, we won't know it. [Laughter]

Munger: I think we've adapted well to the changes in our circumstances.

Change is inevitable so how well you adapt is terribly important.

Buffett: We bought a fair amount of Wells Fargo over the last few years.

Because the economy came back, the real value would have come from buying banks of lesser quality, because their weaknesses drove them down to lower prices, and they needed a good economy to come back.

Another example is buying the marginal copper producer because they benefit the most from a rising copper price. You will make more not buying the best copper producer but the worst.

The same thing can be said for the banks but we felt 100% comfortable buying Wells Fargo and we might have felt 50% comfortable with some of the others. Looking back we should have bought them all and really bought the ones with the worst record because these had the greatest recovery since they had fallen so far.

Q: Why are you allocating so little capital outside the United States despite a significant amount of family-owned businesses in Europe and the fact that a large percentage of global market capitalisation is based outside the US?

Buffett: We've never turned down a chance to make a significant acquisition outside the U.S. because of a feeling we would rather do something in the U.S.

The fact is that we have not had as much luck getting on the radar screen of owners around the world as we have had in the U.S.

Our best bet by far is buying from the founder of a business or the family of the founder. That is our strong suit. In the U.S. almost anyone with a business of size in that category thinks of us and a fair amount would prefer us. While there's some recognition outside of the U.S., it's not as widespread.

In 2006, Eitan Wertheimer of ISCAR wrote me a letter… I hadn't heard of him before… he said that the family had thought about it and the only Company they wanted to sell the business to was Berkshire and that if they didn't sell it to us, they weren't going to sell it.

But otherwise, I've been disappointed that we've had little success outside the country.

Incidentally, ISCAR set a new record in April and it makes me think there's strength in the economy around the world. That may have some slight meaning in terms of how world business is doing. They sell tiny little cutting tools that go into basic industry all over the world. And people don't buy those because they want to make nice ornaments with them, they buy them because they are using them up. We are seeing strength in their business that makes it hard to believe that there is weakness in the industrial world.

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

Buffett: Good question.

It's a question of being self-realistic, and that applies outside of business as well.

Charlie and I have been reasonably good at identifying what we'd call the perimeter of our circle of competence.

In my own case, the area that I've gone out of that circle more than any other is retail. It's easy to think you understand retail and then subsequently find out you don't, as we did with the department store in Baltimore.

You could say I was outside of my circle when I bought the original controlling stake in Berkshire Hathaway.

Being realistic in appraising your own talents and shortcomings is innate.

I certainly know of a number of CEOs that I deal with that have no idea where their circle of competence begins and ends.

We've got a number of managers who are just terrific and know exactly what game they're playing and where they're going to win. They don't go outside of that game.

Now, the old Mrs. B of Nebraska Furniture Mart, she told me she did not want Berkshire Stock when we wanted to acquire that business. That may sound like that was a bad decision, but that was a splendid decision. She didn't know anything about stock but she knew exactly what to do with cash. She knew retailing, she knew real estate and knew what she didn't know and this took her a long way in business life.

That ability to know the game you are able to play and avoid playing outside of that game is a huge asset.

I can't tell you the best way on how to work out your circle of competence. Perhaps get some of your friends that know you well to offer you contributions.

Charlie's given me a few contributions along the way and asked me what the hell I knew about that! [Laughter]

Munger: I don't think it's difficult to figure out your competence. If you're 5'2 you don't have much of a future in the NBA. [Laughter]

If you're 95 you shouldn't take a romantic Hollywood lead. [Laughter]

If you weigh 350 pounds, you shouldn't try dance the lead part in the Bolshoi Ballet. [Laughter]

Buffett: You're ruling out everything I want to do! [Laughter]

Munger: But competency is a relative concept. What I needed to get ahead was to compete against idiots. Thankfully there's a large supply. [Laughter]

Q: Entrepreneurship these days is nearly synonymous with tech amongst young people. If you were 23 and entrepreneurial, what non-tech industry would you start a business in and why?

