Berkshire Hathaway Annual Meeting 2017 Transcript

WARREN BUFFETT: Thank you and good morning! That's Charlie, I'm Warren. You can tell us apart because he can hear and I can see, that's why we work together so well. We each have our specialty.

I'd like to welcome you to Omaha. It's a terrific city and Charlie's lived in California now for about 70 years, but he's still got a lot of Omaha in him. Both of us were born within two miles of this building that you're in. And Charlie, as he mentioned in his description of his amorous triumphs in high school, graduated from Central High, which is about one mile from here. It's a public high school. My dad, my first wife, my three children, and two of my grandchildren have all graduated from the same school. In fact, my grandchildren say they have the same teachers that my dad had. It's a great city; I hope you get to see a lot of it while you're here.

In just a minute we will start a question period—hopefully, a question and answer period—that will last until about noon, and then we'll take a break for an hour or so. We'll reconvene at 1 PM, and then we'll continue with the question and answer period until 3:30 PM, and then we'll break for 15 minutes or so. And then we'll convene the annual meeting of Berkshire. We have three propositions that people wish to speak on, so that could last, perhaps, as long as an hour.

Before we start, I'd like to make a couple of introductions, the first being Carrie Silva who's been with us about seven years. Can we have a light on Carrie? Carrie, are you there? Stand up Carrie, come on.

Carrie puts on this whole program. She came with us about seven years ago, and a few years ago I said "Why don't you just put on the annual meeting for me?" And she handles it all and she has two young children, and she has dozens and dozens and dozens of exhibitors that she works with. You can imagine with all of what we put on and all of the numbers of you that come, the hotels and the airlines and the rental cars and everything, she does it as if she could do that and be juggling three balls at the same time. She's amazing and I want to thank her for putting on this program for us.

I also would like to have you welcome our directors. They will be voted on later, so I'll do this alphabetically. They're here in the front row and if we could just have the spotlight be dropped on them as they're introduced. And alphabetically, there's Howard Buffett, Steve Burke, Sue Decker, Bill Gates, Sandy Gottesman, Charlotte Guyman. We have Charlie Munger next to me, Tom Murphy, Ron Olson, Walter Scott, and Meryl Witmer. One more introduction I'm going to make, but I'll save that for just a minute.

Our Earnings Report was put out yesterday. As we regularly explain, the realized investment gains or losses in any period really mean nothing, I mean, we could take a lot of gains if we wanted to. We could take a lot of losses if we wanted to, but we don't really think about the timing of what we do at all except in relation to the intrinsic value of what we're buying or selling.

We do not make earnings forecasts. And we have, on March 31st we have over $90 billion of net unrealized gains, so if we wanted to report almost any number you can think of, and count capital gains as far as the earnings, we could do it. And I would say that we have a very, very, very slight preference this year, if everything else were equal. Well, it's true in any year, but it's a little more so, this year. We would rather take losses than gains because of the tax effect if two securities were equally valued.

And there’s probably one touch more of emphasis on that this year because we are taxed on gains at 35%, which means we also get the tax benefit of 35% of any losses we take, and I would say that there’s some chance of that rate being lower, meaning that losses would have less tax value to us after this year than they would have the next year. That is not a big deal, but it would be a very slight preference, and it may get to be more of a factor in deferring any gains, and perhaps accelerating any losses as the year gets closer to December 31st, assuming—and I’m making no predictions about it —that there were to be a tax act that had the effect of reducing earnings.

So in the first quarter, insurance underwriting was the swing factor and there’s a lot more about this in our 10-Q, which you can look up on the internet. If you’re seriously interested in evaluating our earnings or our businesses, you should go to the 10-Q because the summary report, as we point out every quarter, does not really get to a number of the main points of valuation.

I would just mention two factors in connection with the insurance situation which I love. In the first four months, not the first three months, GEICO has had a net gain of 700,000 policy holders and that’s the highest number I can remember. There may have been a figure larger than that somewhere in the past. I did not go back and look at them all, but last year, I believe that figure was like 300,000 and this has been a wonderful period for us at GEICO because several of our major competitors have decided— and they publicly stated this, although they just now changed their policy—they intentionally cut back on new business because new business carries with it a significant loss in the first year.

There’s just cost of acquiring new business, plus the loss ratio, strangely enough, on first year business, tends to run almost 10 points higher than on renewal business. So not only do you have acquisition costs, but you actually have a higher loss ratio. So when you write a lot of new business you’re going to lose money on that portion of the business that year. And we wrote a lot of new business and at least two of our competitors announced that they were lightening up for a while on new business because they did not want to pay the penalty of the first year loss, and of course that’s made no order for us, so we just put our foot to the floor and try to write as much new business as we can, and there are costs to that.

A second factor—well, it’s not a factor in the PL, but an important event in the first quarter—is that we increased our float and on the slide, I believe, it shows that year over year, $16 billion. $14 billion of that came in the first quarter of this year, so we had a $14 billion increase in float. And for some years I've been telling you, it's going to be hard to increase the float at all and I still will say the same thing, but it's nice to have $14 billion more, which is one reason if you'll look at our 10-Q, you will see that our cash and cash equivalents, including Treasury Bills and now it's come to well over $90 billion.

I feel very good about the first quarter even though we're operating in a range we're down a little, but one quarter means nothing, I mean, over time. What really counts is whether we're building the value of the businesses that we own and I'm always interested in the current figures, but I'm always dreaming about the future figures.

There's one more person that I would like to introduce to you today and I'm quite sure he's here. I haven't seen him, but I understood he was coming. I believe that he made it today and that is Jack Bogle who I talked about in the Annual Report. Jack Bogle has probably done more for the American investor than any man in the country. Jack, could you stand up? There he is.

[00:25:11]

Jack Bogle, many years ago, he wasn't the only one that was talking about an Index Fund, but it wouldn't have happened without him. I mean, Paul Samuelson talked about it. Ben Graham even talked about it. But the truth is it was not in the interest of the investment industry of Wall Street. It was not in their interest, actually, to have the development of an index fund because it brought down fees dramatically and as we've talked about, some in the reports and other people would comment.

Index funds, overall, have delivered for shareholders a result that has been better than Wall Street professionals as a whole, and part of the reason for that is that they brought down the cost very significantly. So when Jack started, very few people—certainly Wall Street did not applaud him and he was the subject of some derision and a lot of attacks and, now, we're talking trillions when we get into index funds, and we're talking of a few basis points when we talk about investment fees in the case of index funds, but, still, hundreds of basis points when we talk about fees elsewhere.

I estimate that Jack, at a minimum, has saved and left in the pockets of investors, without hurting them overall in terms of performance at all—most performance—he's put tens and tens and tens of billions into their pockets and those numbers are going to be hundreds and hundreds of billions over time. So, it's Jack's 88th birthday on Monday so I just say, "Happy Birthday Jack and thank you on behalf of American investors."

And Jack, I've got great news for you. You're going to be 88 on Monday and in only 2 years, you'll be eligible for an executive position at Berkshire, so hang in there buddy.

Okay, we got a panel of expert journalists on this side and expert analysts on that side and expert shareholders in the middle, and we're going to rotate starting with the analysts. Here we go and we'll do this through the afternoon. If we get through 54, which would be six for each journalist, six for each analyst and 18 more for the audience, then we'll go strictly to the audience.

I don't think I've got any information as to what the situation is on overflow rooms, but we'll go to at least one of them. But let's start off with Carol Loomis of Fortune Magazine, the longest serving employee in the history of Time Inc., I believe, was 60 years and Carol, go to it.

[00:28:52]
CAROL LOOMIS: Thank you from all of us journalists up here. I know that there are many, many people out there who have sent us questions that aren't going to get answered and I just want to say that it's very hard to get a question answered. One thing I could suggest is that you follow Warren's thought in the Annual Report that he wants everybody to go away from this meeting more educated about Berkshire than they were when they came. And one way you can do that is keep your questions quite directly Berkshire-related or we lean in to the annual letter.

Even then, it would be hard to get your question answered that the three of us only have 18 questions in total. But I encourage you to think in the Berkshire-related direction when you're submitting that question next year.

Now, my first question, it's about Wells Fargo, which is Berkshire's largest equity holding at $28 billion at the end of the year and this question comes from a shareholder who did not wish to be identified.

In the wake of the sales practices scandal that last year engulfed the Wells Fargo, the company's independent directors commissioned an investigation and hired a large law firm that assisted in carrying it out. The findings of the investigation—which were harsh—have been released in what is called The Wells Fargo Sales Practices Report. You can find it on the internet. It concludes that a major part of the company's problem was that, and I quote, "Wells Fargo's decentralized corporate structure gave too much autonomy to the community banks senior leadership."

Mr. Buffett, how do you satisfy yourself that Berkshire isn't subject to the same risk with its highly decentralized structure and the very substantial autonomy given to senior leadership of the operating companies?

WARREN BUFFETT: Yeah, it's true that we at Berkshire probably operate on this. We surely operate on a more decentralized plan than any company remotely our size and we count very heavily on principles of behavior rather than laws or rules. That's one reason that every annual meeting you see that Solomon description and that's why I write very few communiqués to our managers, but I send them one once every two years and it basically says that we've got all the money we need. We'd like to have more but it's not a necessity. But we don't have one ounce of reputation more than we need and that our reputation at Berkshire is in their hands.

Charlie and I believe that if you establish the right sort of culture and that culture, to some extent, self-selects who you obtain as directors and as managers that you will get better results that way in terms of behavior than if you have a thousand paged guide book. You're going to have problems, regardless.

We have 367,000, I believe, employees. Now if you have a town with 367,000 households—which is about what the Omaha Metropolitan Area is—people are doing something wrong as we talk here today. There's no question about it. And the real question is whether the managers are worrying and thinking about finding and correcting any bad behavior and whether if they fail in that, whether the message gets to Omaha, and whether we do something about it.

At Wells Fargo, there were three very significant mistakes, but there was one that dwarfs all of the others. You're going to have incentive systems at almost any business. There's nothing wrong with incentive systems but you got to be very careful what you incentivize. And you can't incentivize bad behavior, and if so, you'd better have a system for recognizing it.

At Wells Fargo, there was an incentive system built around the idea of cross-selling and number of services per customer, and the company and every quarterly, investor presentation highlighted how many services per customer. So it's the focus of the organization—a major focus—and, undoubtedly, people got paid and graded and promoted based on that number; at least, partly based on that number.

Well, it turned out that that was incentivizing the wrong kind of behavior. We've made similar mistakes, I mean, any company is going to make some mistakes in designing a system, but it's a mistake and you're going to find out about it at some point. And I'll get to how we found out about it, but the biggest mistake was that—and I don't know, obviously, all the facts as to how the information got passed up the line at Wells Fargo, but at some point, if there's a major problem, the CEO will get wind of it. At that moment, that's the key to everything because the CEO has to act.

That Salomon situation that you saw happened because on April, I think, 28th, the CEO of Salomon, the President of Salomon, the General Council of Salomon, sat in a room and they had described to them by a fellow named John Meriwether some bad practice, terrible practice, that was being conducted by a fellow named Paul Mozer who worked for him. And Paul Mozer was flimflamming the

United States Treasury, which is a very dumb thing to do and he was doing it partly out of spite because he didn't like the Treasury and they didn't like him. So, he put in phony bids for US Treasuries and all of that.

So on April 28th, roughly, the CEO and all these people knew that they had something that had gone very wrong and they had to report it to the Federal Reserve Board in New York—the Federal Reserve Bank in New York. And the CEO, John Gutfreund, said he would do it and then he didn't do it. And he undoubtedly put it off just because it was an unpleasant thing to do.

And then, on May 15th, another Treasury auction was held and Paul Mozer put in a bunch of phony bids again. And at this point, it's all over because the top management had known it ahead of time and now a guy that was a pyromaniac had gone out and lit another fire, and he lit it after they've been warned that he was a pyromaniac, essentially. And it all went downhill from there.

It had to stop when the CEO learns about it, and then he made a third mistake actually, but, again, it pales in comparison to the second mistake. They made a third mistake when they totally underestimated the impact of what they had done once it became uncovered because there was a penalty of $185 million and in the banking business, people get fined billions and billions of dollars for mortgage practices and all kinds of things. The total fines against the big banks, I don't know whether it totals 30 or 40 billion or whatever the number maybe.

So they measured the seriousness of the problem by the dimensions of the fine and they thought $185 million fine signal a less offensive practice than something that involved $2 billion and they were totally wrong on that. But the main problem was they didn't act when they learned about it. It's bad enough having a bad system, but they didn't act.

At Berkshire, we have the main source of information for me about anything that's being done wrong at a subsidiary is the hotline. Now we got 4,000 or so hotline reports. Now we get communications on the hotline, perhaps 4,000 times a year, and most of them are frivolous, you know, "A guy next to me has bad breath," or something like that. But there are a few serious ones.

And the head of our Internal Audit, Becki Amick, looks at all those. A lot of them come in anonymous—probably, most of them—and some of them she refers back to the companies—probably most of them. But anything that looks really serious, you know, I will hear about and that has led to action, to put it, more than once. And we spent real money investigating some of those. We put special investigators on some of them and like I say, it has uncovered certain practices that we would not at all condone at the parent company.

I think it's a good system. I don't think it's perfect. I'm sure they've done an internal audit at Wells Fargo and I'm sure they got a hotline. And I don't know the facts, but I would just have to bet that a lot of communications came in on that and I don't know what their system was for getting them to the right person. And I don't know who did what at any given time, but that was a huge, huge, huge error if they were getting—and I'm sure they were—getting some communications and they ignored them or they just sent them back down to somebody down below. Charlie, if you followed, what are your thoughts on it?

CHARLIE MUNGER: Well it could be that I'm skeptical when some law firm thinks they know how to fix something like this. If you're in a business where you have a whole lot of people where the incentives are very likely to cause a lot of misbehavior, of course you need a big compliance department. Every big warehouse stock brokerage firm has a huge compliance department and if we had one, we would have a big compliance department too, wouldn't we Warren?

WARREN BUFFETT: Absolutely.

CHARLIE MUNGER: Absolutely, but it doesn't mean that everybody should try to solve their problem with more and more compliance. I think we've had less trouble over the years by being more careful in whom we pick to have power and having a culture of trust. I think we have less trouble, not more.

WARREN BUFFETT: But we will have trouble from time to time.

CHARLIE MUNGER: Yes, of course, we're blind-sided some days.

WARREN BUFFETT: Charlie says an ounce of prevention—he said, from Ben Franklin, whom he worships—he said an ounce of prevention is worth a pound of cure. He understated it. An ounce of prevention is worth more than a pound of cure and I would say a pound of cure promptly applied is worth a ton more than cure that's delayed.

Problems don't go away. John Gutfreund said that problem originally was “a traffic ticket”. He told the troops there at Salomon it was a traffic ticket and it almost brought down a business. And some other CEO that had described the problem that he had encountered as a footfall and it resulted in an incredible damage to the institution. And so you've got to act promptly and frankly. I don't know any other system other than hotlines and anonymous letters to me.

I get anonymous letters and I've gotten about three or four of them, probably in the last six or seven years that have resulted in major changes. And very, very occasionally— they're almost always are anonymous—but it wouldn't make any difference because there will be no retribution against anybody, obviously, if they call our attention to something that's going wrong. But I will tell you, as we sit here, somebody is doing—quite a few people—are probably doing something wrong at Berkshire and usually it's very limited and they may be stealing small amounts of money or something like that. But when it gets to some sales practice, like what's taking place at Wells Fargo, you can see the kind of damage it would do.

We will now shift over to the analyst and Johnny Brandt.

JOHNNY BRANDT: Hi Warren, hi Charlie. Thanks for having me. You've addressed the risk of driverless cars to GEICO's business, but it strikes me that driverless trucks could narrow the cost advantage of railroads even if the number of crew members in a locomotive eventually declines from two to zero. Is autonomous technology more of an opportunity or more of a threat for the Burlington Northern?

WARREN BUFFETT: Well I would say that driverless trucks are a lot more of a threat than an opportunity to the Burlington Northern and I would say that if driverless cars became pervasive, it would only be because they were safer and that would mean that the overall economic cost of the auto-related losses had gone down and that would drive down the premium income of GEICO. So I would say if both of those and autonomous vehicles were widespread, it would hurt us if they spread to trucks and they would hurt our auto insurance business, I think.

My personal view is that they will certainly come. I think they may be a long way off, but that will probably, frankly, depend on experience in the first early months of the introduction in other-than-test situations. And if they make the world safer, it's going to be a very good thing, but it won't be a good thing for auto insurers. And similarly, if they learn how to move trucks more safely, there tend to be driver shortages in the truck business now, it obviously improves their position vis-a-vis the railroads, Charlie?

CHARLIE: Well, I think that's perfectly clear.

WARREN: Finally approval, all these years. Okay, station one—the shareholders.

BRIAN MARTIN: Hi Warren and Charlie, my name is Brian Martin and I'm from Springfield, Illinois. An HBO documentary, Becoming Warren Buffett, you had a great analogy comparing investing to hitting a baseball and knowing your sweet spot. Ted Williams knew his sweet spot was a pitch right down the middle. When both of you look at potential investment, what attributes make a pitch in your sweet spot that you'll take a swing at and invest in?

WARREN: Well, I'm not sure I'd define it in exactly the terms you would like, but we sort of know it when we see it and it would tend to be a business that for one reason or another, we can look out five or ten or twenty years and decide that the competitive advantage that it had at the present would last over that period and it would have a trusted manager that would not only fit into the Berkshire culture, but that was eager to join the Berkshire culture. And then it would be a matter of price, but the main, you know, when we buy a business, essentially, we're laying out a lot of money now based on what we think that business will deliver over time and the higher the certainty with which we make that prediction, the better we feel about it.

You can go back to the first—it wasn't the first outstanding business we bought, but it was kind of a watershed event—which was a relatively small company: See's Candy. And the question when we looked at See's Candy in 1972 was "would people still want to be both eating and giving away that candy in preference to other candies"? And it wouldn't be a question of people buying candy for the little bit and we had a manager we liked very much and we bought a business that we paid $25 million for and had it cash. And it was earning about $4 million pre-tax then and we must be getting close to $2 billion or something like that pre-tax that we've taken out of it. But it was only because we felt that people would not be buying necessarily a lower priced candy. I mean, it does not work very well if you go to your wife or your girlfriend on Valentine's Day—I hope they're the same person—and say, you know, "Here's a box of candy honey. I took the low bid". You know, it loses a little as you're going through that speech and we made a judgment about See's Candy that it would be special. And probably not in the year 2017, but we certainly thought it would be special in 1982 and 1992. And fortunately, we were right on it and we're looking for more See's Candies, only a lot bigger. Charlie?

CHARLIE: Yeah but it's also true that we were young and ignorant then.

WARREN: Now we're old and ignorant, yeah.

CHARLIE: Yes, that's true too and the truth of the matter is that it would have been very wise to buy See's Candy at a slightly higher price. But if they'd asked it, we wouldn't have done it, so we've gotten a lot of credit for being smarter than we were.

WARREN: Yeah and to be more accurate, if it had been $5 million more, I wouldn't have bought it. Charlie would have been willing to buy it, so fortunately, we didn't get to the point where we had to make that decision that way. But he would have pushed forward when I probably would have faded.

It's a good thing that the guy came around. Actually, the seller was the grandson of Larry See's son. Am I correct or was it Larry See's the brother? But he was not interested in the business and he was more interested in girls and grapes, actually, and he almost changed his mind.

We did change his mind about selling and I wasn't there. But Rick Guerin told me that Charlie went in and gave an hour talk on the merits of girls and grapes over having a candy company. This is true folks and the fellow sold to us. I pull Charlie out in emergencies like that.

CHARLIE: We were very lucky that early we had the habit of buying horrible businesses because they were really cheap, because it gave us a lot of experience trying to fix unfixable businesses as they headed downward toward doom. And that early experience was so horrible—fixing the unfixable—that we were very good at avoiding it thereafter. So I would argue that our early stupidity helped us.

WARREN: Yeah, we learned that we could not make a silk purse out of a sow's ear, so we went out looking for silk after that.

CHARLIE: We have to try it for a long time and failed and have your nose rubbed in it to really understand it.

WARREN: Okay Becky Quick?

BECKY QUICK: This question comes from a shareholder named Mark Blackly in Tulsa, Oklahoma, and he says, "There has been more news than usual in some of Berkshire's core stockholdings: Wells Fargo, and the incentive and new account scandal; American Express losing the Costco relationship and playing catch up in the premium card space; United Airlines and customer service issues; Coca-Cola and slowing soda consumption. How much time is spent reviewing Berkshire stockholdings and is it safe to assume if Berkshire continues to hold these stocks that the thesis remains intact?"

WARREN: Well, we do spend a lot of time thinking. Those are very large holdings. If you add up American Express, Coca-Cola and Wells Fargo, I mean, you're getting up well into the high tens of billions of dollars and those are businesses we like very much.

There are different characteristics and the cases that you mentioned; United Airlines, we actually are the largest holder of all four of the largest airlines and that is much more of an industry thought. But all businesses have problems and some of them have some very big plusses. You mentioned American Express. If you read American Express's first quarter report and talk about their platinum card, their platinum card is doing very well. There were gains around the world and I think they were 17% or something like that in the UK. And 15% of that is original currency or the local currency. Japan, Mexico, and very good in the United States.

There's competition in all these businesses. If we thought—we did not buy American Express or Wells Fargo or United Airlines, or Coca-Cola with the idea that they would never have problems or never have competition. Why we did buy them is we thought they had very, very strong hands and we liked the financial policies in the case of many of them and we liked their position.

We bought a lot of businesses and we do look to see if they have, durable, competitive advantage. And we recognize that if you got a very good business, you're going to have plenty of competitors that are going try and take it away from you. And then you make a judgment as to the ability of your particular company and product and management to ward off competitors.

They won't go away, but we think—I'm not going to get into the specific names on it—but those companies generally are very well-positioned. I'd liken it to, essentially, if you have a wonderful business—even if it's a small one like See's Candy—you basically have an economic castle. And in capitalism, people are going to try and take away that castle from you. So you want a moat around it protecting it in various ways, and then you want a knight in the castle that's pretty darn good at warding off marauders. But there are going to be marauders and they'll never go away.

If you look at, I think, Coca-Cola was 1886; American Express was 1851 or 1852, starting out with an express business. Wells Fargo, I don't know what year they were started, and incidentally American Express was started by Wells and Fargo as well. So these companies had lots of challenges and they'll have more challenges and the companies we own have had challenges. Our insurance business has had challenges, but we started with National Indemnity was an $8 million purchase in 1968.

And fortunately, we've had people like Tony Nicely at GEICO. We've had Ajit Jain, who has added tens of billions of value and we've got some smaller companies that you probably don't even know about, but really have done a terrific job for us. So, there'll always be competition in insurance, but there'll always be things to do that a really intelligent man with a decent distribution system, various things going for him, can do to ward off the marauders.

So, to the specific question: how much time is spent reviewing the holdings? I would say that I do it every day. I'm sure Charlie does it every day, Charlie?

CHARLIE: Oh, I don't think I have anything to add to that either.

WARREN: We'll cut his salary if he doesn't participate here. Okay, Jay Gelb.

[00:55:05]
JAY GELB: This question is on Berkshire's retroactive reinsurance deal with AIG, which was the largest ever of its kind. Based on AIG's track record of reserve deficiencies, and the opportunity for Berkshire to invest the float, what is your level of confidence that this contract covering up to $20 billion of AIG's reserves in return for $10 billion of premiums will ultimately be profitable for Berkshire?

WARREN: Well, the time we do every deal I think it's smart, and then sometimes we find out otherwise as we go along. The deal that Jay knows but might be unfamiliar to many people is that AIG transferred to us the liability for 80% of $25 billion, excess of $25 billion. In other words, they have to pay the first $25 billion and then on the next $25 billion, we have to pay 80% of what they paid, up to a limit of 20 billion (80% of 25). And we got paid $10.2 billion for that and we had—and this applies to their losses in many classes of business—written or earned before December 31, 2015.

So Ajit Jain—who has made a lot more money for Berkshire for you than I have—he evaluates that sort of transaction. We talk about it a fair amount ourselves. I just find it interesting. I predict we find the $10.2 billion that they're going to give us interesting and we come to the conclusion that we think we'll do well by getting $10.2 billion today with a maximum pay out of $20 billion between now and judgment day on this large piece of business.

AIG had very good reasons for doing this because their reserves had been under criticism and this essentially—probably, ensures I think—put to bed the question whether they were under reserved on that business. And we get the $10.2 billion. And the question is how fast we pay out the money and how much money we pay out. And Ajit has done 99% of the thinking on that and I do 1% and we project out what we think will happen. And we know whatever our projection is that it will be wrong, but we try to be conservative. And we've done a fair amount of these deals—this is the largest.

The second largest was a creature that was formed out of Lloyd's of London some years ago and we've been wrong on one transaction that involved something over a billion of premium—I mean, clearly wrong. And there are a couple of others that may or may not work out depending on what you assumed we earned on the funds, but they're okay.

They probably didn't come out as well as we thought they would, though. But, overall, we've done okay on this. It's less okay when we're sitting around with $90 plus billion of cash, so the incremental $10.2 billion we took in in the first quarter in earning is peanuts at the moment. And peanuts is not what percent of the formula for making this an attractive deal. We do have to soon we'll find uses of the money, but the money will be with us quite a while and I think our calculations are on the conservative side. They're not the identical calculations that AIG makes. I mean, we come up of our own estimate of pay outs and all of that.

And I actually think this is quite a good transaction from AIG's standpoint because they did take $20 billion of potential losses off the $10.2 billion and I think they satisfied the investing community that they're quite unlikely to have adverse development in the period prior to 2015 that was not accounted for by this transaction. Charlie?

CHARLIE: Well it's an intrinsically dangerous kind of activity but that's one of its attractions. I don't think there are any two people in the world that are better at this kind of transaction than Ajit and Warren and nobody else has had the experience with that. Just get me on a lot more of those businesses and I'll accept the little extra worry.

WARREN: There's one thing I should mention, we actually were the only insurance operation in the world who would write that sort of a contract and that were satisfactory to the other party. I mean, when somebody hands you $10.2 billion and says, "I'm counting on you to pay $20 billion back, even if it's 50 years from now, on the last dollar." There are very few people that they want to hand $10.2 billion to. There's limited people on the other side, I mean, there aren't that many people who remotely can have that kind of size deal, but...

CHARLIE: Very few is a good expression. He means one. [Laughter]

WARREN: Okay, we'll go to Station 2.

[01:01:02]
GRANT GIBSON: Hello Mr. Buffett, Mr. Munger. My name is Grant Gibson. I'm from Denver, Colorado and this is my fifth consecutive year here, so thank you for having us.

WARREN: Thanks for coming.

GRANT GIBSON: I appreciate it. With all due respect, Mr. Buffett, this question is for Mr. Munger. In your career of thousands of negotiations in business dealings, could you describe for the crowd which ones sticks out in your mind as your favorite or as otherwise, noteworthy?

CHARLIE MUNGER: Well I don't think I got a favorite but the one that probably did us the most good as a learning experience was See's Candy. It just, the power of the brand, the unending flow of ever-increasing money with no work.

GRANT GIBSON: Sounds nice.

CHARLIE MUNGER: It was and I'm not sure about the Coca-Cola if we hadn't bought the See's. I think that a life properly lived is just learn, learn, learn all the time and I think Berkshire has gained enormously from these investment decisions by learning through a long, long period. Every time you appoint a new person that's never had big capital allocation experience, it's like rolling the dice and I think we're way better off having done it so long. But the decisions blend and the one feature that comes through is the continuous learning. If we had not kept learning, you wouldn't even be here [Pauses]... You'd be alive, probably, but not here. [Laughter]

WARREN: There's nothing like the pain of being in a lousy business to make you appreciate a good one.

CHARLIE: Well, whenever we get into a really good one, that's a very pleasant experience and it's a learning experience. I have a friend who says, "The first rule of fishing is to fish where the fish are. And the second rule of fishing is to never forget the first rule". And we've gotten good at fishing where the fish are.

WARREN: Yeah, that's only metaphoric, but I went to fish with Charlie one time...

CHARLIE: and there were too many other boats in the damn water, but the fish are still there.

WARREN: Yeah, we bought a department store in Baltimore in 1966 and there's really nothing like being in the experience of trying to decide whether you're going to put a new store in an area that hasn't really developed yet enough to support it, but your competitor may move there first and then you have the decision of whether to jump in and if you jump in. That kind of spoils it, and now you got two stores where even one store isn't quite justified.

How to play those games, those business games, you learn a lot by trying and what you really learn is which ones to avoid. And if you just stay out of a bunch of terrible businesses you're off to a very great start as well because we've tried them all.

CHARLIE: You can really learn because the experiences are a lot like eating cockle burgers and it really gets your attention.

WARREN: Well, we won't expand on that. Andrew Ross Sorkin?

[01:04:36]
ANDREW ROSS SORKIN: Good morning Warren, this question comes from a long-time shareholder who I should tell you, accosted me last night in the lobby of the Hilton Hotel with this question: "Warren, for years you stayed away from technology companies saying they were too hard to predict

and didn't have moats. Then you seemed to change your view about technology when you invested in IBM, and again, when you recently invested in Apple. But then, on Friday, you said IBM had not met your expectations and sold a third of our stake. Do you view IBM and Apple differently and what have you learned about investing in technology companies?"

WARREN: Well I do view them differently, but obviously when I bought the IBM and started buying it six years ago, I thought it would do better in the six years that have elapsed than it has. And Apple—I regard them as being quite a different business.

I think Apple was much more of a consumer products business in terms of sort of analyzing moats around it and consumer behavior and all that sort of thing. It's obviously a product with all kinds of tech built into it, but in terms of laying out what their prospective customers will do in the future as opposed to say, an IBM customer, it's a different sort of analysis. That doesn't mean it's correct and we'll find out over time, but they are two different types of decisions and I was wrong on the first one and we'll find out whether I'm right or wrong on the second. But I do not regard them as apples and apples and I don't quite regard them as apples and oranges. But it's somewhat in between on that, Charlie?

CHARLIE: Well, we avoided the tech stocks, as we felt we had no advantage there and other people did. And I think that's a good idea not to play where the other people are better. But you know, if you ask me in retrospect, what was our worst mistake in the tech field, I think we were smart enough to figure out Google. Those ads worked so much better in the early days than anything else. So I would say that we failed you there and we were smart enough to do it and didn't do it. We do that all the time, too.

WARREN: We were their customer very early on with GEICO, for example, and we saw—these figures are way out of date—but as I remember, we were paying them $10 or $11 a click (or something like that). And any time you're paying somebody $10 or $11 bucks every time somebody just punches a little thing where you got no cost at all, you know, that's a good business unless somebody's going to take it away from you.

And so we were close up seeing the impact of that. And incidentally if any of you don't have anything to do in your hotel rooms tonight, just keep punching Progressive or something and you're going to... Don't really do that. This all just happened to cross my mind.

But, you know, you've almost never seen a business like it. And I think for LASIK surgery and things like that, I think the figures were $60 or $70 a click with no incremental, no cost. And I know the guys. I mean, they actually designed their prospectus. They came to seem me and, they, a little bit after the original one, when they went public, a little bit after Berkshire even and so I had plenty of ways to ask questions or anything of the sort and educate myself. But I blew it.

CHARLIE: We blew Walmart too. It was a total cinch. We were starting up to figure that out and we didn't.

WARREN: Yeah, figuring out; execution is what counts. Anyway, and I could be making two mistakes on IBM. It's harder to predict in my view the winners in various items or how much price competition will enter into something like cloud services and all that.

I made a statement the other day which, it's really remarkable and I asked Charlie whether he could think of a situation like it where one person has built an extraordinary economic machine in two really pretty different industries, you know, almost simultaneously as has happened...

CHARLIE: From a standing start at zero.

WARREN: From a standing start at zero with competitors with lots of capital and everything else, to do it in retailing and to do it with the Cloud, like Jeff Bezos has done. I mean, people like the Mellons invested in a lot of different industries and all of that, but he has been in effect the CEO, simultaneously, of two businesses starting from scratch, that if—you know Andy Grove at Intel used to say, "think about if you have a silver bullet and you could shoot it and get rid of one of your competitors, who would it be?"

Well, I think that both in the Cloud and in retail there are a lot of people that would aim that silver bullet at Jeff. And it's a different sort of game, but at the Washington Post, he's played that hand as well as anybody I think possibly could. So, it's a remarkable business achievement where he's been involved actually in the execution—not just bank rolling it—of two businesses that are probably steered by their competitors almost and as any you can find. Charlie have you got any further thoughts?

CHARLIE: Well, we're sort of like the Mellons: old-fashioned people who've done all right and Jeff Bezos is a different species.

WARREN: And we missed it entirely and so then, we never owned a share of Amazon. Okay, Greg Warren?

GREGG WARREN: Warren, my question relates to some recent stock purchases as well. Unlike the railroads which benefit from colossal barriers to entry due to their established and practically impossible to replicate networks of rail and rights of way, the airline industry seems to have few (if any) advantages.

Even with the consolidation we've seen during the past 15 years, the barriers to entry are few and the exit barriers are high. The industry also suffers from low switching costs and intense pricing competition and is heavily exposed to fuel costs with rising fuel prices being difficult to pass on and declining fuel prices leading to more price competition.

Compare this with real customers who have few choices and thus, with limited buying power and where fuel charges allow the industry to mitigate fuel price fluctuations. While you've noticed several times since the airlines that purchased were announced that the two industries are quite different and that comparisons should not be made to Berkshire's moving to railroads a decade ago.

Could you walk us through what convinced you that the airlines were different enough this time around for Berkshire to invest close to $10 billion in the four major airlines because it would seem to me that UPS, which you have a small stake in and FedEx, both of which have wider economic moats built on more identifiable and durable competitive advantages, would be a better option for long-term investors?

WARREN: Yeah, the decision, in respect to airlines, had no connection with our being involved in the railroad business. I mean, you can classify them and maybe as transportation businesses or something, but it had no more connection than the fact that we own GEICO or any other business.

You couldn't pick a tougher industry, you know. Ever since Orville went up and I said that if anybody had really been thinking about investors, they should have had Wilbur shoot him down and save everybody a lot of money for a hundred years. You can go to the internet, type in "airlines and bankrupt" and you'll see that something like a hundred airlines in that general range had gone bankrupt in the last few decades and, actually, Charlie and I were directors for some time of US Air. And people write about how we had a terrible experience in US Air and it was one of the dumbest things I'd ever done and there's a lot of competition.

CHARLIE: You made a fair amount of money out of it, too.

WARREN: Yeah and we made a lot of money out of it.

CHARLIE: We don't deserve.

WARREN: But we made a lot of money out of it because there was one little brief period when people got all enthused about US Air and after we left as directors and after we sold our position, US Air managed to go bankrupt twice in the subsequent period. I mean, you've named all of the—not all of them—but you've named a number of factors that just make for terrible economics.

And I will tell you that if capacity—you know, it's a fiercely competitive industry. The question is whether it's a suicidally competitive industry, which it used to be. I mean, when you get virtually every one of the major carriers and dozens and dozens and dozens of minor carriers are going bankrupt, it ought to come to a point where you find that maybe you're in the wrong industry.

It has been operating for some time now at 80% or better of capacity being available—seat miles—and you can see what deliveries are going to be and that sort of thing. So if you make—I think it's fair to say that they will operate at higher degrees of capacity over the next five or ten years than the historical rates, which caused all of them to go broke. Now, the question is whether even when they're doing it in the '80s, they will do suicidal things in terms of pricing, remains to be seen.

They actually, at present, are earning quite high returns on invested capital; I think higher than either FedEx or UPS if you actually check that out. But that doesn't mean tomorrow morning if you're running one of those airlines and the other guy cuts his prices, you cut your prices. And as you say, there's more flexibility when fuel goes down to bring down prices than there is to raise prices when prices go up.

So, you know, it is no cinch that the industry will have some more pricing sensibility in the next 10 years than they had in the last 100 years, but the conditions have improved for that. They got more labor stability than they had before because, basically, they've been through bankruptcy and they're all going to sort of have an industry pattern bargaining, it looks to me like. They're going to have a shortage of pilots to some degree, but it's not like buying See's Candy. Charlie?

CHARLIE: No, but the investment world has gotten tougher with more competition, more affluence and more absolute obsession with finance throughout the whole country. And we picked up a lot of low hanging fruit in the old days where it was very, very easy and we had huge margins of safety.

Now we operate with a less advantageous general climate and maybe we have small statistical advantages, where in the old days it was like shooting fish in a barrel, but that's all right. It's okay if it gets a little harder after you get filthy rich.

WARREN: Charlie's more philosophical than I am on that point.

CHARLIE: I can't bring back the low hanging fruit, Warren. You're just going to have to keep reaching for the higher branches.

WARREN: Gregg, I think the odds are very high that there are more revenue passenger miles five years from now or ten years from now. If the airline companies are only worth five or ten years from now what they're worth now in terms of equity, we'll get a pretty reasonable rate of return because they're going to buy in a lot of stock at fairly low multiples. So, if the company's worth the same amount at the end of the year and there's fewer shares of stock outstanding, over time we make decent money on all four of the major airlines are buying in stock at a...

CHARLIE: You got to remember that the railroads were a terrible business for decades and decades and decades, and then they got good.

WARREN: Yeah, I like the position. Obviously, by buying all four, it means that it's very hard to distinguish, at least in my mind, it's hard to distinguish who will do the best. I do think the odds are quite high if you take revenue passenger miles flown five or ten years from now. It will be a higher number and there'll be low-cost people who come in and you know, the Spirit of the World and JetBlue, whatever it may be.

But my guess is that all four of the companies we have will have higher revenues. The question is what their operating ratio is. They will have fewer shares outstanding by a significant margin, so even if they're worth just what they're worth today, we could make a fair amount of money, but it is no cinch by a long shot. Okay, Station 3?

[01:19:14]
SIBYLLE ARIANS: Good morning everybody. My name is Sibylle Arians. I'm from Germany and I'm a member of the Board of Ethecon Foundation Ethics & Economy. I'm very happy that I can put my question here and maybe you are not as happy as I am to listen to it.

WARREN: Well, we'll try to stay happy. Thank you for coming.

SIBYLLE ARIANS: Thank you. Mr. Buffett, a few years ago, I saw a movie in which you proclaimed that the printout on the dollar bill, "In God we trust" does not really oppress your philosophy. In your opinion only cash counts and your credo is, "In the dollar I trust."

WARREN: I don't think I've ever said that, actually.

SIBYLLE: Well, I can show you the movie that will prove.

WARREN: Show me a clip...

SIBYLLE: Well maybe it was just joking, but always behind a joke there is also a truth. Well, you laughed heartily at that moment, you as one of the most richest men of all times on this earth. A goodhumored, friendly, elderly gentleman, whatever motivated those who designed the dollar notes, they certainly wanted to say that there is something higher than the value of this printed paper.

Regrettably, you have shown many times in your life that you see this differently. You have accumulated billions of dollars, showed extraordinary cleverness and skill and you know better to pick up than many others, who like you, use the rules which are inherent to capitalism for their own intentions. But, have you ever given a thought to what troubles and sacrifices slavery and destruction of Mother Earth and even diseases and deaths stick to the dollar bills which you gather so eagerly? [Boos from the audience]

Let's take Coca-Cola. Ethecon Foundation Ethics & Economy from Germany has awarded the Black Planet Award to the members of the Board of Directors as well as to the large shareholders, Warren Buffett and Herbert Allen, because you are co-responsible for all of what makes this group make so much money, isn't it? Among other things, Coca-Cola deprives people of their drinking water in drought prone areas of the world.

WARREN: Well, at some point, are you asking a question?

SIBYLLE: Then what was contaminating the groundwater in these areas?

WARREN: I don't want to interrupt you, but are you making a speech or asking a question?

SIBYLLE: Well, I'll put my question right now.

WARREN: Okay, good.

SIBYLLE: Will you give up your Coca-Cola shares if the destruction of the environment, the monopolization of the right to healthy drinking water and the shameless exploitation of the workers continue?

CHARLIE: Well, that's more of a speech than a question. [Applause]

WARREN: Yeah, yeah. I don't think that quote that you had earlier, I've said once or twice that, it should say, "In the Federal Reserve we trust" because they print the money and if they print too much of it, it could decline in value, but to my knowledge I have never said anything like you originally said.