Buffett: I'd probably do what I actually did at 23…I'd likely go into the investment business. I would look at lots of companies and talk to lots of people and learn from them what I could about different industries.

What I did when I was 23 was that I got interested in the coal industry so I would go visit the CEOs of eight to ten coal companies. I usually dropped in and they would see me. They figured a fellow from Omaha, who looked like me, couldn't be too harmful. [Laughter]

I would ask them a lot of questions but two key questions I would ask at the end of the meeting was if they had to put all their money into any coal company but their own, which one would it be and why. After I got the answer I would then say, as part of this deal if you had to sell short a competitor, which one would it be and why.

If I went around to everyone in the coal business and asked that, I would know more about the coal companies from an economic standpoint than anyone of those managers.

There are lots of ways to learn about companies such as through reading or personal contact. But what you have to have is the curiosity. It really needs to turn you on to learn about them. And what can turn you on more than asking questions about coal companies? [Laughter]

You'll eventually find one that particularly interests you, like for me it was the insurance business. You might become well equipped to start your own insurer or perhaps choose to work for the best insurance company.

If you just keep learning things something will come along that you find extremely useful. You just need to be open to it.

Munger: It is worth using the trick that Larry Bird (NBA player) used. He wanted an agent to negotiate his new contract and interviewed a number of agents asking them why he should pick them. He then asked them, if not them, who would they recommend? When they all picked the same number two choice, he hired that agent and got the best contract in history.

Buffett: We did the same thing at Salomon. I asked the senior managers there, who besides you should run the place and why.

One guy told me that there was nobody compared to him. [Laughter]

He was gone from the firm within a few months. [Laughter]

Not a bad system to use. You can really learn a lot just by asking. If you talk to enough people that know a lot about a certain area, you can learn a lot. People like to talk.

You just have to be open to it. You will find your spot. You might not find it the first day or week or month but you will find it.

I was really lucky because I found it when I was seven or eight years old.

Q: Warren, you have expressed concern that hotels are price gouging in the Omaha area over the Berkshire Meeting weekend. Should the law of supply and demand apply for hotel rooms in Omaha?

Buffett: Absolutely. That's why we have encouraged AirBnB (www.airbnb.com) to come in and they are supplying some rooms this year.

If you have a small industry looking to host an event, they can pick a moderate sized city. But if you have a big industry event you have to go Vegas otherwise supply and demand is out of whack.

If you have an event not sized by the people scheduling you can outstrip rational supply of rooms.

Augusta can't size its industry to the Masters and the Masters won't move. Omaha can't size its hotel industry to the Berkshire meeting.

What really bothered me was the three day minimum. That was particularly irritating given people are coming in for a one day event.

We did not want to move to Dallas. We're not going to move. Omaha people love this event. It's an economic boom for Omaha and people get a good impression of Omaha.

We can't expect anybody to build more hotels for three days a year.

AirBNB is a flex in the supply arrangement and that makes a lot of sense.

Munger: Nothing to add.

Q: How has your frugality helped or hurt Berkshire over the years?

Buffett: Let’s first ask who is the more frugal of the two of us. Charlie? [Laughter]

Munger: On personal consumption, Warren is more frugal than me. Warren still lives in the same house he bought in the 1950s.

Buffett: I do not think that the standard of living equates with the cost of living beyond a certain point. There is a point where there is no difference. In fact you get inverse correlation. My life would be worse off with six houses and a whole bunch of other things. It just doesn’t correlate.

Munger: Frugality has helped Berkshire. I look out at this audience and I see a lot of understated frugal people. We collect you people.

Buffett: But forget about that this weekend! The more you buy the more you save at our concession at these crazy prices. [Laughter]

Q: What differences do you have in calculating intrinsic value versus Graham’s *Security Analysis* and Phil Fisher?