And I would say this, I think I've been eating things I like to eat all my life and Coca-Cola, this Coca-Cola's 12 ounces, I drink about five a day. There's about 1.2 ounces of sugar in it and if you look at where different people get their sugar and calories from, they get them from all kinds of things, I happen to believe that I like to get 1.2 ounces with this and it's enjoyable. Since 1886 people have found it pleasant.

And I would say that if you pick every meal in terms of what somebody in some recent publications told you is the very best for you, I offer you that, I'd say "Go to it." But if you told me that I would live one year longer if I'd eat nothing but broccoli and asparagus and everything my Aunt Alice wanted me to eat all my life, or I would eat everything I enjoyed eating including chocolate sundaes and Coca-Cola and steak and hash browns. You know, I would rather eat in the way I enjoyed for my whole life than eat some other way and live another year. And I do think that choice should be mine, you know.

If somebody decides sugar is harmful, maybe it would encourage the government to ban sugar. But sugar in Coca-Cola has not ever been eating sugar, you know, put on my Grape Nuts in the morning or whatever else I'm having. So I think Coca-Cola's been a very, very positive factor in America and the world for a long, long time. And you can look at a list of achievements of the company and I really don't want anybody telling me I can't drink it. Charlie?

CHARLIE: Well, I've solved my Coca-Cola problem by drinking Diet Coke and I swill the stuff. I've been doing it for just as long as you've been taking all those Coca-Cola's that are—I've had breakfast with Warren when all he has are Coca-Colas and nuts.

WARREN: And pretty damn good, too.

CHARLIE: If you keep doing that, Warren, you may not make a hundred.

WARREN: Well, I think there's something in longevity to be feeling happy about your life too.

CHARLIE: Absolutely. [Applause]

WARREN: Okay, Carol?

CAROL LOOMIS: This question is from Franz Traunberger of Austria and it concerns intrinsic value, which is neither—Warren you may amend this, it's my definition here—but, which is neither a company's accounting value nor its stock market value, but rather its estimated real value.

So the question is, "At what rate has Berkshire compounded intrinsic value over the last 10 years? And at what rate—including your explanation for it, please—do you think intrinsic value can be compounded over the next 10 years?"

WARREN: Yeah, intrinsic value, you know, can only be calculated—or gains, you know—in retrospect. But the intrinsic value to your definition would be the cash to be generated between now and judgment day, discounted at an interest rate that seems appropriate at the time. And that's varied enormously over a 30 or 40-year period.

If you pick out 10 years you're back to May of 2007, and we have some unpleasant things coming up. But I would say that we've probably compounded at about 10% and I think that's going to be tough to achieve—in fact, almost impossible to achieve—if we continue in this interest rate environment. That's the number one. If you ask me to give the answer to the question—if I could only pick one statistic to ask you about the future before I gave the answer—I would not ask you about GDP growth. I would not ask you about who was going to be president. I *would* ask you what the interest rate is going to be over the next 20 years on average (the 10-year or whatever you wanted to use). And if you assume our present interest rate structure is likely to be the average over 10 or 20 years, then I would say it would be very difficult to get to 10%. On the other hand, if I were to pick with a whole range of probabilities on interest rates, I would say that that rate might be somewhat aspirational and it might, well, it might be doable.

And if you would say "well, we can't continue these interest rates for a long time", I would ask you to look at Japan. You know, where 25 years ago, we couldn't see how their interest rates could be sustained and we're still looking at the same thing. So I do not think it's easy to predict the course of interest rates at all.

And, unfortunately, predicting that is embedded in giving a good answer to you. I would say the chances of getting a terrible result in Berkshire are probably as low as about anything you can find. The chances of getting a sensational result are also as low as anything you can find. So my best guess would be in the 10% range, but that assumes somewhat higher interest rates–not dramatically higher–but somewhat higher interest rates in the next 10 or 20 years than we've experienced in the last seven years, Charlie?

CHARLIE: Well there's no question about the fact that the future with our present size is—in terms of percentage rates of returns—is going to be less glorious than our past. And we keep saying that, and now we're proving it.

WARREN: Do you want to end on that note Charlie or would you care?

CHARLIE: Well, I do think Warren's right about one thing. I think we have a collection of businesses that on average has better investment values than say the S&P average. So I don't think you shareholders have a terrible, terrible problem.

WARREN: Yeah and I would say that we probably—well, I'm certain—we do have more of a shareholder orientation than the S&P 500 as a whole. I mean, this company has a culture where decisions are made for as an owner, as a private owner would make them and, frankly, that's a luxury we have that many companies don't have. I mean, they're under pressures today, sometimes to do things.

One of the questions I asked the CEO of every public company that I meet is, "what would you be doing differently if you owned it all yourself?" And the answer, you know, is usually this and that and a couple of other things. If you would ask us, the answer is we're doing exactly what we were doing if we owned them all, all the stock ourselves. And I think that's a small plus over time. Anything further, Charlie?

I think we have one other advantage. A lot of other people are trying to be brilliant and we're just trying to stay rational and it's a big advantage. Trying to be brilliant is dangerous, particularly when you're gambling. Okay, Jonathan?

[01:32:10]
JONATHAN BRANDT: If corporate tax rates are reduced meaningfully, Berkshire will enjoy a one-time boost to book value because of its sizeable deferred tax liability and its go-forward earnings should be higher, too (at least in theory). How much of the reduced tax rate will be passed along to Berkshire's customers through, for instance, lower electricity rates or lower railroad shipping rates, and how much will go to Berkshire shareholders?

WARREN: Yeah, the question is: in the case of our utility businesses, do all the benefits of lower tax rates goes to customers? And it should be because we are allowed a return on equity, in general. I mean, I'm simplifying a little bit, but we're allowed a return on equity that's computed on an average tax basis. And the utility commissions—if taxes were raised—would presumably give us higher rates to compensate for that.

And if taxes are lowered, they would say you're not entitled to make more money just because tax rates, on equity, because tax rates have been lowered, so forget about the utility portion of the deferred taxes.

The deferred taxes that are applicable to our unrealized gains and securities, we would get all the benefit of. Because I mentioned we had $90 billion plus of unrealized gains and if the rates were changed on those in either direction, our owners—dollar for dollar—will participate in that.

And then you get into the other businesses. You mentioned the railroad, but it can be all of our other businesses. To some extent, if tax rates are lowered, different degrees and different industries, depending on the number of players, the competitive conditions, some of it almost certainly gets competed away and some of it would likely not be competed away.

Economists can argue about that a lot, but I've seen it in action in a lot of cases. You got a big decline in rates, for example, in the UK and we've had them, over my lifetime, we had 52% corporate rates, you know we've had a lot of different numbers, so I have seen how economic behavior works and I would say that it's certain that some of any lower rate would be competed away and it's virtually certain that some would then hand off the benefit to the shareholders. It's very industry and company-specific in how that plays out. Charlie?

Well, we have dollar for dollar, I mean, there's $90 billion or $95 billion and if the rate were to drop 10%, that $9.5 billion, by 10 percentage points, that $9.5 billion is real. On the other hand, if it goes up, as it did, it went up from 28% to 35%, they can take it away from us, too.

CHARLIE: Well, I think it's true that we're peculiar in one way. If things go to hell in a handbasket and then get better later, we're likely to do better than most others. And we don't wish for that and we don't want our country to have to suffer through it and we fear what might happen if the country went through the wringer like that. But, if that real adversity comes, we're likely to do better in the end. We're good at navigation through that kind of stuff.

WARREN: Yeah and occasionally there will be.

CHARLIE: And we're quite good at it.

WARREN: There will be occasional hiccups in the American economy. It doesn't have much to do with those President or anything like that. Those people may get blamed or given credit for different things, but it is the nature of market systems to occasionally go haywire in one direction or the other and it's been here with us and it'll be here with us.

It's not on a regular sine wave type picture or anything of the sort, but it's certain to happen from time to time. We will probably have a fair amount of money and credit at that time and we, certainly, we're not affected. When the rest of the world is fearful, we know America's going to come out fine and we will not have any trouble psychologically acting at all.

And then the question is, "How much do we have in the way of resources?" We'll also never put the company in any kind of risk just because we see a lot of opportunities. We'll grab all the ones we can that we can handle and not lose a day of sleep. I didn't quite get that, but in any event, we will now go to Station 4.

[01:37:24]
DR. BRUCE: Dr. Bruce Hertz from Glenview, Illinois. I wanted to thank you for allowing me to attend. I feel both honored and blessed. My question for Mr. Buffett is, "You've always advised us to purchase equities that appreciate in value, yet a few years ago you sold your used Cadillac at a tremendous profit. How can you justify selling a depreciating asset for a significant profit?" Thank you.

WARREN: Actually I gave it to Girls Inc. and they sold it and it was kind of an interesting—a very nice guy bought it for a hundred and some thousand dollars. And Girls Inc. got the money. And he came with—actually, with his family and he drove it away without any plates. He was driving back to New York and he got picked up by the police in Illinois and he started giving this explanation about how he'd given this money to Girls Inc. and was driving the car back and he had this nice looking family with him and the cops were quite skeptical. But, fortunately, I had signed the dashboard for him as part of the deal and so they looked at that and then they just said, "Well, did he give you any stock tips?" And they let it go. I can't recall ever selling a used car at a profit, but I don't think I've ever sold any personal possession. Well, I've got a house for sale.

CHARLIE: You don't have any personal possessions.

WARREN: Yeah, anything you see with a figure attached like that.

CHARLIE: You're a fatter version of Mohandas Gandhi, Mahatma Gandhi.

WARREN: That was a very nice guy that bought it and his check cleared so we're fine. [Audience laughter] Becky?

[01:39:55]
BECKY QUICK: I'd like to ask a question that can serve as a follow-up to the question that Carol had asked and Charlie in that response said that he thinks that Berkshire's businesses, on the whole, will do better than the S&P 500. Clark Cameron from Birmingham, Alabama who owns 281 shares of Berkshire B writes in and asks, "Why have you advised your wife to invest in Index Funds after your death rather than Berkshire Hathaway?" I believe Munger has counseled his offspring to "not be so damn stupid as to sell."

WARREN: She won't be selling any Berkshire to buy the Index Funds. All of my Berkshire, every single share, will go to philanthropy. I don't even regard myself as owning Berkshire, you know, basically. It's committed. [Applause]

So far about 40% has already been distributed, so the question is somebody who is not an investment professional will be—I hope reasonably elderly by the time that the estate gets settled—and what is the best investment? Meaning one that there would be less worry of any kind connected with and less people coming around and saying, "Why don't you sell this and do something else," and all of those things. She's going to have more money than she needs and the big thing to anyone is for money to not to be a problem. And there will be no way that if she holds the S&P—or virtually no way absent something happening with weapons of mass destruction—but virtually no way that she'll have all the money she possibly can use. She'll have a little liquid money so that if it's down tremendously at some point—if they close the stock exchange for a while or anything like that—she'll still feel that she's got plenty of money.

And the object is not to maximize it. It doesn't make any difference whether the amount she gets doubles or triples or anything of the sort. The important thing is that she never worries about money the rest of her life. And I had an Aunt Katie here in Omaha who Charlie knew well and worked with her husband as did I. And she worked very hard all her life and had lived in a house—she paid, I don't know, $8,000 for—at 45th and Hickory, all her life. And because she was in Berkshire, she ended up—she lived to 97—she ended up with a few hundred million.

And she would write me a letter every four or five months and she said, "Dear Warren, you know, I hate to bother you but might I run out of money?" And I would write her back and I would say, "Dear Katie, it's a good question because if you lived to 986 years, you're going to run out of money." And then about four or five months later, she'd write me the same letter again. And I've seen there's no way in the world that she's got plenty of money that then becomes a minus in your life. And there will be people that you've got a lot of money that come around with various suggestions for you—sometimes well-meaning, sometimes not so well-meaning.

So if you've got something that's certain to deliver, you know, it was all in Berkshire they'd say, "Well, if Warren was alive today and he'll be telling me to do this". I just don't want anybody to go through that and the S&P will be—I think, actually, what I'm suggesting is what a very high percentage of people should do something like that and I don't think they will have as—I think there's a chance they won't have as much peace of mind if they own one stock and they've got neighbors and friends and relatives that are trying to do some, like I say, sometimes well-intentioned, sometimes otherwise, to do something else. So I think it's a policy that will get a good result and it's likely to stick. Charlie?

CHARLIE: Well as Becky said, the Munger clan is it different. I want to hold on to Berkshire.

WARREN: Well I want to hold to Berkshire too.

CHARLIE: No, I mean, I recognize the logic of the fact that S&P algorithm is very hard to beat, you know, a diversified portfolio of big companies. It's all but impossible for most people. But you know, I'm just more comfortable with the Berkshire.

WARREN: Well it's the family business. But I've just seen too many people if they get older, particularly, just having to listen to the arguments of people...

CHARLIE: Well, if you're going to protect your heirs from the stupidity of others, you must have some good system. But I'm not much interested in that subject.

WARREN: Okay. Okay, Jay?

[01:45:15]
JAY GELB: Berkshire reportedly partnered with 3G and Kraft Heinz's attempt to acquire Unilever for $143 billion. How much was Berkshire willing to invest in this deal and does this mean Berkshire's next large acquisition is likely to be in partnership with 3G?

WARREN: Yeah, with Kraft Heinz, you'd have to distinguish between two situations. Kraft Heinz was a widely-owned company in which we and 3G act as a control group and have a little over 50% of the stock, but as originally contemplated, it's no certainty that this exactly is what would happen.

We would have invested in additional $15 billion and 3G would have invested an additional $15 billion if a friendly agreement could have been reached. So if the deal have been made, if the independent directors of Kraft Heinz had approved the transaction, then the likelihood is that would have invested $15 billion, but it would have required the approval at the end of any directors as well.

Now, Kraft Heinz in going forward would with making that offer wanted to be sure that there would be enough equity capital in addition to the debt that would be incurred to make the deal. And so, informally, we basically committed the $15 billion. It only was approved on the basis that we have a deal with Unilever and initially, we thought they would be at least possibly interested in such a deal. When we found out otherwise, we withdrew the offer. So it would have been $15 billion in additional money in all probability. Okay, Station 5?

[01:47:32]
AUDIENCE: Dear Honorable Mr. Buffett and Mr. Munger, I'm ____ Wah from China. My company, ____ Holdings is spreading value investing philosophy in Asia. My business partner, ____ and I are committed to awake 100 million Chinese people to return to rational way of re-investing. The hardest thing in this world is to change people's values or belief systems and we should like to awake investors to change from speculate in the market to investing in the market. It's not changing the speculators' values or their belief system. May I ask you, Mr. Buffett, can you kindly advise us what we should do to spread your value investing philosophy or is there any words of encouragement? Thank you.

WARREN: In any system, Keynes wrote about this in 1936, I think, it was in the General Theory or '35; I think it was in Chapter 12. It was a great chapter on investing and he talked about investment speculation and the propensity of people to speculate and the dangers of it and worded eloquently.

There's always the possibility of, I mean, there's always some speculation, obviously, and there's always some value investors and all of that sort of thing in the market. But when speculation gets rampant, and when you're getting what I guess Charlie would call social proof, that has worked recently, people can get very excited about speculating in markets and we will have it from time to time in this market.

There's nothing more agonizing than to see your neighbor, who you think has an IQ of about 30 points below you getting richer than you are by buying stocks. And whether it's internet stocks or whatever and people succumb to it and those succumb in this economy, just as elsewhere.

There's also a point which gets to your question, I would say that earlier on in the development of markets, there is probably some tendency for them, I think, to be more speculative than markets that have been around for a couple of hundreds of years.

Markets have a casino characteristic that has a lot of appeal to people, particularly when they see, like I said, people get rich around them. And those who haven't gone through the cycles before are probably a little more prone to speculate than people who have experienced the outcome of wild speculations.

Basically, in this country, Ben Graham, in the book I read in 1949, was preaching investment and that book continues to sell very well. But if the market gets hot, new issues are doing well and people on leverage are doing well, a lot of people will be attracted to not only speculation but what I would call gambling.

And I'm afraid that would be true in the United States and I would think that China—being a newer market, essentially in which there's widespread participation—it's likely to have some pretty extreme experiences in that respect. We will have some in this country too. Charlie?

CHARLIE: Well, I certainly agree with that. The Chinese will have more trouble. They're very bright people, they have a lot of action and, sure, they're going to be more speculative. And it's a dumb idea and to the extent you're working on it, well, you're on the side of the angels but lots of luck.

WARREN: Well, it will offer the investor more opportunities, actually, if they can keep their wits about them, if you have wild speculation. Charlie just mentioned earlier that if we get into periods that are very tough, Berkshire certainly will do reasonably well because we won't get fearful. And fear spreads like you cannot believe until you've seen a few examples of it.

At the start of September 2008, you had 35 million people with their money in money market funds, with $3.5 trillion in them and none of them were afraid that that dollar wasn't going to be a dollar when they went to cash in their money market fund. And three weeks later they were all terrified and $175 billion floated out in three days.

So, the way the public can react is really extreme in markets and that actually offers opportunities for investors. People like action and they like to gamble, and if they think there's easy money to be made, a lot of them, you'll get a rush to it and for a while it will be self-fulfilling and create new converts, until the day of reckoning comes.

Just keep preaching investing and if the market swings around a lot you'll keep adding a few people here and there to a group that recognizes that markets are there to be taken advantage of, rather than to instruct you as to what is going on. Okay, Andrew? Any more on that, Charlie?

CHARLIE: We've done a lot of preaching, Warren, without much effect.

WARREN: Right and that's probably good from our standpoint. Okay Andrew?

[01:54:10]
ANDREW ROSS SORKIN: Thank you, Warren. This question comes from Ryan Prince. President Donald Trump and his advisors have talked about proposing a substantial investment tax credit to provide incentives for long-term corporate fixed capital investment. In BNSF, Berkshire owns a sprawling infrastructure portfolio requiring regular routine maintenance investment of substantial scale.

What impact would an investment tax credit have on BNSF as capital investment decision-making from a return on investment at capital perspective, as well as in terms of timing? And just as importantly, given the current economy and employment picture, would such a tax credit amount to subsidization of otherwise mandatory maintenance capital investment or a proper incentive to stimulate investment?

WARREN: Yeah, well it would all have been on how it's worth because we've had investment tax credits in this country and we've had bonus depreciation, which is another form of it, and we do get extra first year depreciation, that does not enter into our calculation very much.

In fact, certainly, at the Berkshire level, I've never instructed anybody to do anything different because of investment tax credits or accelerated appreciation. There may be some calculations done down at the operating company level. It's certainly true in something like wind projects and solar projects. They are dependent on the tax law, currently. There may come time when there aren't, but they wouldn't have been done without some subsidization through the tax law.

I would say, if you change the depreciation schedules and double depreciation, triple depreciation, that we're going to do what we need to do at the railroad to make it safer and more efficient. If we just had ordinary depreciation and I doubt if there'd be any dramatic differences.

Obviously, if you were going to, say buy a bunch of planes and the law was going to change on 31st December and the math made it better until January 1st or do like this until December 31st, and make that kind of calculation. But I can't recall in all the years that I've ever sent out anything to our managers saying, "Let's do this because the tax law has changed or is being changed or might be changed," or something of the sort.

As I mentioned earlier, a change is just a little bit if you think there's going to be a change in capital gains rates. At a given time, obviously, if the rates are going to be lower, give or take losses at a time and defer gains maybe a little, and that's why it's useful.

Actually, if the Tax Committees in the Senate and the House are working on something, it might be useful if the Chairman would say that if we do make any changes we're likely to use this effective date or something of sort, and I think they've done that a few times in the past.

The big tax-driven item is in wind and solar and that is a specific policy because the government has decided they want to move people—or society has decided they want to move people—toward those forms of electric generation. And the market system wouldn't do it. There may come a time when the market system will do it all by itself.

We won't make big changes and it's so speculative anyway, in terms of even what the law would be. But beyond that, if it becomes less speculative as the law, I mean, maybe it looks like something that's going to. It doesn't change us big time at all. Charlie?

CHARLIE: Nothing to add. I'm not going to change anything at the railroad for some little tax jiggle.

WARREN: If we need a bridge repaired, we're going to repair the bridge. We need a lot of track maintenance all the time and that sort of thing. I don't think Matt and I have ever had a talk about it since we've owned the railroad. Gregg?

[01:58:45]
GREGG WARREN: Warren, my question also relates to Burlington Northern. Despite the current administration's belief that they can bring the coal industry back, market forces continue to lead into the industry's demise. While 90% of US coal consumption is driven by electricity generation, natural gas has been both cheaper and cleaner burning, and renewable electricity generation has remade parts of the market as wind and solar have gained scale and become cheaper alternatives.

This has created problems for Burlington Northern. With coal shipments accounting for just 18% of volume and revenue for the railroad last year, down from an average of 24% for both measures the previous 10 years. While some of this was due to the large buildup of coal supplies the past couple of winters—which finally seem to be working their way out—what are your expectations for the contribution of coal in the longer term? And I know that the railroad currently handles some export shipments going through Canada's specific coast ports, but will there be enough growth there to offset domestic demand? Or will BNSF need to rely more heavily on segments—like intermodal—to offset lost coal volumes?

WARREN: Yeah, the answer is coal is going to go down over time; I don't think there's much question about that. The specifics of any given year relate, very importantly, to the price of natural gas. I mean, right now the demand is somewhat up, a fair amount up, from last year because natural gas is at $315 or $320 and the utilities can produce electricity, in many cases, quite a bit cheaper with coal than with natural gas; whereas with $2, it would be natural gas.

But over time, coal, in my mind, is essentially certain to decline as a percentage of the revenue of the railroad. The speed at which it does, you don't build or create generation plants overnight. You can't predict the rate and if natural gas is cheap enough it's going you'll see a big conversion back to natural gas. Coal is going to go down as a percentage of revenues significantly.

Certainly, over 10 years it will be quite significant and who knows exactly year by year? We are looking for other sources of growth than coal. If you're tied to coal you got problems. Charlie?

CHARLIE: Well, If you go over the extremely long-term, I think that all hydrocarbons will be used, including all the coal. So, I think that in the end, these hydrocarbons are a huge resource for humanity and I don't think we've got any good substitute. I've never minded saving them for the next generation. I don't like using them up very fast, so I'm off on a road of my own on this one.

People think that all these hydrocarbons are going to be stranded and the whole world is going to change. I think we're going to use every drop of the hydrocarbon sooner or later. We'll use them as chemical feed stocks. I regard all these things as very hard to predict and I'm not at all sure of it. I would eventually expect natural gas to be pretty short in supply.

WARREN: A change in storage would make a big difference. We will produce, within a few years, as much electricity in Iowa where virtually there's much electricity in Iowa from wind as our customers use, but the wind only blows about 35% of the time or something like that and sometimes it blows too hard. But the storage, I'm having it 24 hours a day, 7 days a week is a real problem even if we got the capability of producing, like I say, a self-sufficient amount, essentially, in Iowa before very long.

Our shipments of coal are up fairly substantially this year on the BNSF, but they were very low last year and as you said, stockpiles grew and have come down somewhat; they're still on the high side. But, in my mind, Charlie has got a longer-term outlook on this. In my mind, we're going to be shipping a whole lot less coal 10 or 20 years from now than we are now. I think there's some decent prospects in other long hauls. I mean, it's a pretty cheap way to move bulk commodities long distance—railroads. And I think it's a good business, but the coal aspect of it is going to diminish. Okay, Station 6?

[02:04:06]
MARCUS: Good morning, it's Marcus Burns from Sydney, Australia. My question, Mr. Buffett is: you used to buying capital-light cash-generative businesses, but now buy lower growth capital consumptive businesses. I realize Berkshire generates a lot of cash flow, but would shareholders have been better off if you had continued to invest in capital-light companies?

WARREN: Well, we'd love to find them. I mean, there's no question that buying a high return on assets, very light-capital intensive that's going to grow, beats the hell out of buying something that requires a lot of capital to grow. And this varies from day-to-day, but I believe—and I don't think it's sufficiently appreciated—I believe that, probably, the five largest American companies by market cap—and some days we're in that group and some days we're aren't. Let's assume we're not in that group—on a given day, they have a market value of over $2.5 trillion.

That $2.5 trillion is a big number. I don't know what are the aggregate market cap of the US market is, but that's probably getting up close to 10% of the whole market cap of the United States. If you take those five companies, essentially, you could run them with no equity capital at all, none. That is a very different world than when Andrew Carnegie was building a steel mill and then using their earnings to build another steel mill and getting very rich in the process, or Rockefeller was building refineries and buying tank cars.

Generally speaking, for a very long time is our capitalism, growing and earning large amounts of money required considerable reinvestment of capital and large amounts of equity capital, the railroads being a good example. That world has really changed and I don't think people quite appreciate the difference. You literally don't need any money to run the five companies that are worth collectively more than $2.5 trillion and who have outpaced any number of those names that were familiar. If you looked at the Fortune 500 list, 30 or 40 years ago, you know, whether it was Exxon or General Motors or you name it.

We would love, I mean, there's no question that a business that doesn't take any capital and grows and has, you know, almost infinite returns on required equity capital, is the ideal business. And we own a couple of businesses, a few businesses, that earn extraordinary returns on capital but they don't grow. We still love them, but if they were in fields that would grow, believe me, they would be number one on our list. We are seeing those that we can buy and that we understand well, but you're absolutely right that that's a far, far, far better way of laying our money than what we're able to do when buying capital-intensive businesses. Charlie?

CHARLIE: Yeah, the chemical companies of America, at one time, were wonderful investments. Dow and DuPont sold at 20 sometimes earnings and they kept building more and more complicated plants and hiring more Ph.D. chemists and it looked like they owned the world. Now, most chemical products are sort of commoditized and it's a tough business being a big chemical producer.

In comes all these other people like Apple and Google and they're just on top of the world. I think the question is basically right that the world has changed a lot and that the people who have made the right decisions and getting into these new businesses that are so different from the old ones have done very well.

WARREN: Yeah, Andrew Mellon would be absolutely baffled by looking at the high cap companies now. I mean the idea that you could create hundreds of billions of value, essentially without assets, without tangible assets.

CHARLIE: Fast, fast.

WARREN: Fast, yeah, but that is the world. When Google can sell you something where GEICO was paying $11 bucks or something every time somebody clicked something, that is a lot different than spending years finding the right site and developing iron mines to supply the steel plants and the railroads to haul the iron to where the steel is produced and distribution points and all that sort of thing.

Our world was built and when we first looked at it, our US, our capitalist system, basically, was built on tangible assets and reinvestment and all that sort of thing. And a lot of innovation and invention to go with it, but this is so much better if you happen to be good at it. To essentially be able to build hundreds of billions of market value without really needing any capital, that is a different world than what existed in the past, and I think it's a world that's likely to continue. I don't think the trend in that direction is over by a long shot.

CHARLIE: A lot of the people, who are chasing that sort of thing very hard now, in the venture capital field, are losing a lot of money. It's a wonderful field but not everybody is going to win big in it. A few are going to win big in it.

WARREN: Okay, Carol?

[02:10:15]
CAROL LOOMIS: This question is from a shareholder in California, in the Silicon Valley area, who didn't want his name mentioned because he said he wasn't looking for publicity, but whose picture makes him appear to be a millennial.

Every Berkshire shareholder knows about the stock market value of Berkshire, but my question is about the value of Berkshire to the world. For instance, the value of Apple to the world has been iPhones. The value of GEICO is cost-effective auto insurance. The value of 3G—and I will tell you that there are some shareholders who would be arguing that here—but the value of 3G is improved operations.

But about Berkshire, I just don't know. In managing Berkshire's subsidiaries, as Mr. Munger once famously said, you practice delegation just short of abdication, so hands-on management can't be the answer. That means the majority of Berkshire's subsidiaries would do just as well if they were to stay independent companies. So that's my question, "What is the value of Berkshire to the world?"

WARREN: Well I would say the question about, I'm with him to the point where he says, which he accurately describes as delegation to the point of abdication. But I would argue that that abdication, actually, in many cases, will enable those businesses to be run better than they would if they were part of the S&P 500 and the target, perhaps, of activists or somebody who wants to get some kind of a jiggle in the short-term.

So, I think that our abdication, actually, has some very positive value on the companies. But that you have to look at it, my company, that we've got probably 50 managers in attendance here and, naturally, they're not going to say anything, probably on television or anything, where they're not concerning. But if you get them off in a private corner and just ask them whether they think their business can be run better with a management by abdication from Berkshire. But also with all the capital strengths of Berkshire where any project that makes sense can be funded in the moment without worrying whether the banks are still lending like in 2008, or whether Wall Street will applaud or something of that sort.

So, I think, our hands-off style actually, I think, can add significant value in many companies. But we do have managers here that you could ask about that. We certainly don't add to value by calling them up and saying that we've developed a better system, you know, or running GEICO better than Tony Nicely can run it or anything of the sort. We have very objective view about capital allocation. We can free managers up.

I would say that we might very well free up, at least 20% of the time, of a CEO in the normal public, who would otherwise have a public company, just in terms of meeting with analysts and the calls and dealing with banks and all kinds of things that essentially. We relieve them up, so that they can spend all of their time figuring out the best way to run their business. So I think we bring something to the party—a benefit— even if we're just sitting there with our feet up on the desk. Charlie?

CHARLIE: Yeah, we're trying to be a good example for the world. I don't think we'd be having these big shareholder meetings if there wasn't a little bit of teaching ethos at Berkshire and I have watched it closely for a long time. I'd argue that that's what we're trying to do is set a proper example. Stay sane. Be honest, yeah. So, I'm proud of Berkshire and I don't worry too much if we sell Coca-Cola.

WARREN: I would say GEICO is an extraordinary well-run company and it wouldn't be extraordinary well-run if it weren't public. But it has gone from two and a fraction percent of the auto insurance market to 12% and part of the reason—a small part—the real key is GEICO and Tony Nicely. But part of the reason is that when other—at least two of our competitors—big competitors said that they would not meet their profit objectives if they didn't lighten up their interest in new business 8 or 10 months ago.

I think our business decision to step on the gas is a better business decision. But I think that GEICO, as a public company, would have more trouble making that decision than they do when they're part of GEICO. Because we are thinking about nothing but where GEICO is going to be in 5 or 10 years. And if that requires, I mean, we want new business costs to capitalize earnings, in the short-term, and other people have different pressures.

I'm not arguing on how they behave because they have a different constituency than GEICO has with Berkshire and what Berkshire has with its shareholders in turn. I think, in that case, our system is superior, but it's not because we work harder. Charlie and I don't do hardly anything. Jonathan?

[02:16:32]
JONATHAN BRANDT: Could you please talk about your periodic payment annuity business? The average interest rate on these contracts is 4.1%, which doesn't sound particularly attractive given the current interest rate environment. Is the duration of these liabilities long enough to make that an attractive cost to funds or were these contracts executed primarily when rates were higher?

WARREN: Well, those contracts, these are what are called structured settlements, primarily. When somebody young has a terrible auto accident or whatever it may be— perhaps urged by the court, urged by family members (who really do have the interest of the injured party at heart)—they may convert what could be a large sum settlement, probably against the insurance company, you know, maybe a million dollars, maybe $2 million, into periodic payments for the rest of the life of the injured party. And we issue those for other insurance companies and banks.

Sometimes the court directs that Berkshire should be the one to issue those because you're talking with somebody's life 30 or 40 or 50 years from now and the court or the lawyer or the family may want to be very, very sure that whoever makes that promise is going to be around to keep it. And Berkshire has a preferred position in that.

We look—to get to your question, Johnny—we look for taking the longer maturity situations. We always have. And we have to make assumptions about mortality and then we have to decide what interest rate will do it. The 4.1% is a mix of a lot of contracts over a lot of years, obviously. We write maybe $30 million of this, $20 to $30 million a week, looking for the long maturities.

And so, if you take an average of 15 years or something of sort, that's how we come up with that sort of a figure. We adjust them to interest rates at all times. And when doing that, we're making assumptions that we're going to earn more money than is inherent in the cost of these structured settlements. It's a business we've, I think, we got 6 or 7 billion up now, and we'll keep doing them. And incidentally, probably a significant percentage of the 6 or 7 billion we're not yet paying anything on somebody else may have the earlier payments. They're certainly weighted far out.

So, it's a business that we'll be in 10 or 20 years from now. We've got some natural advantage because people trust us more than any other company to make those payments. And it could test us whether we earn over time a return above that which we're paying to the injured party, and that's a bet we're willing to make. But if interest rates continued at present levels for a long time, we would—assuming we kept the money in fixed-income instruments—we would have some loss in it. We've got an allowance in there, for instance, for the expenses, incidentally, because we do make monthly payments to these people, eventually.

And we have to keep track of whether they're still alive or not because you cannot count on the relatives of somebody that's deceased. When a check is coming in every month, to notify you properly that the person has become deceased. But that number will go up over time. If interest rates stay where they are, that 4.1% will come down a little bit as we add new business. Okay, Station 7.

[02:20:47]
HARRY HONG: Thank you Mr. Buffett and Mr. Munger for all you've done and the opportunity to learn even more from your approach to investing in life. My name is Harry Hong and I'm a respirologist from Vancouver, British Columbia.

The question involves back in 2001, you made an initial investment in USG shortly before the company declared bankruptcy due to their mounting asbestos liability. You held those shares through the bankruptcy process even though standard wisdom says that the equity in Chapter 11 is usually worthless. Can you explain why you felt USG's equity was a safe investment?

WARREN: Well I don't really remember all the details then.

CHARLIE: It was very cheap, very cheap.

WARREN: Yeah, but I would say this. USG, we own I'm not sure what percentage, but it's a very significant percentage on them.

CHARLIE: 20% or something.

WARREN: Probably 30% or something like that, but USG, overall, has just been disappointing because the gypsum business has been disappointing. I think, I may be wrong, I think they went bankrupt twice, personally. Asbestos, going back and then, subsequently, because they just had too much debt. So it has not been a brilliant investment. Now, if gypsum prices were at levels that they were in some years in the past, it would have worked out a lot better.

CHARLIE: But it hasn't been terrible.

WARREN: No, it hasn't been terrible but if gypsum took—it's taken a real dive several times and there has been too much gypsum capacity. And then when it comes back the management has been—not necessarily at USG, but including USG, perhaps—they got more optimistic about future demand than they should have and they're, going back historically, where they like to build new plants and it's a business where the potential supply have been significantly greater than demand in a lot of years.

I mean, you've seen housing starts since 2008 and 2009 not come back anywhere near as much as people anticipated. So gypsum prices have moved up, but not dramatically, so just put that one down as not one of our great ideas. It's not one of my great ideas. Charlie wasn't involved in that. It's no disaster though.

CHARLIE: No, it isn't.

WARREN: Becky?

[02:23:35]
BECKY QUICK: This question comes from Axel ___ in Germany who writes, "If Ajit Jain were to retire or, god forbid, be promoted, what would the impact be on the insurance operations, both with regards to underwriting profit, as well as the development of float?

WARREN: Well nobody could possibly replace Ajit. I mean, you can't come close. But we have a terrific operation in insurance—we really do—outside of Ajit. And it's terrific squared with Ajit; there are things only he can do. But there are a lot of things that are institutionalized, a lot of things in our insurance business, where we've got extraordinary abled management, too.

So Ajit, for example, bought a company that nobody here has heard of, probably, called Guard Insurance a few years ago. They're a Workers' Comp primarily. It's based in Wilkes-Barre, Pennsylvania, and it's expanding like crazy in Wilkes-Barre and it's been a gem. Ajit oversees it, but we've got a terrific person running it.

We bought Medical Protective some years ago. Tim Kenesey runs that. Ajit oversees it, but Tim Kenesey can run a terrific insurance company with or without Ajit, but he's smart enough to realize that if he's got somebody like Ajit willing to oversee it to a degree, that's great, but Tim is a great insurance manager all by himself and Medical Protective has been a wonderful business for us. Most people don't know we own it. The company goes back into the 19th century, actually.

We've got a lot of good operations. If you look at that section in the Annual Report called Other Insurance Company, and that is, in aggregate, that is a wonderful insurance company and there's very few like it.

GEICO is a terrific company, so Ajit has made more money for Berkshire than I have, probably, but we still got what I would consider the world's best property casualty insurance operation, even without them and with them, you know, nobody—I don't think anybody comes close. Charlie?

CHARLIE: Well, a few years ago California made a little change in its Workers' Compensation Law and Ajit saw instantly that it would cause the underwriting results to change drastically. And he went from a tiny percent of the market, bought 10% of the market—which is big—and he just grabbed a couple of billion dollars (at least) out of the air, like he was snapping his fingers. And when it got tough he pulled back. We don't have a lot of people like Ajit. It's hard to just snap your fingers and grab a couple of billion dollars out of the air.

WARREN: Actually, the California Workers' Comp, though, Guard has moved into that. We have got a lot of terrific insurance managers. I mean, I don't know of a better collection any place, and Ajit has found some of those. I've gotten lucky a few times. I mean Tom Nerney, at US Liability. That goes back 15 to 16 years. It is a terrific operation and huge, but it's so well-managed, and people don't even know we own these things. But you look at that last line and now we've added Peter Eastwood with Berkshire Hathaway, especially. And these are really good businesses, I got to tell you.

When you can produce underwriting profits and on top of that just hand more float, we don't have many businesses like that. Those are great businesses. We got $100 billion plus of money that we get to earn on while at the same time, overall, on balance we're likely to make some additional money for holding them. If you can get somebody to hand you $104 billion and pay you to hold it while you get to invest it and get the proceeds, it's a good business.

Now, most people don't do well at it and the problem is that what I just described tempts lots of people to get into it. And recently people have gotten into it really just for the investment management. It's a way to earn money offshore and we don't do that, but it can be done for smaller companies with investment managers. So there's a lot of competition there, but we have some fundamental advantages in certain areas. Plus we have absolutely terrific managers to maximize those and we're going to make the most of it.

I've just been handed something Kraft Heinz came out with. They just came out with a commercial a few days ago, maybe a few weeks ago, at the Directors meeting they had this. I had three of these. I'm sure that there's members of the audience who may not approve of it, but I've got to tell you folks, it's good.

It's a cheesecake arrangement with topping and fill it up with cream cheese, so you can create your own cheesecake and I thought that I can eat it while Charlie is talking and you'll be able to get it at the halftime. It's selling very well and I think, just so you don't feel too guilty, it's 170 calories for this. Surely, when like I said, I had three of these, I don't mind having 500 to 600 calories for dessert. I'll let somebody else eat the broccoli and I'll have the desert.

So, we'll be eating this, but you too at half-time. I think they brought 8 or 9 thousand of these. I'll be disappointed if we don't run out. Actually, I'll be disappointed in you and not them. Okay, Jay?

[02:30:40]
JAY GELB: This question is on the topic of succession planning. Warren, there seems to be fewer mentions by name of top-performing Berkshire managers in this year's annual letter. Does this mean you're changing your message regarding the succession plan for Berkshire's next CEO?

WARREN: Well, the answer to that is no and I didn't realize there were fewer mentions by name. I write that thing out and send it to Carol and she tells me to go back to work. I don't actually think that much about how many personally get named. I would say this, and this is absolutely true: we have never had more good managers because we've got more good companies. But we have never had more good managers than we have now, but it has nothing to do with succession. Charlie?

CHARLIE: Well, I certainly agree with that. We don't seem to have a whole lot of 20-year-olds.

WARREN: Certainly not at the front table.

CHARLIE: No.

WARREN: We've got an extraordinary group of good managers, which is why we can manage by abdication. It wouldn't work if we had a whole bunch of people who had come with the idea of getting my job. I mean, if we had 50 people out there, all who wanted to be running Berkshire Hathaway, it would not work very well but they have the jobs they want in life.

Tony Nicely loves running GEICO. They have jobs they love and that's a lot better, in my view, than having a whole bunch of them out there that are kind of doing their job, they're kind of hoping that the guy who's competing with them will fail so that when I'm not around, they'll get the nod. It's a much different system that exists at most large American corporations. Charlie, you got anything to add?

CHARLIE: No.

WARREN: Well, we'll go to Station 8.

VICKY WEI: Hi Warren and Charlie. My name is Vicky Wei, I'm a MBA student from the Wharton School of Business. This is my first time to be in a meeting and I'm really excited about it. Thanks for having us here.

WARREN: Thanks for coming.

VICKY WEI: My question is where do you want to go fishing for the next 3 to 5 years? Which sectors are you most bullish on and which sectors are you most bearish on? Thank you.

WARREN: Yeah, Charlie and I do not really discuss sectors much nor do we let the macro environment or thoughts about it enter into our decision. We're really opportunistic and we, obviously, are looking at all kinds of businesses all the time. It's a hobby with us almost, probably more with me than Charlie. But we're hoping we get a call and we've got a bunch of fliers and I would say this for both of us, we probably know within the first 5 minutes or less whether something is likely to or has a reasonable chance of happening.