Buffett: Graham didn’t get too specific about intrinsic value in terms of precise calculations.

It’s become properly equated with private business value. The first one who came up with that was Aesop.

The intrinsic value of any business, if you can foresee the future perfectly, is the present value of all cash ever distributed by that business from now til judgment day. We’re obviously not perfect at estimating that. You put money in and you take money out.

Aesop said a bird in the hand is worth two in the bush. That was 600 BC but that hasn’t been improved much by the business professors by now. Today you ask, how sure are you that there’s two in the bush? How far is the bush? Where are interest rates? etcetera.

I started out looking at more quantitative factors and Charlie came along and said I should think more about qualitative factors and he was right.

If you buy a McDonald’s franchise, if you buy General Motors, whatever it will be, it really is cash in cash out, discount rate, all that standard stuff.

Q: It seems like every central banker around the world is trying to create inflation. Should investors and business owners be thinking about inflation and interest rates?

Buffett: Yes, Inflation would hurt us, but it would hurt most businesses.

There are certain assets which are highly leveraged which would benefit from inflation.

If tonight drones are set up over the U.S. and drop $1 million in every household, the question we would ask is would the country be better off? Every family has an extra $1 million that they didn't have the day before.

The trick in that circumstance is to find out that you have $1 million before anyone else. You will do very well if you beat the crowd. But essentially you don't create wealth through inflation. Berkshire's earnings per share would go up. Our book value in dollars would go up but the value of your investment in real terms would go down.

Munger: A good example of inflation is in Weimar, Germany. Those who owned common stock like Berkshire's got through and everybody else got wiped out. Of course, you create so much misery, you get Hitler, a world war, a holocaust and so forth. It's not a good thing to let things go that far. And so, I don't like this huge confidence that you can print money and spend it. I think there is a limit. I am never going to forget Weimar Germany.

We can handle subpar growth over some stretch of time but it's dangerous to let politicians print money.

Buffett: The good thing about incredible inflation is that it can wipe out your mortgage.

Munger: In Weimar, Germany they gave you the mortgage back.

Buffett: That's the way it happened folks. [Laughter]

Q: Is criminal activity being institutionalized on Wall St?

Munger: I think behaviour on Wall Street has enormously improved as a result of the crisis. I think the worst of it is behind us.

You'll never have perfect behaviour when you have human beings living in the land of easy money. This is always going to happen to some extent.

Buffett: How do you feel about the prosecution of individuals versus corporations?

I do think criminal prosecutions do change behaviour a lot. It looks to me like we're getting there.

Buffett: I may be biased by my experience at Salomon but I lean way more to the prosecution of individuals than corporations.

I literally saw a bad act, or multiple bad acts, by some people and negligence in reporting by a few that destroyed thousands and thousands of people's lives. This is forgetting about the financial investment.

What I have seen is it is way easier to prosecute corporations. They will simply write a cheque.

The prosecutor knows he is going to get a win if it goes against the company. It's a way tougher job to go against the individual. The company is going to cave, it does not make sense to fight it if you can simply write a cheque while the individual is fighting to stay out of jail. So the prosecutor is going to take the easy case and probably grab a headline with the easy case if he goes against the corporation. I still prefer going after individuals.

Munger: I do too.

Q: Do you have plans to buy a professional sports team?

Buffett: I owned a quarter of a minor league team but it's not responsible for my position on the Forbes 400. [Laughter]

The answer is no.

If we ever start talking about buying a sports team, it's time to start talking about successors. [Laughter]

Sports in general is not an incredible business. Nike has done incredibly well but we own Spalding and Russell. Spalding has been around for a long time. Back in the 1880s Albert Spalding was trying to take baseball global.

Generally speaking if you look at a golf club, football, baseball glove, or helmet businesses they are not very profitable.