It's just about going through there and the first question is, can we really ever know enough about this and come to a decision. That knocks out a whole bunch of things and there's a few. And then, if it makes it through there, there's a pretty good or reasonable chance we may do something, but it's not sector-specific. We do love the companies, obviously, with the moats around the product where consumer behavior can be, perhaps, predicted further out. But I would say it's getting harder for us, anyway, to anticipate consumer behavior than we might have thought 20 or 30 years ago.

I think that it's just a tougher game now but we'll measure it and look at it in terms of returns on present capital, returns on prospective capital. A lot of people give you some signals as to what kind of people they are even in talking in the first 5 minutes and whether you're likely to actually have a satisfactory arrangement with them over time, so a lot of things go on fast, but we know the kind of sectors we kind of like or the type of business we kind of like to end up in, but we don't really say we're going to go after companies in this field or that field or another field. Charlie, do you want to?

CHARLIE: Yeah, some of our subsidiaries do a little bolt on acquisitions that make sense and that's going on all the time. Of course we like it, but I would say the general feel of buying whole companies, it's gotten very competitive. There's a huge industry of doing these leverage buyouts—that's what I still call them.

The people who do them think that's kind of a bad marker, so they say they do private equity. It's like making a janitor call himself the chief of engineering or something. But at any rate, the people who do the leverage buyouts, they can finance practically anything in about a week or so through shadow banking and they can pay very high prices and get very good terms and so on. So it's very, very hard to buy businesses. And we've done well because there's a certain small group of people that don't want to sell to private equity and they love the business so much they don't want it just dressed up for resale.

WARREN: We had a guy some years ago who came to see me and he was 61 at the time, and he said: "Look, I've got to buy a business. I've got all the money I can possibly need, but there's only one thing that worries me when I drive to work." Actually, there's more than one guy who has told me that. They used the same term. There's only one thing that bothers him when he go to work, you know, "If something happens to me today and my wife is left, you know, I've seen these cases where executives in the company try to buy them out cheap or they sell to a competitor or other people." He says, "I don't want to leave her with a business. I want to decide where it goes but I want to keep running it and I love it."

And he said, "I thought about selling it to a competitor, but if I sell it to a competitor, their CFO is going to become the CFO of the new company and then, I'm down the line and all these people who helped me build the business, a lot of them are going to get dumped and I'll walk away with a ton of money and some of them will lose their jobs."

He said, "I don't want to do that." Then he said, "I can sell it to a leverage buyout firm, who would prefer to call themselves private equity, but they're going to leverage it to the hilt and they're going to resell it. They're going to dress it up some, but in the end, it's not going to be in the same place. I don't know where it's going to go." I said, "I don't want to do that."

So, he said, "It isn't because you're so special." He said, "There just isn't anyone else." If you're ever proposing to a potential spouse don't use that line. But that's what he told me and I took it well and we made a deal.

So, logically, unless somebody has that attitude, we should loosen this market. I mean, you can borrow so much money, so cheap, and we're looking at the money as pretty much all equity capital and we're not competitive with somebody that's going to have a very significant portion of the purchase price carrying the debt and maybe averaging 4% or something.

CHARLIE: And he won't take the losses, so it goes down he gets part of the profit if it goes up.

WARREN: Yeah, his calculus is just so different than ours and he's got the money to make the deal. So, if all you care about is getting the highest price for your business, you know, we are not a good call. And we will get some calls, in any event, and we can offer something that. I wouldn't call it unique, but it's unusual.

The person that sold us that business and a couple of others, actually, it's almost word for word, the same thing they say. They are all happy with the sale they make, very happy. And they have lots and lots and lots of money and they're doing what they love doing, which is still running the business. And they know that they made the decision that will leave their family and the people who worked with them all their lives, in the best possible position. And that's—in their equation—they have done what's best.

But that is not the equation of many people and it certainly isn't the equation of somebody who buys and borrows every dime they can with the idea of reselling it after they maybe dress up the accounting and do some other things. But when the disparity gets so wide between what a heavily debt-financed purchase will bring as against an equity-type purchase, it gets to be tougher. There's just no question about it, and it will stay that way.

CHARLIE: But it's been tough for a long time and we've bought some good businesses.

WARREN: Yeah. Okay, Andrew?

[02:40:51]
ANDREW ROSS SORKIN: Warren, this comes from Sheryl, who I think is here, who asked to remain anonymous, writes, "Three years ago, you were asked at the meeting about how you thought we should compensate your successor? You said it was a good question and you would address it in the next annual letter. We've been patiently waiting. Can you tell us now, at least philosophically, how you've been thinking about the way the company should compensate your successor, so we don't have to worry when the paid consultants arrive on the scene?"

WARREN: Well, unfortunately, at my age I don't have to worry about things I said three years ago, but this guy is obviously much younger and remembers. I'm not, well, I'll accept his word that I said that.

There's a couple of possibilities, actually, and I don't want to get into details on them but you may have and I actually would hope that we would have somebody: A) that is already very rich. Which they should be, and have been working a long time and have got that kind ability. That's very rich and, really, is not motivated by whether they have ten times as much money than they (and their families) can need, or a hundred times as much. And they might even wish to perhaps set an example by engaging for something far lower than, actually, what you can say their true market value is.

That could or could not happen, but I think it would be terrific if it did, but I can't blame anybody for wanting their market value. And then, if they didn't elect to go in that direction, I would say that you would probably pay them a very modest amount and then have an option, which increased in value or increased in strike price annually. Nobody does this, hardly. Graham Holdings has done it. The Washington Post Company did it a little bit, but it would increase because—and assuming that there was substantial retained earnings every year—because why should somebody retain a bunch of earnings and then claim they've actually improved the value simply because they withheld the money from shareholders.

So it's very easy to design that and in private companies people do design it that way. They just don't want to do it in public companies where they get more money the other way. But they might have a very substantial one that could be exercised about whether shares had to be held for a couple of years after retirement so that they really got the result over time that the majority of the stockholders would be able to get in. And not be able to pick their spots as to when they exercised and sold a lot of stock.

It's not hard to design and it really depends who you're dealing with in terms of actually how much they care about money and having money beyond what they can possibly use. And most people do have an interest in that and I don't blame them. What do you think, Charlie?

CHARLIE: Well one thing I think, that I've avoided all my life, is compensation consultants. I hardly can find the words to express my contempt.

WARREN: I will say this, if the board hires a compensation consultant after I go, I will come back.

CHARLIE: Mad, mad. So I think there's a lot of mumbo jumbo in this field and I don't see it going away.

WARREN: Oh it isn't going to go away, now. It's going to get worse and I mean, if you look at the way compensation gets handled, everybody looks at everybody else's proxy statements and says we can't possibly hire a guy that hasn't been…

CHARLIE: It's ridiculous.

WARREN: And so on. And the Human Relations Department, you know, who works for the CEO, comes in and suggests a consultant. What consultant is ever going to get another assignment that says you should pay your CEO below down in the fourth quarter, because you're going to get a fourth quarter result?

It isn't that the people are evil or anything; it's just the nature of the situation. It produces the result that is not consistent with how representatives of the owner should behave.

CHARLIE: It's even worse than that. Capitalism is the golden goose that we all live on and if people, generally, have contempt for it because they don't like the pay arrangements and the system, your capitalism may not last as well. And that's like killing the golden goose. So I think the existing system has a lot wrong with it.

WARREN: I think there is something coming in pretty soon. I may be wrong about this, where companies are going to have to put in their proxy statement the CEO is paid at the average pay or something like that. That isn't going to change anything, I mean…

CHARLIE: It won't change a thing.

WARREN: It won't change a thing and, you know, it will cost us at Berkshire.

CHARLIE: By the way, it won't get any headlines either. It will be tucked away.

WARREN: It will cost us a lot of money with 367,000 people employed around the world. And I mean, we'll hope to get something that makes it somewhat simpler so we can use estimates or something of the sort. But to get the median income or mid income or whatever the power of the rules may read, you know.

CHARLIE: That's what consultants are for, Warren.

WARREN: It is human nature that produces this. I write in this letter to the managers every two years, I say, "The only excuse I won't take on something is that everybody else is doing it." But of course, "everybody else is doing it" is exactly the rationale for why people did not want to count the cost of stock options as a cost.

I mean, it was ridiculous. All these CEOs went to Washington and they got the Senate, I think, to vote 88 to 9, to say the stock options aren't a cost. And then, a few years later it became so obvious that they finally put it in, so it was a cost. It reminded me of Galileo or something. I mean, all this guy...

CHARLIE: Worse, it was way worse. The Pope behaved better to Galileo than they. He was...

WARREN: Anyway, I would hope, you know, like I say, somebody—and I'm not talking about the current successor or anybody else—I mean, these successors down the line have probably gotten very, very wealthy by the time they're running Berkshire.

The incremental value of wealth gets very close to zero at some point and there is a chance to use it as a different sort of model. But I don't have any problem if a system is devised that recognizes retained earnings. I've never heard anybody talk about it at the 20 Boards I've been on. If you and I were partners in a business and we kept retaining earnings in the business and I kept having to add the value to buy a portion of you out at a constant price, you'd say this is idiocy. But of course, that's the way that all the option systems are designed. And it's better for the CEO and for the consultants. And of course, usually if there's some correlation between what CEOs are paid and what boards are paid. If CEOs were getting paid at the rate that they got paid 50 years ago, adapted to present dollars, director pay would be lower. So, it's got all these built-in things that, to some extent, sort of kindle the...

CHARLIE: No Berkshire director is in it for the money.

WARREN: Well, they are; they own a lot of stock and they bought it on the market.

CHARLIE: Yeah, it's a very old-fashioned system.

WARREN: I looked at one company the other day and seven of the directors had never bought a share of stock with their own money. They've been given stock but not one, well, I can't say not one, but seven of the directors had never actually bought a share of stock. And there they are, you know, making decisions on who should be CEO and how they should be paid and all that sort of thing. But they never felt like shelling out a dollar themselves; they've been given a lot of stock.

You know, we're dealing with human nature here, folks. What you want is to have a system that works well, in spite of how human nature is going to drive it. And we've done awfully well in this country in that respect. I mean American businesses, overall, has done very well for Americans, generally, but not every aspect of it is exactly what you want to teach your kids. Okay, Gregg?

[02:50:28]
GREGG WARREN: Warren, between 2010 and 2015, intermodal rail traffic enjoyed double digit rates of revenue growth as shorter haul freight converted from truck to rail. During the past year or so

though, cheaper diesel prices and more readily available truckload capacity had made trucking more competitive leading to a decline in the intermodal rail traffic.

While car load growth is expected to be solid longer term, helping to offset weakness in other segments, like coal, what impact do you expect the widening of the Panama Canal—which was completed last year—to have on the West Coast port shipments that BNSF has traditionally carried through to exchange points for the Eastern US Railroads as shippers elect to have goods unloaded at ports in the Gulf of Mexico or up the Eastern seaboard?

While lots of volumes is never a good thing, could there be a small trade off here as the bottleneck in Chicago, where most of these West cargo is handed off, eases a bit over time as some of the current traffic gets rerouted?

WARREN: Well, Chicago has got lots of problems and it's going to continue for a while. I mean, that requires a big solution. When you think of how the railroads developed, Chicago was the center. And they laid the rails and there were a whole bunch of different railroads, you know, a hundred years ago, and the city grows up around them and everything. So Chicago can be a huge problem.

But getting to intermodal. I think intermodal could do very well, but you are correct that car loadings actually hit a peak in 2006. So here we are 11 years later and the investment of the five big Class 1 railroads—four of the biggest, if you look at their investment, beyond appreciation—it's tens and tens of billions of dollars and we're carrying less freight than the four in aggregate—than we were in 2006. And coal continued to increase.

It's a good business that has big advantages over truck in many respects. Truck gets much more of a free ride, in terms of the fact that their right of way—which is the highway system—is subsidized to a much greater degree beyond the gas tax than the railroad industry. But it has not been a growth business in physical volume to any great degree. I think it's unlikely to be.

I think it's likely to be a good business. I think we've got a great territory. I like the West better than the East and, as you mentioned, there will be some intermodal traffic that gets diverted to Eastern ports, perhaps. Overall, we got terrific system in that respect and we will do well. It would be more fun if we had something where you could expect aggregate car loadings to increase 2% or 3% or 4% a year but I don't think that's going to happen. I do think our fundamental position is terrific, however. I think we earn decent returns on capital, but I think that's the limit of it. Charlie?

CHARLIE: Nothing to add.

WARREN: Okay, Station 9?

[02:54:02]
AUDIENCE: I'm from Gurnee, Illinois. Thank you for doing everything you do for us. I have a question. The two of you have largely awarded capital allocation stakes by bouncing ideas off of one another. Will this continue long into Berkshire's future? And I'm interested both at the headquarters and at subsidiaries.

CHARLIE: It can't continue very long.

WARREN: Don't get defeatist, Charlie. Any successor that's put in at Berkshire, capital allocation abilities and proven capital allocation abilities are certain to be uppermost in the Board's minds. Or in the current case, in terms of my recommendation and Charlie's recommendation, for what happens after we're not around.

Capital allocation is incredibly important at Berkshire. Right now we have $280 or $290 billion whatever of shareholder's equity. If you take the next decade alone—nobody can make accurate predictions on this—in the next 10 years, if you just take, and appreciation right now is another $7 billion a year, something on that order. The next manager in the decade is going to have to allocate maybe $400 billion or something like that—maybe more—and it's more than what has already been put in.

So, 10 years from now, Berkshire will be an aggregation of businesses where more money has been put in in that decade than everything that took place ahead of time. So you need a very sensible capital allocator in the job of being CEO of Berkshire and we will have one. It would be a terrible mistake to have someone in this job where really capital allocation might even be their main talent. It probably should be very close to their main talent and of course, we have an advantage at Berkshire in that we do know how important that is and there is that focus on it.

And in a great many companies, people get to the top through ability and sales. Sometimes they come from the legal side, I mean, all different sides. And they then have the capital allocation, sort of in their hands. Now, they may not establish strategic thinking divisions or they may listen to investment bankers and everything, but they better be able to do it themselves.

If they come from a different background or haven't done it, it's a little bit...as I put in one of my letters, I think, it's like getting to Carnegie Hall playing the violin and then you walk out on the stage and they hand you a piano. It is something that Berkshire would not do well if somebody was put in who had a lot of skills in other areas but really did not have an ability of capital allocation. I've talked about it as being something I call a "money mind."

People can have 120 IQ or 140 IQ or whatever it may be. Very similar scoring abilities in terms of intelligence tests, and some of them may have minds that are good at one type of thing and some of them in another. I've known very bright people that do not have money minds and they can make very unintelligent decisions. They can do all kinds of other things that most mortals can't do, but it just isn't the way their wiring works. And I've dealt with other people that really would not do that brilliantly. They do fine but on an SAT test or something like that, but they've never made a dumb money decision in their life. And Charlie, I'm sure, has seen the same thing.

So, we do want somebody and hopefully they've got a lot of talent. But we certainly do not want somebody if they lack a money mind. Charlie?

CHARLIE: Well, there's also the option of buying in stock, so it isn't like it's some hopeless problem. One way or another, something intelligent will be done.

WARREN: And a money mind will recognize when it makes sense to buy in stock and doesn't. And in fact, it's a pretty good test for some people, in terms of managements on how they think about something like buying in stock. It's not a very complicated equation if you sort of think straight about that sort of a subject, but some people think that way and some don't and they'll probably be miles better at something else. But they say some very silly things when you get to something that seems so clear, as whether, let's say buying in stock makes sense. Anything further, Charlie?

CHARLIE: No.

WARREN: Okay, Carol?

[02:59:40]
CAROL LOOMIS: This question comes from Steve from Connecticut. Warren, you've made it very clear in your annual letter that you think the Hedge Fund Compensation scheme of 2 and 20 generally does not work well for the fund's investors. And in the past you have questioned whether investors should pay "financial helpers" as much as they can. But financial helpers can create tremendous value for those they help.

Take Charlie Munger for instance. In nearly every annual letter—and on the movie this morning—you described how valuable Charlie's advice and counsel has been to you, and in turn, to the incredible rise in Berkshire's value over time. Given that, would you be willing to pay the industry standard "financial helper fee" of 1% on assets to Charlie or would you perhaps even consider 2 and 20 for him? What is your judgment about this matter?

WARREN: Yeah, well I've said in the Annual Report that I've known maybe a dozen people in my life—and I said there are undoubtedly hundreds or maybe thousands out there—but I've said that I've known, personally, a dozen where I would have predicted or did predict in a fair number of those 12 cases, I did predict that the person involved would do better than average in investing over a long period of time. Obviously, Charlie is one of those people. So would I pay him? Sure. But would I take financial advisers as a group and pay them 1% with the idea that they would deliver results to me that were better than the S&P 500 by 1% and thereby leave me breaking even against what I could have done on my own?

There's very few, so it's just not a good question to ask, whether I'd pay Charlie 1%. That's like asking whether I'd pay Babe Ruth, you know, $100,000 or whatever it was, to come over from the Red Sox to the Yankees. I mean, sure I would have. But there weren't very many people I would have paid $100,000 to in 1919 or whenever it was, to come over to the Yankees. It's a fascinating situation because the problem isn't that the advisers are going to do terrible. It's just that you have an option available that doesn't cost you anything that is going to do better than they are in aggregate.

It's an interesting question. I mean, if you hire an obstetrician—assuming you need one—they're going to do a better job of delivering the baby than if the spouse comes in to do it or if they just pick somebody up off the street. And if you go to a dentist, if you hire a plumber, and all the professions, there is value added by the professionals, as a group, compared to doing it yourself or just randomly picking a layman.

In the investment world it isn't true. I mean, the active group, the people that are professionals, in aggregate, are not, cannot, do better than the aggregate of the people who just sit tight. And if you say, "Well, in the active group, there's some person that's terrific," I will agree with you. But the passive people can't all pick that person and they don't know how to identify them.

CHARLIE: It's even worse than that. The expert who's really good, when he gets more and more money and he suffers just terrible performance problems, so you'll find the person who has a long career at 2 and 20. And if you analyze it, then all the people that have lost money because some of the early people have had a good record but more money coming in later and they lose it. The investing world is just a morass of wrong incentives, crazy reporting, and I'd say a fair amount of delusion.

WARREN: Yeah, if you ask me whether those 12 people I picked would do better than the S&P working with $100 billion, I would answer that probably none of them would. I mean, that would not be their perspective performance but when I was talking of them or referencing them and when they actually worked and practiced, they dealt generally with pretty moderate sums.

As the sums grew, their relative advantage diminished. I mean, it's so obvious from history. The example I used in the report, I mean the guy who made the bet with me, and incidentally all kinds of people didn't make the bet with me, because they knew better than to make the bet with me. There were hundreds, at least a couple of hundred underlying hedge funds. These guys were incented to do well. The fund of funds manager was incented to pick the best ones he could pick. The guy who made the bet with me was incented to pick the best fund of funds.

Tons of money and just with those five funds, a lot of money went to pay managers for what was sub-normal performance over a long period of time. It can't be anything but that and it's an interesting profession when you'll have tens of thousands or hundreds of thousands of people who are compensated based on selling something that in aggregate can't be true superior performance. But it will continue and the best sales people will tend to attract the most money and because it's such a big game, people will make huge sums of money—you know, far beyond what they're going to make in Medicine, or you name it. I mean, you know, repairing the country's infrastructure, I think the big money, huge money is in selling people the idea that you can do something magical for them.

If you even have a billion dollar fund and get 2% of it for terrible performance, that's $20 million. In any other field it will just blow your mind, but people get so used to it in the field of investment that it just sort of passes along. And $10 billion, I mean $200 million fees? We've got two guys in the office and they're managing $11 billion. No they're not, sorry they're managing $20 billion between the two of them—$21 billion, maybe—and we pay them $1 million a year, plus the amount by which they beat the S&P. They have to actually do something to get contingent compensation which is much more reasonable than 20%.

But, how many hedge fund managers in the last 40 years have said, "I only want to get paid if I do something for you. Unless I actually deliver something beyond what you can get yourself, I don't want to get paid." It just doesn't happen and it gets back to that line that I've used but when I asked a guy, "How can you, in good conscience, charge 2 and 20?" And he said, "Because I can't get 3 and 30." Anymore Charlie? Or have we used up our…?

CHARLIE: I think you've beaten up on them enough.

WARREN: Yeah, well, Jonathan?

[03:08:05]
JONATHAN BRANDT: Precision Castparts represents the second largest acquisition Berkshire has ever made. There wasn't much qualitative or quantitative information about it in the 2016 Annual. Would you be willing to update us here with how it is doing currently? What excites you about its prospects and what worries you most about it? I'm also curious if there were any meaningful purchase price

adjustments beyond intangible amortization that negatively impacted Precision's earnings in 2016, as was the case with Van Tuyl in 2015? And finally, are there any opportunities, insight for both acquisitions?

WARREN: Yeah, we've actually made acquisitions and we'll make more because we've got an extraordinary manager and we've got a terrific position in the aircraft field, so that will be sensible. That will be the chance for sensible acquisitions and we've already made two, anyway, and we will make more over time.

The amortization of intangibles is the only big purchase price adjustment. That's something over $400 million a year and non-deductible. In my mind, that's $400 million and some of earnings. I do not regard the economic goodwill of Precision Castparts being diminished with that rate annually. I've explained that in some degree.

As a very long-term business, you can worry about 3D printing; I don’t think you have to worry about aircrafts being manufactured. But aircraft deliveries can be substantially altered in relation to any given backlog in most cases, so the deliveries can be fairly volatile. But I don’t think the long-term demand is anything I worry about. The question is whether anybody can do it better or cheaper or, like I said, whether 3D printing, at least, takes away part of the field in some respect. But overall, I would tell you, I feel very good about Precision Castparts.

It is a very long-term business. I mean, we have contracts that run for a very long time. And like I say, the initiation of a new plane may be delayed or something of the sort. But if you take a look at the engine that’s in the other adjoining room here and in our exhibition hall, you would, if you were putting that engine together with a 20 or 25 year life or whatever it may have, carrying hundreds of people, you would care very much about your supplier.

And you’d care not only in the quality—which would be absolutely you’d care, of the work being done —but you also—if you were an engine manufacturer or an aircraft manufacturer further down the line—you would care very much about the reliability of delivery on something which you do not want a plane or an engine that is 99% complete while somebody is dealing with the problem of faulty parts or anything else that would delay delivery. So the reliability is incredibly important and I don’t think anybody has a reputation better than Mark Donegan and the company for delivery. So I love the fact we bought Precision Castparts. Charlie?

CHARLIE: Yeah, well what's interesting about the two is that it’s a very good business for just a fair price. But this is no screaming bargain like the old days. For quality businesses, you pay up now a lot more than we used to.

WARREN: Yes, that’s absolutely true and you don’t get a bargain price. The $400 million plus, incidentally, it goes on for quite a while too. And we'll explain it in the report, just like as we all explained it, the depreciation chart to the railroad would not be adequate. I mean, it’s the way accounting works. I don't even want to tell you about this one, but starting the first of next year, accounting is going to become sort of a nightmare in terms of Berkshire and other companies because they’re going to have us mark our equities to market, just like we were a Wall Street trading firm or something. And those changes in the value of Coca-Cola or American Express or anything are going to run through the income account every quarter. In fact, they run through it every day in this area, so that it really will get confusing. Now, it’s our job to explain things so that you aren’t confused when we report GAAP earnings, but GAAP earnings, as reported will become even more meaningless looking only at the bottom line than they are now.

CHARLIE: That was not necessarily a good idea.

WARREN: No, I think it's a terrible idea, but we'll deal with it. I mean, it's my job to explain to what extent GAAP accounting is useful to you in evaluating Berkshire and the times when it actually distorts things. Accounting isn't supposed to describe value. On the other hand, it's a terribly useful tool if understood, in order to estimate value with your analyzing businesses. So you can't blame the auditing profession for doing what they think is their job, which is not to present value, although by using these market values...

CHARLIE: But you can blame the auditing...

WARREN: What was that?

CHARLIE: You can blame the auditing profession for that one. That was really stupid.

WARREN: Yeah, I agree with that actually. But we will do our best to give you—we're always going to give you—the audit figures and then we're going to explain their shortcomings in either direction and what you should use and what you probably should ignore in looking at those numbers, and using them to come to a judgment as to the value of your holdings. And I'll explain it to you the same way I would explain it to my sisters or anybody else.

We want you to understand what you own and we try to cover the details that are really important in that respect. I mean, there are a million things you can talk about that are just of minor importance when you're talking about a $400 billion market value. But they're the things that if Charlie and I were talking about the company, they'd be the figure or the interpretations or anything that we would regard as important in sort of coming to an estimate of the value of the business.

You can't knock the media, they only got a few paragraphs to describe the earnings of Berkshire every quarter, but if they simply look at bottom line numbers, what can be silly this year will become absolutely ludicrous next year because of the new rule that comes into effect for 2018. Okay, Station 10?

[03:16:11]
JAMES CHEN: Hello Warren, this is a question from China. I'm James Chen, a Pension Fund Manager from China, Shanghai. My question is quite simple. What is the probability for duplicating your great investment track record in China stock market in the next decade or two, in terms of a maximum _? And so, in a sense my friends are from _ Fund Management House for guiding me in raising this question. Thank you.

WARREN: Charlie, you're the expert on China.

CHARLIE: It's like determining the order of presidency between the—allows them fully—I do think that the Chinese stock market is cheaper than the American market and I do think China has a bright future. And I also think that there'll be growing pains, of course. We have this opportunistic way of going through life. We don't have any particular rules about which market we're in or anything like that.

WARREN: Well Charlie's delivered a headline anyway now. Longer prediction, China market will outperform US and I've just been informed it's 12:15 so I apologize if you're hungry for holding over for 15 minutes. So we'll reconvene around 1:15 and I'll see you then. Thanks.

[03:17:51]
END OF FIRST PART

[04:24:21]
START OF AFTERNOON SESSION

WARREN: Okay, we're back for action and we'll go right to Becky.

[04:24:29]
BECKY QUICK: All right, this question comes from Anne Newman. She's says that she's a shareholder of the Class B stock and her question is, "The primary investment strategy of 3G Capital is extreme cost-cutting after the purchase of the company. This typically includes the elimination of thousands of jobs. With the current US President focusing on retention of US jobs, will Berkshire Hathaway still consider future investments in 3G Capital if those investments result in the purchase of US companies and the elimination of more US jobs?"

WARREN: Essentially, 3G management—and I've watched them very close at Kraft Heinz—basically they believe in having a company as productive as possible. And of course, the gains in this world—for the people in this room and people in Omaha and the people throughout America—have come through gains and productivity.

If there had been no change in productivity, we would be living the same life as people lived in 1776. Now, the 3G people do it very fast and they're very good at making a business productive with fewer people than operated before. You know, we've been doing that in every industry, whether it's steel or cars or you name it and that's why we live as well as we do.

We prefer, at Berkshire—I wrote about this a year ago—we prefer to buy companies that are already run efficiently because frankly, we don't enjoy the process at all of getting more productive. I mean, it's not pleasant, but it is what has enabled the country to progress and nobody has figured out a way to double people's consumption per capita without in some way improving productivity per capita.

It's a good question whether it's smart overall if you think you're going to suffer politically because political consequences do hit businesses. So I don't know that I can answer the question categorically, but I can tell you that they not only focus on productivity and do it in a very intelligent way, but they also focus to a terrific degree on product improvement, innovation and all of the other things that you want a management to focus on. And I hope that at the lunch time, if you had the Kraft Heinz cheesecake, you'll agree with me that product improvement and innovation there is just as much a part of the 3G playbook as productivity.

Personally, we have been through the process of buying into a textile business that employed a couple of thousand people and went out of business over a period of time where the source of business was headed for oblivion. And it is just not as much fun to be in a business that cuts jobs rather than one that adds jobs. So, Charlie and I would probably forego personally having Berkshire directly buy businesses where the main benefits would come from increasing productivity by actually having fewer workers. But I think it's prosocial to think in terms of improving productivity and I think the people of 3G do a very good job at that. Charlie?

CHARLIE: Well, I agree, I don't see anything wrong with increasing productivity. On the other hand, there's a lot of counter-productive publicity to doing it. Just because you're right doesn't mean you should always do it.

WARREN: Yeah, I'd agree with that. Jay?

[04:28:36]
JAY GELB: Berkshire's cash and Treasury bill holdings are approaching $100 billion. Warren, a year ago, you said Berkshire might increase its minimum valuation for share buybacks above 1.2 times book value if this occurred. What are your latest thoughts on raising the share with purchase threshold?

WARREN: When the time comes—and it could come reasonably soon—even while I'm around, but we really don't think we can get the money out in a reasonable period of time into things we like. We have to re-examine, then what we do with those funds that we don't think can be deployed well. And at that time, it would make a decision and it might include both. But it could be repurchases, it could be dividends.

There are different inferences that people draw from a dividend policy than from a repurchase policy in terms of expectations that you won't cut a dividend and that sort of thing. So you have to factor that all in. But if we felt that we had cash that was unlikely to be used—excess cash—in a reasonable period of time and we thought repurchases, at a price that was still attractive to continuing shareholders was feasible in a substantial sum—that could make a lot of sense.

At the moment, we're still optimistic enough about deploying the capital that we wouldn't be inclined to move to a price much closer where there's only a narrow spread between an intrinsic value and the repurchase price. But, at a point the burden of proof is definitely on us. I mean, the last thing we like to do is own something that a hundred times earnings where the earnings can't grow. As you point out, we got almost $100 billion. It's $90 billion plus invested in a business—we'll call it a business—where we're paying almost a hundred times earnings and it's kind of a lousy business.

CHARLIE: It's more after every tax earnings.

WARREN: Yeah, so we don't like that and we shouldn't use your money that way for a long period of time. And then, the question is, are we going to be able to deploy it? And I would say that history is on our side, but it would be more fun if the phone would ring instead of just relying on history books. I am sure that sometime in the next 10 years—and it could be next week or it could be nine years from now—there will be markets in which we can do intelligent things on a big scale.

But it would be no fun if that happens to be nine years off—and I don't think it will be—but just based on how humans behave and how governments behave and how the world behaves. But like I say at a point, the burden of proof really shifts to us big time and there's no way I can come back here three years from now and tell you that we hold $150 billion or so in cash or more snd we think we're doing something brilliant by doing it. Charlie?

CHARLIE: Well, I agree with you and the answer is maybe.

WARREN: He does have a tendency to elaborate. Station 11?

[04:32:37]
AUDIENCE: Thank you Mr. Buffett and Mr. Munger. I am Anel Daren from Short Hills, New Jersey and New Delhi, India. This is my 18th time to this wonderful event and profoundly thank you for your extraordinary wisdom, generosity and time. As I am involved with sustainable investments that also do not directly harm animals, I would appreciate your perspective, if any, on the practices of your CTB subsidiary, which is somewhat involved in big poultry and egg production. Somewhat indirectly related as you shared your concern on nuclear war extensively at the last annual meeting. I would love to pick your brain on Albert Schweitzer's Nobel Peace Prize acceptance speech shortly after the first nuclear bombs were detonated, that compassion can attain its full breadth and depth if it is not limited to humans only. Thank you.

WARREN: Well that's a pretty broad question. I would say, on your first point, we have a subsidiary, CTB, run by Vic Mancinelli and I sit down with him once a year and he's a terrific manager. He's one of our very best. You don't hear much about him and they do make the equipment for poultry growers.

I can't answer your question, specifically, but I would be glad to have you get in contact with Vic directly because I know that that question you raised is a major factor in what they do. I mean, they do care about how the equipment is used in terms of poultry and egg production, and as you know, a number of the largest purchasers and the largest producers are also in the same camp. But I can't tell you enough about it directly that I can give you a specific answer, but I can certainly put you in touch with Vic and I think you would find him extremely well-informed and doing some very good things in the area that you're talking about.

In terms of the nuclear weapon question, I'm very pessimistic on weapons of mass destruction, generally; although I don't think that nuclear is quite as likely as either biological, primarily biological and maybe cyber. I don't know that much about cyber, but I do think that's the number one problem of mankind. But I don't think I can say anything particularly constructive on it. Charlie?

CHARLIE: Well, I don't think we mind killing chickens and I do think we're against nuclear war.

WARREN: We are not actually a poultry producer but they use our equipment and that equipment has been changed substantially in the last 10 or 15 years. But, again, I'm just not that good on the specifics that I can give them to you, but I can certainly put you in touch with Vic. Andrew?

[04:36:22]
ANDREW ROSS SORKIN: Warren, since Todd and Ted joined Berkshire, the market cap of the company has doubled and cash on hand is now nearly $100 billion. It doesn't look like Todd and Ted have been allocated new capital on the same relative basis, why?

WARREN: Well, actually, I would say they have been. I think we started out with $2 billion. I could be wrong, but in my memory it was $2 billion with Todd when he came with us. So, there have been substantial additions and, of course, their own capital has grown just because, say in a sense, they retained their own earnings. So, yeah, they are managing a proportion of Berkshire's capital, also measured by marketable securities.

I think they're managing a proportion that's pretty similar, maybe even a little higher than when each one of them entered and Ted entered a year or two after Todd. I think they would agree that it's tougher to run $10 billion than it is to run $1 or $2 billion. I mean, your expectable returns go down as you get into larger sums. But the decision to bring them on has been terrific. They've done a good job of managing marketable securities. They've made more money than I would have made with that same—what is now $20 billion, but originally it was $2 billion—and they've been a terrific help in a variety of ways beyond just money management.

So that decision, that's been a very, very good decision and they're smart. They have money minds. They're good specifically at investment management, but they're absolutely first-class human beings and they really fit Berkshire. Charlie gets credit for Todd. He met Charlie first and I'll claim credit for Ted and I think we both feel very good about the decisions. Charlie?

CHARLIE: Well, I think the shareholders are very lucky to have them because they both think like shareholders. After all, it came up that way and that is not the normal way that employees think. It's a pretense that everybody takes on, but the reality is different and these people really deeply think like shareholders. And they're young and smart and constructive, so we're all very lucky to have them around.

WARREN: Yeah, their mindset is 100% "what can I do for Berkshire", not "what can Berkshire do for me"? And believe me, you can spot that over time with people and on top of that, they're very talented. It's hard to find people young, ambitious, very smart, that don't put themselves first. Every experience we've had, they do not put themselves first, and they put Berkshire first. And believe me I can spot it when people are extreme in one direction or another. Maybe I'm not so good around the middle, but you couldn't have two better people in those positions. But you can say, "Well, why don't you give them another $30 billion each or something?" I don't think that would improve their lives or their performance.

They may be handling more as they go along, but the truth is, I've got more assigned to me than I can handle at the present time as proven by the fact that we got this $90 billion plus around. I think there are reasonable prospects for using it, but if you told me I had to put it to work today, I would not like the prospect. Charlie?

CHARLIE: Well, I certainly agree with that. It's a lot harder now than it was at times in the past.

WARREN: Greg?

[04:40:54]
GREG WARREN: Warren, plans for your ownership stake, which is heavily concentrated in Class A shares, are fairly well-known. With the bulk of the stake going to the Bill and Melinda Gates Foundation and four different charities over time, your annual pledges to these different charities involved the conversion Class A shares which hold significantly greater voting rights than the Class B shares. As such, as the voting control held by your estate will diminish over time with the whole layer of super voting shares being eliminated in the process.

While the voting influence of Class B shareholders are expected to increase over time, it will not be large enough to have a big influence on Berkshire's affairs. With that in mind, in recognizing the greater importance on having Berkshire buy back and retire Class A shares in the long run, I was just wondering if the firm has compiled a pipeline of potential future sellers from the ranks of the company's existing shareholders. Given the limited amount of liquidity for the shares, privately negotiated transactions with these sellers—like the one you negotiated in December 2012—would end up being in the best interest of both parties.

WARREN: Well, again, it would depend on the price of Berkshire. So in terms of what I give away annually, in the last two years it's been about $2.8 billion per year. That's one day's trading in Apple. The amount I'm giving away, in terms of Berkshire's market cap, you're down to 7/10th of 1% of the market cap, so it's not a big market factor and it really wouldn't be that illiquid. So, I know a few big holders that might have 8,000 or 10,000 shares of A, but the market can handle it.

Now, when we bought that block of, I think, it was 12,000 shares of A, we bought it because we thought it increased the intrinsic business value of Berkshire by a significant amount. And we paid this over what the market was at the time. We were open to that up to 120% and who knows if it came along at the time and it was 124% or something. It was a very large block and the directors decided that was okay. So it was a significant discount, we might very well buy it.

But in terms of the orderly flow of the market or anything like that, there will be no problems just as there haven't been, you know, when I've given away—I do it every July—when I've given away the last two years. Some of the foundations may keep it for a while, but they have to spend what I give them and they may build up a position in B for a fairly significant dollar amount, but they're going to sell it. And it is true that for a period after I die, there'll be a lot of votes still in the estate and later in the trust, but that will get reduced over time.

I see no problem with our capitalization over time. I like the idea of a fair number of votes being concentrated with people that believe in the culture strongly and would not be thinking about whether they get a 20% jump in the stock if somebody came along with some particular plan. But eventually, that's going to get diminished and continues to get diminished. I think in terms of, you know, there's a very good market in Berkshire shares and if we can buy them at a discount from intrinsic business value and somebody offers us some, a big piece and it may be selling at 122% or 124%, I would pick up the phone and call the directors and see if they didn't want to make a change.

And we did it once before and if it made sense, I'm sure they'd say yes. And if it didn't make sense, I'm sure they'd say no. So, I don't think we have any problem in terms of blocks of stock right now. I don't think people that own it have a problem selling it and I don't think we have a problem in terms of evaluating the desirability of repurchasing it. Charlie?

CHARLIE: Nothing to add.

WARREN: Okay, Station 1?

[04:45:21]
ERIN: Hello, my name is Erin Bayer and I was born and raised in Pasadena, California and I currently live in New York City. It's been a dream of mine to come here today. I've been a proud BH shareholder for almost 20 years. I asked my dad for stock for Christmas when I was 15, and I kept thinking about if I had the opportunity to ask you a question today, that I should make it one that would change my life. Well, that question is: do you know any eligible bachelors living in the New York City area?

WARREN: Well, you certainly have the approach toward life that Charlie and I would have.

ERIN: The question that might make my Monday back in the office...back in 2011, you purchased Bank of America preferred stock with a warrant. You had the opportunity at a later date to exercise and convert those into common shares. When you're looking at evaluating the decision to exercise the position—which would increase all of our entire Berkshire Holdings or the value of the Berkshire Holdings—what are you going to consider when you're looking at that?

WARREN: Well if the price of the stock is above $7 a share, which seems quite likely, whether we were going to keep it or not, it would still make sense for us to exercise the warrant shortly before it expired because it would be a valuable warrant. But it's only a valuable warrant if it's converted or if it's exercised and exchanged into common, and that warrant does expire.

As I put it in the Annual Report, our income from the investment would increase if Bank of America ever got to where it was paying 11 cents quarterly. We get $300 million a year off the preferred. And for us to use the preferred as payment in the exercise of the warrant, we would want to feel that we were getting more than $300 million a year and that would take 11 cents quarterly. They may or may not get to where they pay that amount before the warrant expires in 2021.

If it does get to there, we'll exercise the warrant and then instead of owning the $5 billion of preferred and the warrant will have 700 plus million shares of common, then that becomes a separate decision. Do we want to keep the 700 million shares of common? If it were to happen today, I would definitely want to keep the stock. Now, who knows what other alternatives may be available in 2021. But, as of today, if our warrant were expiring tomorrow, we would use the preferred to buy 700 million plus shares of common and we would keep the common.

If they get to 11 cents quarterly dividend, we'll convert it and we'll very likely keep the common. And if we get to 2021, if the common's above $7, which I would certainly anticipate, we will exercise. So that's all I can tell you on that, but I certainly wish you success on your other objective and I think probably the fellow will be using very good judgment too. Okay, Charlie?

CHARLIE: Well, I think it's a very wise thing for a woman that owns Berkshire stock—and I think good-looking woman—to put her picture up like that.

WARREN: It does give me a thought though, we might actually start selling ads in the Annual Report.

Okay, that incident, that BofA purchase, it literally was true that I was sitting in the bathtub when I got the idea of checking with BofA whether they'd be interested in that preferred. But I've spent a lot of time in the bathtub since and nothing's come to me, so clearly I either need a new bathtub or we got to get into a different kind of market. Carol?