Charlie, are you looking at the Clippers, or no? [Silence]

Now I'm worried that he is! [Laughter]

Munger: Whatever Warren hates about sports businesses I hate more. [Laughter]

Q: What do you make of the larger trend of activism in corporate America?

Buffett: I don't think it'll go away and it scares the hell out of a lot of managers. There are certainly cases where corporate management should be changed.
If activist investors get the price of the stock up one way or another that's usually going to end their interest. Often they are not looking for permanent changes in the business.

The funds flowing to activist investors has multiplied in recent years and that means they can play the game on a much bigger scale. Anything on Wall Street that looks like it is successful will generate funds flow that will go on till it's no longer successful.

Munger: Well you are right that activism is causing problems for corporate management. Frankly, nobody feels immune to activism anymore.

On the other side the activists are making a lot of money and in the culture we live in people don't care about where money is earned or where they get it.

In some of this stuff you will find an activist who is not somebody you would marry into the family who is dealing with a company you would not buy into.

It reminds me of Oscar Wilde's description of fox hunting - The pursuit of the uneatable by the unspeakable.

I don't think it's good for America.

Q: What is the most intelligent question you have ever been asked on investing?

Buffett: I frequently get this question from college students. They always ask what the hardest question is. I never have a single good answer.

Q: What do you think about the education markets in China and America in the future?

Munger: Well at least we are getting the easier questions later. [Laughter]

Buffett: Whatever he says I agree with. [Laughter]

Munger: I think America made a big mistake when it allowed a lot of its public schools to go to hell. [Applause]

Asian cultures are less likely to do that to the extent that Asian cultures are avoiding our mistakes and I just wish we were more like them. [Applause]

Buffett: I probably shouldn't tell you this one but since he couldn't hear those last few words I get a little worried about Charlie. I thought he was maybe losing his hearing but I did not want to confront him about it so I went to the doctor.

I said "Hey look Doc. I have this wonderful partner but I think maybe his hearing is going out. How do you say that to someone you have known that long?"

He said talk to him in a normal voice from across the room and let me know what happens. So the next time I was with him I stood across the room and said "I think we should buy General Motors at $35, do you agree?" Not a flicker.

So I go halfway across the room and ask again. "Charlie, I think we should buy General Motors at $35, do you agree?" Nothing.

Get right next to him, in his ear. "Charlie, I think we should buy General Motors at $35, do you agree?"

He said, "Warren, for the third time, yes!" [Laughter]

Q: How important is the federal government to the health of the housing market?

Buffett: I think that the 30 year fixed rate mortgage is a terrific boon to homeowners. It is not a great instrument to own as an investor. It has done a lot for home ownership. It let people get into homes a little earlier than otherwise and kept costs down quite a bit.

The government guarantee does keep costs down, no private organizations can do this. Home mortgages are an $11 trillion market. There is not the insurance capacity for private industry to do the job and the rates would be much higher.

I think we keep the government in the picture but the question is how to keep them in the picture but not the politics?

Munger: When private industry was allowed to take over, we got the biggest bunch of thieves and idiots you can imagine to threaten all of us. I am not very trustful of private industry in this field.

As much as I hate politicians the existing system is pretty sound. At the moment Fannie and Freddie are being conservative and making almost all the home loans. I think that is okay, with not having banks race to the bottom in terms of issuing securities.

Q: Can you comment on the recent book 'Dream Big: A Glimpse Inside the Strategies and Tactics of 3G Capital'.

Buffett: The book was written in Portuguese and a best seller in Brazil for the last year. But it just got translated very recently. The book is available in the event hall at Bookworm!

Munger: I think it is only available in the Kindle version, the only hard copy I am aware of is at Bookworm downstairs so that will cause quite a run on the market.

Buffett: We will raise the prices. [Laughter]

Q: Can you comment on their [3G] ingredients for success? What important factors like your relationships or brand name can be passed on to your successor?

Buffett: The person following me will bring the same qualities including the ability to write a very big cheque. The Berkshire brand may have started with me but it will continue after I am gone.

Going on to our Brazilian friends at 3G. They're very smart. They're very focused. They're very determined. They're never satisfied. And as I said earlier, when you make a deal with them, you make a deal with them. They don't overreach or over promise. They have a lot of good qualities.

If you read the book you will learn a lot more about qualities that made them what they are. We are very fortunate to be associated with them and we are very fortunate to be associated with a number of the managers.

We want to be good partners ourselves because this attracts a good reputation. This is a reputation that Berkshire deserves and Charlie and I do our part towards keeping this reputation intact.
This makes people want to join them and that will be part of the Berkshire brand. Charlie?

Munger: Yeah I always say, the best way to get a good spouse is to deserve one.

Buffett: What's your second way? [Laughter]

Q: What impact will the sharing economy, such as Uber and AirBnB have on existing industries?

Buffett: They are obviously trying to disrupt other businesses. Those businesses will fight back in competitive ways and fight back through legislation.

When any business is threatened they try to fight back. Go back to when State Farm came on the scene in 1921. The agency system was sacrosanct in terms of insurance, it had been around forever.

They fought over having the #1 agency in town. You wanted to get the agent and the policyholder wasn't really being thought about. Then GEICO came along with a better mousetrap.

The insurance companies fought back and insisted on state laws based on agents.

In the end the better mousetrap usually wins. The people with the second or third best mousetrap will try and keep that from happening.

Of the ones you name, I don't know anything about them. I mean I know what they do but I don't know their specific prospects. We stay away from those kinds of companies.

We know there will be change but we don't know who the winners will be. We try to stick to businesses where we know the winners. A lot of our businesses, energy/railroad, will be winners. It doesn’t mean there will be no change but they will be winners.

We just sit and watch the others but don’t get tempted. Charlie?

Munger: I think the new technology will be disruptive. I think retailers in particular are facing some very significant threats.

When you get computer capacity all over the world at this scale. It will change the world. It will hurt a lot of people but Berkshire is in good shape.

Buffett: Where do you think we are most vulnerable Charlie?

Munger: Oh, I don't think I want to name them. [Laughter]

Q: Should financial literacy be taught in school? When should it begin and what should they learn?

Buffett: Certainly. The earlier the better. Habits are such a powerful force in everyone's life, certainly good financial practices.

I would get letters all the time from people that committed some financial lunacy or another but they did not know it was lunacy. Their parents didn't teach it to them.

Digging yourself out of the hole that financial illiteracy could cause can take a lifetime.

We have done a little bit with this, with our secret millionaires club [cartoon for children starring Warren Buffett]. We want to talk to people at a very young age.

There is also a problem with adult financial literacy. It's hard to be smarter or have better habits than your parents unless the schools act. It can be done, a lot can be through the internet.

It is important to have good habits. Anything you can do early, certainly through the school system has my vote. Charlie?

Munger: Well I'm not sure the schools are at fault, it is the parents. [Applause]

Buffett: I agree it's important but not everyone has the right parents. [Laughter]

Munger: It's hard to fix people with the wrong parents. [Laughter]

Buffett: If you had the job of fixing people what would you do?

Munger: The main problem with education is not the grade schools, it is the finance courses in major universities. There is a lot wrong with these courses, even the economics departments. If you want to fix the world, start there. [Applause]

Buffett: There was a period, certainly for two years, where the net utility of knowledge given to finance majors was negative. I think maybe it is getting better.

It was extraordinary to watch universities teach people very dumb things. Even to obtain positions in the departments of these schools you had to subscribe to this orthodoxy which made no sense at all. It got stronger and stronger.

Now it is changing, but it may have soured my feeling on education to a certain degree. But it was bad.

Munger: You would have liked academics better if you had taken physics instead of finance. [Laughter]

Buffett: I'm glad I didn't. [Laughter]

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