[04:49:54]
CAROL LOOMIS: This is a question from George Benaroya and it adds a layer to the discussion about 3G a little bit ago. He says, "I am a very happy long-term shareholder, but this is a concern I have regarding Berkshire Hathaway's Kraft Heinz investment. This investment has done well in economic terms. The carrying value is $15 billion and the market value was $28 billion in 2016. But, the DNA of 3G is quite different from ours. We do not make money by buying companies and firing people. 3G fired 2,500 at Kraft Heinz. That is what private equity firms do, but we are not a private equity firm. Our values have worked for us for over 50 years. There is a risk that as 3G continues to deviate from our principles, they will eventually harm both our value and our values. How do we prevent that from happening?"

WARREN: Well, it's interesting. I mentioned earlier that it was very gradual, but it would have been probably a better decision. We fired 2,000 people over time, and some retired and left and all of that. But at the textile operation, you know, it didn't work. And Hochchild-Kohn (the successor) fortunately sold it to somebody else. But eventually they closed up the department stores because department stores—at least that particular one and a good many, actually, including our competitors in Baltimore—could not make it work.

Walmart came along with something and now Amazon's coming along with something, but it changed the way people bought. We mentioned our poultry, the CTB, which is a lot of different farm equipment. The farm equipment often that CTB develops, the idea is that it's more productive than already what is out there, which means fewer people are employed on farms.

We had 80% of the American working population working on farms a couple of hundred years ago. And if nobody had come up with things to make it more productive farming, we'd have 80% of people working on farms now. It means that we'll be living in a far, far more primitive way.

So if you look at the auto industry, it gets more productive. If you look at any industry, they're trying to get more productive. Walmart was more productive than department stores and that will continue in America. And it had better continue or our kids won't live any better than we do. Our kids will live better than we do because America does get more productive as it goes along and people do come up with better ways of doing things.

When Kraft Heinz finds that they can do whatever amount of business, $27 billion worth of business or something and they can do it with fewer people, they are doing what American business has done for a couple of hundred years and why we live so well. But they do it very fast. They're more than fair in terms of severance pay and all of that sort of thing, but they don't want to have two people doing the job that one can do.

I frankly don't like going through that. Having faced that, I faced that down at Dempsters in Beatrice, Nebraska and it really needed change. But the change is painful for a lot of people and I just would rather spend my days not doing that sort of thing having had one or two experiences. But I think that it's absolutely essential to America that we become more productive because that is the only way we have more consumption per capita and have more productivity per capita. Charlie?

CHARLIE: Well, you're absolutely right. We don't want to go back to subsistence farming. I had a week of that when I was young on a Western Nebraska farm and I hated it and I don't miss the elevator operators who used to sit there all day in the elevator round the little crank, you know. So on the other hand, as you say, it's terribly unpleasant for the people that have to go through it and why would we want to get into the business of doing that over and over ourselves. We did it in the past when we had to when the businesses were dying. I don't see any moral fault in 3G at all, but I do see that there is some political reaction that doesn't do anybody any good.

WARREN: Milton Friedman, I think it was, used to talk about the time—probably apocryphal—he would talk about the huge construction project in some communist country and they had thousands and thousands and thousands of workers out there with shovels digging away on this major project. And then they had a few of these big earth moving machines behind which were idle and which could have done the work in one-twentieth of the time of the workers.

So the economists suggested to the local party worker—whoever it was—that why in the world didn't they use these machines to get the job done in one-tenth or one-twentieth of the time instead of having all these workers out there with shovels and the guy replied, "Well, yeah, but that would put the workers out of work," and Friedman said, "Well then why don't you give them spoons to do it instead?" Jonathan?

[04:55:50]
JONATHAN BRANDT: I understand that Berkshire is much more liquid than is ideal right now with $113 billion of consolidated cash and bonds versus policyholder float of $105 billion, but I have trouble calculating how much incremental buying power Berkshire has at any point in time. You've talked about having a minimum of $20 billion in cash on a consolidated basis, but for regulatory risk control or liquidity purposes, is there some minimum amount of float beyond the $20 billion that has to be in cash bonds or say, preferred stocks. Or can all but $20 billion be put into either common stocks or invested into wholly-owned businesses if you found attractive opportunities? What does the balance sheet look like if you were fully invested and where does additional debt fit into the equation, if at all?

WARREN: Yeah I wouldn't conflate the cash and the bonds. I mean, when we talk about $20 billion in cash, we could own no bond beyond that; $20 billion would be the absolute minimum. Since I've said $20 billion is a minimum, I'm not going to operate with $21 billion any more than I'm going to see a highway, a truck sign that says maximum hold, 30,000 pounds or something and then drive 29,800 across of them.

So we won't come that close. But the answer is that we're not inclined to use that. Obviously, if we found something that really lit our fire, we might use something like that, but it is unlikely under today's circumstances. But $20 billion is an absolute minimum. You can say that because I say $20 billion is an absolute minimum, it probably wouldn't be over $24 billion or $25 billion. And we could do a very large deal if we thought it was sufficiently attractive.

I mean, we have not put our foot to the floor on anything for really a very long time. But if we saw something really attractive—we spent $16 billion back when we were much smaller in a period of two or three weeks, probably three weeks maybe, in the fall of 2008, and we never got to a point where it was any problem for me sleeping at night. Now we obviously have a lot more money to put out, so if a good—Charlie, at what point, if I called you would you say, "I think that's a little bit big for us today?"

CHARLIE: I would say about $150 billion.

WARREN: Well, in that case I'll call you. I'm a little more conservative on that, actually, Charlie, but we both would do a very, very big deal.

CHARLIE: We don't have to agree perfectly.

WARREN: Yeah, it'd have to be, but if we find a really big deal that makes compelling sense...

CHARLIE: Now you're talking.

WARREN: We're going to do it. Okay, Station 2?

[04:59:11]

AUDIENCE: Hello Mr. Buffett, Mr. Munger. My name is Philip. I'm 19 years old from Brazil and your partnership with Jorge Paulo Lemann and his associates at 3G has been very successful, taking into account great outcome of transactions such as the Kraft Heinz merger. Even though you and Jorge Paulo have different investment methods, would you and Charlie consider him to be a member of your board or even your successor?

WARREN: I don't think that will happen, but I think it would complicate things in terms of the board membership, but we love the idea of being their partner and I think there's a good chance that we will do more and perhaps even bigger things together. But, we're probably unlikely to be doing much change in the board, certainly, in the next few years. There will be a successor and the successor could very well be while I'm alive. But there's a very high probability that will be from somebody that's been in our company for some time. The world could change in very strange ways, but that is a very, very high probability. Charlie?

CHARLIE: All I can say is that my back hurts when I come to these functions because I want to indicate to my fellow shareholders that they probably got seven more good years to get out of Warren.

WARREN: Charlie is inspiring, I've got to tell you that, but we've been very, very lucky in life and so far our luck seems to be holding. Okay, Becky?

[05:01:10]
BECKY QUICK: This question comes from Drew in Atlanta Georgia and he asks, "Is Fruit of the Loom experiencing difficulties related to the distribution channel shift towards online and the troubles in the brick and mortar retail world? If so, do you believe the difficulties are short-term in nature?" And then, Drew goes on to add, "I'm hoping millennials haven't bucked the underwear trend too."

WARREN: Well he may know more about that than I do. The answer is, essentially, no, so far, but anybody that doesn't think that online isn't changing retail in a big way and that anybody who thinks they're totally insulated from it is incorrect. I mean, the world is changing big time. Like you said, Fruit of the Loom, it really hasn't changed much. And our furniture operation, which is setting a record so far, again this year, for the shareholders weekend.

I mentioned it in the report that I think we did $45 million in one week and our furniture operations, it's hard to see any effect from online. Outside of our own online operations, we had really good same store gains. You can take, you know, where there's a Nebraska Furniture Mart or RC Willey, whether it's in Sacramento or Reno or Boise or Salt Lake City, which in Boston has done very well on the same store basis.

So we don't really see it, but there are many things we didn't see 10 years ago that then materialized. One thing you may find interesting is that the furniture market here in Omaha, which is an extraordinary operation, the online has grown very substantially. And I may be wrong on this, but I think it's getting up to—I'd like to check this, but I think it's getting pretty close to 10% or so of volume.

But, there's a very significant percentage of those people still go and pick the product up at the Furniture Mart. So, apparently, it's the time spent entering the store, maybe the checkout lines or whatever it may be, I'm surprised that it gets to be that percentage. But the one thing about all this is we keep looking at the figures and trying to figure out what they're telling us.

So far, I would not say that it's affected Fruit of the Loom in a significant manner. I would not say it's affected the furniture operation in a significant manner, but I have no illusions that 10 years from now it's going to look anything like today. If you think about it, you know, if you go back a hundred years to the great department stores, what did they offer?

They offered incredible selection. You know, if you had a big department store in Omaha, you had a thousand bridal dresses. And if you lived in a small town around the local valley you had two or something of the sort. So the department store was the big exciting experience of variety and decent prices and convenient transportation because people took the streetcars to get there.

And then along came the shopping center and they took what was vertical before and they made it horizontal and they changed it into multiple ownerships. But they still kept incredible variety and assortments and convenience of going to one place and accessible transportation because now the car was the method.

And then we went through the discount stores and all of that. But now you've got the internet and you've got assortments and you have people that are coming in at low prices and the transportation is taken care of entirely.

So the evolution that has taken place, the department store is online now, basically. Except much expanded in assortment, much more convenient and lower prices. So the world has evolved and it's going to keep evolving, but the speed has increased dramatically. And what'll happen with the brands is they are going to be tested in a variety of ways and they have to make decisions as to whether they try to do it online themselves or work through an Amazon, or whether they try to hang onto the old methods of distribution while embracing new ones.

There are a lot of questions in retail and in branding that are very interesting to watch and you'll get some surprises in the next 10 years, I can promise you that. Charlie?

CHARLIE: It would be certainly unpleasant if we were in the department store business. Just think of what we avoided, Warren.

WARREN: Yeah we got very lucky, actually, because we were in the department store business and our business was so lousy that we recognized it. If it had been a little bit better, we would have hang on and we owe a tremendous gratitude to Sandy Gottesman, our Director, who is here in the front row, because he got us out of the business when Charlie and I and Sandy were partners in that. And something that we paid $6 a share for, I think it's worth about $100,000 a share now because we got out of the business and if it had been a somewhat better business, it might be worth $10 or $12 a share now. So, sometimes you get lucky. We don't miss it either, do we, Charlie?

CHARLIE: No we don't miss it.

WARREN: Jay?

[05:07:12]
JAY GELB: This question is on Berkshire's intrinsic value. A substantial portion of the company's value is driven by operating businesses rather than the performance of the securities portfolio. Also, the values of previously acquired businesses are not marked up to their economic value, including GEICO,

MidAmerican and Burlington Northern. Based on these factors, is book value per share still a relevant metric for value in Berkshire?

WARREN: Well, it's got some relevance but it has a whole lot less relevance than it used to. And that's why I don't want to drop the book value per share factor, but the market value tends to have more significance as the decades roll along. It's a starting point and, clearly, our securities aren't worth more than we're carrying for and carrying them for at that time. And on the other hand, we've got the kind of businesses you've mentioned, but we've some small businesses that are worth ten times or so, you know what would occur, but we also have some clunkers, too.

The best method, of course, is just to calculate intrinsic business value. But it can't be precise. We think the probability is exceptionally high that 120% understates it, although if it was all in securities, 120% would be too high. But as the business has evolved, as we built in unrecognized value at the operating businesses—unrecognized for accounting purposes—I think it still has some uses being kind of the base figure we use.

If it were a private company and 10 of us here owned it, instead we just sit down annually and calculate the businesses one by one and use that as a base value, but that gets pretty subjective when you got as many as we do. So, I think, the easiest thing is to use those standards we're using now AND recognizing the limitations in them. Charlie?

CHARLIE: Yeah I think that equities in the insurance company—offsetting shareholders' equity in the company—are really not worth the full market value because they're locked away in a high tech system. And so I basically like it when our marketable securities go down and our own businesses go up.

WARREN: Yeah, we're working to that end. We've been working that way for 30 years now or something like that.

CHARLIE: We've done a really good job, too.

WARREN: Yeah.

CHARLIE: We have replaced a lot of our marketable securities with unmarketable securities that are worth a lot more.

WARREN: Yeah and it's actually a more enjoyable way to operate, too, beyond that money.

CHARLIE: Yeah, we know a lot of people we wouldn't otherwise be with—good people.

WARREN: Okay, Station 3?

[05:10:36]
MICHAEL MONAHAN: Hello.

WARREN: Hi.

MICHAEL MONAHAN: My name is Michael Monahan and I'm from Long Island, New York. I don't know if this question qualifies as investment advice, so I have a short different question if you don't want to answer this one. Unlike the last shareholder from Zone 3, this will not be some speech nor a protest. One of your most well-known pieces of investment advice is to buy what you know.

Additionally, you said earlier, one of the main criteria for buying is if you could ever understand the business. Ever since I came to my first meeting in 2011 you were not known for being a tech guy. You've said smartphones are too smart for you, you don't have a computer at your desk, and you've only tweeted nine times in the last four years.

WARREN: It was either that or going to a monastery.

MICHAEL MONAHAN: Despite this, you've recently been investing, looking and talking more about tech companies. My question to you and also to Charlie, to comment, is what turned you from the Oracle of Omaha to the Tech Maven of Omaha?

WARREN: Well, I don't think I've talked that much about tech companies, but the truth is we made a large investment in IBM, which has not turned out that well. We haven't lost money, but in terms of the bull market we've been in, it's been a significant laggard. And then, Charlie, recently, we took a large position in Apple, which I do regard as more a consumer goods company in terms of certain economic characteristics. Although it has a huge tech component in terms of what that product can do or what other people might come along to do to leapfrog it in some way. No guarantees, but I think I'll end up being one for two instead of "O" for two. But we'll find out. Charlie?

I make no pretense whatsoever of being on the intellectual level of some 15-year-old that's got an interest in tech. I think I may know, have some insights into consumer behavior. I certainly can get a lot of information on consumer behavior and then try to draw inferences about what that means about what consumer behavior is likely to be in the future.

The other thing I'll guarantee is I'll make some mistakes on marketable securities and I've made them in other areas than tech. So you might not bat 1.000, no matter what industries you try to stick with. I know insurance pretty well, but I think we probably lost money on an insurance stock, perhaps once or twice over the years. So you don't bat 1.000, but I have gained no real knowledge about tech in the last, well, since I was born actually. Charlie?

CHARLIE: I think it's a very good sign that you bought the Apple. It shows either one of two things, either you've gone crazy or you're learning. I prefer the learning explanation.

WARREN: Well so do I, actually. Andrew?

[05:14:30]
ANDREW ROSS SORKIN: Hi Warren, this one's a fun one. Thomas is here; he's a 27-year-old shareholder from Kentfield, California. And I should preface this question by saying that he was here 17 years ago, at 10 years old, asked you a question from the audience asking you if the internet might hurt some of Berkshire's investments. At the time you said you wanted to see how things would play out. He's now updated the question.

"What do you think about the implications of artificial intelligence on Berkshire's businesses beyond autonomous driving and GEICO, which you've talked about already? In your conversations with Bill Gates, have you thought through which other businesses will be most impacted? And do you think

Berkshire's current businesses will have significantly more or less employees a decade from now as a function of artificial intelligence?" He mixed a couple of questions together.

WARREN: Yeah, I certainly have no special insights on artificial intelligence, but I will bet a lot of things happen in that field in the next couple of decades, and probably a shorter time frame. They should lead, I would certainly think. But again, I don't bring much to this party. But I would certainly think they would result in significantly less employment in certain areas, but that's good for society. And it may not be good for a given business, but let's take it to the extreme.

Let's assume one person could push a button and essentially to various machines, there's robotics, all kinds of things, turn out all of the output we have in this country. So there's just as much output as we have, it's all being done by—instead of 150 some million people being employed—one person. Is the world better off or not?

Well it certainly would involve less hours of work per week and so on. I mean, it would be a good thing, but it would require enormous transformation in how people relate to each other, what they expect of government, you know all kinds of things. And of course, as a practical matter, more than one person would keep working. But pushing the idea that way, you'd certainly think that's one of the consequences of making great progress in artificial intelligence. And that's enormously prosocial, eventually.

It's enormously disruptive in other ways and it can have huge problems in terms of a democracy and how it reacts to that. It's similar to the problem we have in trade, where trade is beneficial to society, but the people that see the benefits day by day of trade don't see a price of Walmart on socks or whatever they're importing that says you're paying X, but you would pay X plus so many cents if you bought this domestically.

So they're getting these small benefits and invisible benefits and the guy that gets hurt by it, who is the roadkill of free trade, feels it very specifically, and that translates into politics. It gets very uncertain as to how the world would adjust, in my view, to great increases in productivity.

Without knowing a thing about it, I would think that artificial intelligence would have that, usually, beneficial social effect. But a very unpredictable political effect if it came in fast, which I think it could. Charlie?

CHARLIE: Well, you're painting a very funny world where everybody's engaged in trade and the trade is: "I give you golf lessons and you dye my hair". And that would be a world kind of like the Royal family of Kuwait or something and I don't think it would be good for America to have everything produced by one person and the rest of us just engaged in leisure.

WARREN: How about if we just got twice as productive in a short period of time so that 75 million people could do what 150 million people are doing now?

CHARLIE: I think you'd be amazed how quickly people would react to that.

WARREN: In what way?

CHARLIE: Favorably. That's what happened during a period when everybody remembers with such affection, back in the Eisenhower years. 5% a year or something, people loved it. Nobody complained that they were getting air-conditioning and they didn't have it before. Nobody wanted to go back to stinking, sweating nights in the South.

WARREN: Well if you cut everybody's hours in half, it's one thing. But if you fire half the people and the other people keep working, I just think it gets very unpredictable. I mean, I think we saw some of that in this election because I think that...

CHARLIE: Well, we've adjusted to an enormous amount of it. It just came along a few percent per year.

WARREN: Well, and the question then is if you...

CHARLIE: I don't think you have to worry about coming out with 25% a year. I don't think you have to worry about it. You're going to get less than 2% a year, that's what worries them.

WARREN: Okay we'll move on, but it's an absolutely fascinating subject to see what happens with this. But it's very, very hard to predict if in some way we've got 36,000 people, say, employed at GEICO, if you could do the same—perform all the same functions, Berkshire will do the same functions even if we do it with 5 or 10,000 people and it came on quickly. And the same thing is happening in the great many other areas. I don't think we've ever experienced anything quite like that and maybe we won't experience anything like it in the future. I don't know that much about AI.

CHARLIE: I don't think you have to worry about that.

WARREN: Well, that's because I'm 86.

CHARLIE: It's not going to come quickly.

WARREN: Okay, Gregg?

[05:20:48]
GREGG WARREN: Warren, during the past five years, Berkshire Energy's investments in solar and wind generation has been about equal with around $4.7 billion dedicated to capital projects in each segment. Based on the company's end of your capital spending forecast for 2017 through 2019, investments in wind generation were expected to be more than seven times greater than investments in solar generation in the next three years with just over $4.5 billion going into wind generation.

I'm just wondering how much of that future spending is tied to PacifiCorp's recently announced $3.5 billion expansion plan, which is heavily weighted towards improving and expanding the subsidiaries of BHE and whether the economics for wind are that much better than solar, given that many Americans are also spending heavily on wind investments. Or is this just a disparity between the two segments being driven more by genuine capacity needs, which would imply that you have much more solar capacity than you need?

WARREN: Yeah we don't look at it as having more solar capacity than we need or anything like it. It's really a question of what comes along. I mean, the projects that are internally generated, they're externally offered to us, and we got a big appetite for wind or solar. We have seen—you know, just based on those figures—we have seen more wind lately. But we have no bias toward either one. I mean if we saw $5 billion of attractive solar projects we could do and didn't happen to see any wind during that period, it wouldn't slow us down from doing the $5 billion or vice versa.

So we have a huge appetite for projects in either area. We're particularly well-situated—I think I've explained or talked about it in the past—because we pay lots of taxes. And therefore, solar and wind projects all involve a tax aspect to them. And we can have all those much better than any other, certainly, electric utilities. Most electric utilities, really, they don't have that much money left over after dividends. And frequently the taxes aren't that significant.

At Berkshire, we pay lots of taxes and we've got lots of money, so it's really just a question of doing the math on the deals as they come along. We've been very fortunate in Iowa in finding lots of projects that made sense. And as a result, we've got a much lower price for the electricity than our main competitor in the state. We got a lower price in any state that touches us. We told the people why they won't have a price increase for many, many, many years. We guaranteed that.

So this worked out extremely well, but if somebody walks in with a solar project tomorrow and it takes $1 billion or $3 billion, we're ready to do it. There's no specific and the more the better. There's no specific preference between the two. Obviously it depends on where you are in the country. I mean, Iowa is terrific for wind and obviously, California is terrific for sun and there are geographical advantages to one or the other. But from our standpoint, we can do it in many places and we will grow in many places. Okay, Station 4?

[05:24:36]
JOEY: Hi, my name is Joey and I'm an MBA candidate at Wharton. Thank you for having us. Amazon has been hugely disruptive due to the brilliance of Jeff Bezos, whom Charlie earlier called "the business mind of our generation." What is your current outlook on Amazon and why hasn't Berkshire bought in?

WARREN: Well because I was too dumb to realize what was going to happen. Even though I admired Jeff—I've admired him for a long, long time and watched what he was doing—but I did not think that he could succeed on the scale he has. And I certainly didn't even think about the possibility of doing anything with Amazon Web Services or the Cloud. So if you'd ask me the chances that while he was building up the retail operation that he would also be doing something that was disrupting the tech industry, that would have been a very, very long shot for me and I've underestimated the brilliance of the execution.

I mean it's one thing to dream about doing this stuff online. But it takes a lot of ability and you know, you can read his 1997 Annual Report and he laid out a road map and he's done it and done it in spades. And if you haven't seen his interview on Charlie Rose three or four months ago on Charlierose.com, go to and listen to it because you'll learn a lot. At least I did.

It always looked expensive and I really never thought that he would be where he is today. I thought he was really brilliant, but I did not think he would be where he is today when I looked at it three, five, eight, twelve years ago, whenever it may have been. Charlie, how did you miss it?

CHARLIE: It was easy. What was done there was very difficult and it was not at all obvious that it was all going to work as well as it did. I don't feel any regret about missing out on the achievements of Amazon, but other things were easier and I think we screwed up a little.

WARREN: No, we won't pursue that line.

CHARLIE: Well, I meant Google.

WARREN: Well, we missed a lot of things.

CHARLIE: Yes, we missed a lot of things and we'll keep doing it. Luckily, we don't miss everything, Warren, that's our secret; we don't miss them all.

WARREN: Okay, we'd better move on, I think. He may start getting specific. Carol?

[05:27:41]
CAROL LOOMIS: The creator of this question, Jim Kiefer of Atlanta, has even higher expectation for Warren's longevity than Charlie does. "Mr. Buffett, we all hope you win the record as mankind's oldest living person, but at some point, you and our Charlie will go and Berkshire's stock may then come under selling pressure. My question is, "If Berkshire's stock falls to a price where share repurchase is attractive, can we count on the Board and top management to repurchase shares?"

I ask this question, both because of past comments you have made about not wanting to take advantage of shareholders and because some of the passages of the Owner's Manual lead me to believe this might be an instance when the board does not choose to repurchase shares. "Can you clarify what course of action we might expect about repurchases in the circumstances I have outlined?"

WARREN: As far as I'm concerned, they're not taking advantage of shareholders if they buy the stock when it's undervalued. That's the only way they should buy it and they should. But in doing so, there were a few cases back when Charlie and I were much younger, where there were very aggressive repurchases or the equivalent of repurchases by people. And the repurchases instantly made a lot more sense than they do now. But they were done by people who either, for various techniques, tried to depress the shares. And if you're trying to encourage your partners to sell out at a depressed price by various techniques, including misinformation—but there's other techniques—I think that's reprehensible. But our Board wouldn't be doing that.

I'll take exception to the first part of it, but I'll still answer the second. I think the stock is more likely to go up. If I die tonight, I think the stock would go up tomorrow and there'd be speculation about breakups and all that sort of thing. So it would be a good Wall Street story that this guy that's obstructed breaking up something where some of the parts might sell for more than the whole. That wouldn't necessarily be—probably be worth less than the whole—but it might sell temporarily for more than the whole and that wouldn't happen.

So I would bet in that direction. But if for some reason it went down to a level that's attractive, I don't think the board is doing anything in the least that's reprehensible by buying into stock at that point—no false information, no nothing. And their buying means that the seller would get a somewhat better price, but there are a lot of sellers that you'd get a mildly better price than if they weren't buying. And the continuing stockholders would benefit.

So I think that it's obvious what they would do. And I would think that it's obvious that it's pro-shareholder to do it, and I think they would engage in pro-shareholder acts and as far as the eye can see. I mean, we got that sort of Board. Charlie?

CHARLIE: Well, I think you are. I might suddenly get very stupid very quickly, but I don't think our Board is going to have that problem.

WARREN: I want to think about that one. Okay, Jonathan?

[05:31:15]
JONATHAN BRANDT: Warren, in the past you've enjoyed discussing accounting for options grants. I'm curious what's your view of the new accounting standard which mandates that companies report lower tax provisions based on so-called excess tax benefits enjoyed when share-based compensation ends up being more profitable for the grantees than what is initially modeled? These so-called excess benefits used to go through the shareholder's equity line on the balance sheet. Which accounting method makes more sense to you, the old method or the new?

WARREN: Johnny, I think you know a lot more about it than I do, so if I were asked to answer that question, I'd probably call you up and say, "What should I say?" It's not a factor that will enter into Berkshire, so I really am not, I mean, I've heard just a little bit about that accounting standard, but I really don't know anything about it. Charlie?

CHARLIE: It's not a big deal, Warren.

WARREN: Yeah, well I know that, yeah. There are a few things in accounting we really disagree with and whether they might be material to somebody trying to evaluate Berkshire and, you know, that primarily gets in to amortization of intangibles. It certainly gets them to realize capital gains and that sort of thing. And we will go to great lengths to try to tell our partners, basically—not all are accounting experts or anything—and we will try to make clear to them, at least, what our view is, the same way as if I had a family business and I was talking to my sisters or something about it.

But unless it's material, we'll probably stay away from trying to apply it on any new accounting standards. If it's material to Berkshire, we'll go to great lengths to at least give our view. Charlie?

CHARLIE: Well, I certainly agree with that. What he's talking about is not very material to Berkshire.

WARREN: No it isn't and it really won't be, you know.

CHARLIE: Yeah, I know.

WARREN: Some of these others are though and we will bring those up as they come up. We are reporting $400-and-some-million dollars less in our earnings than if Precision Castparts had remained a public company. Well with Precision Castparts, are the earnings less real? Is the cash list real? Is anything because it's moved the ownership? I don't think so, and I want to convey that belief to shareholders and they can debate whether it's right or wrong.

But I think it's a mistake not to comment and just assume that the owners understand that. Because it's a fairly arcane point and so we pointed out. But we also pointed out if we think the depreciation is inadequate, as for evaluation purposes, the depreciation is inadequate at very capital intensive business like BNSF, which we, I must say still love, anyway. Charlie, anymore?

CHARLIE: No.

WARREN: Okay, Section 5.

[05:34:30]
ADAM BERGMAN: Thank you and good afternoon. I'm Adam Bergman with Sterling Capital in Virginia Beach, Virginia. Earlier today, Mr. Munger commented on the valuation of China versus the US market. My question for you is, "Are market cap to GDP and cyclically adjusted P/E still valid ways to consider market valuation and how do those influence Berkshire's investment decisions?" Thank you.

WARREN: I guess Charlie's overall values are in China. I would say that both of the standards you mentioned are not paramount at all in our valuation of securities. It's harder. People are always looking for a formula. And there is an ultimate formula, but the trouble is you don't know what to stick in for the variables. That's the value of anything. Being the present value of all the cash that's ever going to distribute, but the P/E ratios, I mean, every number has some degree of meaning; it means more sometimes than others.

But the valuation of a business, it's not reducible to any formula where you can actually put in the variables perfectly and both of the things that you mentioned. Yet themselves, get bandied around a lot. It's not that they're unimportant, but sometimes they can be very important, sometimes they can be almost totally unimportant. It's just not quite as simple as having one or two formulas and then saying the market is undervalued or overvalued. Or a company is undervalued or overvalued.

The most important thing is future interest rates. And people frequently plug into current interest rate, saying that's the best they can do. After all, it does reflect the market's judgment, and the 30-year bond should tell you what people who are willing to put up money for 30 years and have no risk of dollar gain or dollar loss at the end of the 30 year period. But what better figure can you come up with? I'm not sure I can come up with a better figure, but that doesn't mean I want to use the current figure either.

So I would say that I think Charlie's answer will be, that it does not come up with China versus the US market based on what you've mentioned as yardsticks. Charlie you tell them.

CHARLIE: All I meant was that, I said before that the first rule of fishing is to fish where the fish are. Is that a good fisherman can find more fish in China if fish is the stock market, that's all I meant. It's a happier hunting ground.

WARREN: This doesn't really directly relate, I want to go back to one question that was mentioned earlier. I really think, if you want to be a good evaluator of businesses—an investor—you really ought to figure out a way without too much personal damage to run a lousy business for a while. I think you can learn a whole lot more about business by actually struggling with a terrible business for a couple of years than you learn by getting into a very good one where the business itself is so good that you can't mess it up.

I don't know whether Charlie has a view on it or not, but it certainly was a big part of our learning experience and I think a bigger part in the sense that being involved with good business was actually being involved in some bad businesses and just seeing...

CHARLIE: How awful it was.

WARREN: How awful it is and how little you can do about it. And our IQ does not solve the problem and a whole bunch of things. It’s a useful experience, but I wouldn’t advise too much of it. Don’t you think so, Charlie?

CHARLIE: It was very useful to us. There’s nothing like personal painful experience if you want to learn. And we certainly had our share of it.

WARREN: Okay, Becky?

[05:39:21]
BECKY QUICK: This question comes from Tom and he’d like be called Tom Spend from Pennsylvania. He says, "In life, business, and investing, strategies often work until they don’t work. Other than a massive insurance loss, any thoughts on what could cause the Berkshire enterprise to not work?"

[05:39:40]
CHARLIE: Good question.

WARREN: Well if there were something changed. If we got some infection, outside agent of some sort to change the culture in some major way; an invasion of different thought. But as a practical matter, I don’t think anything—you know, it’s the things you can think of, but I can’t think of anything that can harm Berkshire in a material, permanent way except weapons of mass destruction. But I don't regard that as a low probability.

It would take a recession, a depression, a panic, hurricanes, earthquakes. They all would have some effect, and in some cases, it might even lead that we would do better because of them. But, if there were a successful—as measured by the aggressor—nuclear, chemical, biological or cyber-attack on the United States. And there are plenty of people who would like to pull that off—or organizations and maybe even a few countries—it could disrupt society to such an extent that it would harm us.

But I think with the variety of earning streams, with the asset positions, with the general philosophy of the play, I think that we would be very close to the last one affected. But if somebody figures out how to kill millions of Americans and totally disrupt society, then all bets are off. Charlie?

CHARLIE: Well, I agree. It would take something really extreme. And just take the question like, British Petroleum took a huge loss with one oil well blowing and Berkshire has all these independent subsidiaries and they really are independent. And the parent company is not alarmed if there’s one horrible accident somewhere. We would tend to pay of course—maybe more than our legal liability—but we are not one-accident-in-one-subsidiary that can cause a lot of damage. We’re better protected than most companies. In every way Berkshire is structured to handle stresses.

WARREN: It’s the kind of thing we think about all the time and we’ve thought about it ever since we started. But I really don’t know any company that could take more general adversity. Or even specific adversities. But if you get into what could happen with weapons of mass destruction, that is something we can’t predict about. But if that ever happens, there’ll be more to worry about than the price of Berkshire. Jay?

[05:42:55]
JAY GELB: Berkshire Hathaway specialty insurance generated $1.3 billion of premium volume in 2016. This business is on the smaller end of commercial property casualty insurers in terms of scale, although

its volume did grow 40% last year. In a highly competitive commercial PNC environment, what gives you confidence that Berkshire Hathaway's specialty is destined to become one of the world's leading commercial PNC insurers as you said in this year's Annual Letter?

WARREN: Yeah, I think it will be. And I think how fast it grows it does depend very much on the market. I mean, we are not interested in trying to be a price cutter in a market where the prices already aren't that attractive. But we have built the scale worldwide and a lot of it has just been added in recent months in just over the past year.

We will grow a lot, but if the market should turn hard for any reason, we would grow a lot faster. But we are destined—at Berkshire Hathaway especially—to be one of the leading PC firms in the world. Just as we were destined to have—when a chip came in, even though we had nothing—we were destined to become a very important reinsurer throughout the world. And in certain ways, almost the only reinsurer for certain types of risks in the world. And we got the people, we got the capital, and we got the reputation.

There is no stronger company in the insurance world and there won't be than the Berkshire Hathaway Insurers. We got the talent there. It will grow. It may grow slowly some years. It may have big jumps just like the reinsurance operation did many years ago. But it's a very important addition to Berkshire that brought that on. I just wish we could have started it a little earlier, but you had to have the right people. And they came to us. And as you say—whatever it was, a billion, $3 billion for last year—and we'll write more this year. But we won't write as much as if we were in a hard market. Station 6?

[05:45:38]
SALLY: Good afternoon, my name is Sally from Australia, but I currently reside in Austin, Texas. My question, Mr. Buffett, "I have heard that Mr. Munger says your greatest talent is that you're a learning machine, that you never stop updating your views. What are the most interesting things you've learned over the last few years?"

WARREN: Well it is fun to learn. Charlie is much more of a learning machine than I am. I'm a specialized one and he does as well as I do in my specialty. And then he got a much more general absorption rate than I have about what's going on in the world. But it's a world that gets more fascinating all the time, and a lot of fun can occur when you learn you were wrong on something.

That's when you really learn that the old ideas really weren't so correct and you have to adapt to new ones and that, of course, is difficult. I don't know that I would pick out. Well I think actually what's going on in America is terribly, terribly interesting and, politically, all kinds of things. But just the way the world's unfolding, it's moving fast. I do enjoy trying to figure out now what's going to happen. But what's even happening now, but I don't think I got any special insights that would be useful, but maybe Charlie does.

CHARLIE: Well I think buying the Apple stock is a good sign in Warren. And now, he did run around Omaha, and as he was, he'd take his grandchildren's tablets away and he did market research and I do think we keep learning.

More importantly, we don't unlearn the old tricks and that is really important. You look at the people who try and solve their problems by printing money and lying and so forth. Take Puerto Rico. Who would have guessed that a territory of the United States would be in bankruptcy? Well I would have predicted it because they behave like idiots.

WARREN: We did not buy any Puerto Rico bonds.

CHARLIE: No. And if you go to Europe, look at the government bond portfolios we're required to hold in Europe. There are no Greek bonds and the bonds of nobody but Germany. Just everywhere you look in Berkshire somebody is being sensible and that is a great pleasure. And then you combine that with being very opportunistic so that when something comes along like a panic, it's like playing with two hands instead of one in a game that prefers two hand. It helps to have a fair sized repertoire and, Warren, we've learned so damn much. There are all kinds of things we've done in the last 10 years we would not have done 20 years ago.

WARREN: Yeah that's true. It's interesting and I've mentioned this before, but one of the best books on investment was written, I think, in 1958—I think I read it around 1960—by Philip Fisher called Common Stocks and Uncommon Profits.

CHARLIE: All the countries or companies went to hell, eventually.

WARREN: It talked about the usefulness of what he called a "scuttlebutt method" and that was something I didn't learn from Graham. But every now and then, it's turned out to be very useful. Now it doesn't solve everything and I mean, there are a whole lot of...

CHARLIE: I saw you do it with American Express and the Salad Oil scandal. If you're doing it on Apple, you know decades later.

WARREN: Yeah, in certain cases, you actually can learn a lot just by asking a lot of questions and I give Philip Fisher credit. That book goes back a lot of years, but as Charlie said, some of the companies he picked as winners forever did sort of peter out on him. But the basic idea that you can learn a lot of things just by asking, in some cases.

I mean, if I got interested in the coal industry—just say, to pick one out of the air. You know, when I was much younger, more energetic, if I went and talked to the heads of 10 coal companies and I asked each one of them, way later into the conversation after they felt like talking and I would just say, "If you had to go away for 10 years on a desert island and you had to put all of your family's money into one of your competitors, which one would it be and why?"

And then, I'd ask them if they had to sell short one of their competitors for 10 years, with all their family money, why? And everybody loves talking about their competitors and if you do that with 10 different companies, you'll probably have a better fix on the economics of the coal industry than any one of those individuals has.

There are ways of getting at things and sometimes they're useful and sometimes they're not. But sometimes they can be very useful and the idea of just learning all the time about it. I'm more specialized than that by far than Charlie. I mean, he wants to learn about everything and I just want to learn about something in Berkshire. It's a very useful attitude to have toward the world and, of course, I don't know who said it, but somebody said the problem is not in getting the new ideas, but shutting the old ones. And there's a lot of truth to that.

CHARLIE: We would never have bought ISCAR if it had come along 10 years earlier. We would never have bought Precision Castparts if it had come along 10 years earlier. We are learning and, my God, we're still learning.

WARREN: Okay, Andrew?

[05:52:09]
ANDREW ROSS SORKIN: Hi Warren, this is my final question. In 2012, you were quoted as saying, "I think the healthcare problem is the number one problem of America and of American business. We have not dealt with that yet." Do you believe that the current administration's plan to repeal and replace ACA will ultimately benefit the economy in Berkshire or not?

WARREN: Yeah well I'll give you two answers here. The first one being, that if you go back to 1960 or thereabouts, corporate taxes were about 4% of GDP. I mean, bounce around some, and now they're about 2% of GDP. And at that time, healthcare was 5% of GDP and now it's about 17% of GDP. So when American business talks about taxes strangling our competitiveness and that sort of thing, they're talking about something that, as a percentage of GDP, has gone down from 4% to 2%. While medical costs—which are borne to a great extent by business—have gone from 5% to 17%.

So medical costs are the tapeworm of American economic competitiveness. I mean, if you're really talking about it—and business knows that they don't feel they can do much about it—but the tax system is not crippling Berkshire's competitiveness around the world or anything of the sort.

Our health costs have gone up incredibly and will go up a lot more. And if you look at the rest of the world, there were half a dozen countries that were around our 5% if you go back to the earlier years. And while we were at 17% now, they're at 10% or 11%. So they have gained a five or six-point advantage—the world—and even in these countries with fairly high medical costs.

CHARLIE: And that's with socialized medicine.

WARREN: Yeah so it's huge. Whatever I said then goes and is accentuated now. That is a problem this society is having trouble with and it's going to have more trouble with. And regardless of which party is in power or anything of the sort, it almost transcends that.

In terms of the new act that was passed a couple of days ago versus the Obama Administration Act, it' a very interesting thing. All I can tell you is the net effect of that act on one person is that my federal income taxes would have come down 17% last year if what was proposed went into effect.

It is a huge tax cut for guys like me and you'll have to figure out the effects of the rest of the act. But the one thing I can tell you is, if it goes through all the way to the House, put in, I mean, anybody with $250,000 year of adjusted gross income and a lot of investment income, is going to have a huge tax cut. And when there's a tax cut, either the deficit goes up or they get the taxes from somebody else. So as it stands now, that is the one predictable effect if it should pass. And the Senate will do something different and go over to conference and who knows what happens, but that is in the law that was passed a couple of days ago. Charlie?

CHARLIE: Well I certainly agree with you about the medical care. What I don't like about the medical care is that we're getting too much medicine. There's too much chemotherapy on people that are all but dead and all kinds of crazy things going on in Medicare and in other parts of the health system.

There are so many vested interests that it's very hard to change. But I don't think any rational person—looking objectively from the outside at the American system of medical care—we all love the new lifesaving stuff and the new chemotherapies and the new drugs and all that. But my God, this system is crazy and the cost is just going wild. And it does put our manufacturers at a big disadvantage with other people where the government is paying the medical cost. And so I agree with Warren, totally.

WARREN: If you had to bet 10 years from now if it will be higher or lower than 17% of GDP?

CHARLIE: Well if present terms continue, it'll get more and more. There are huge vested interests in having this thing continue the way it is and they're very vocal and active, and the rest of us are indifferent, so, naturally we get a terrible result. And I would say that on this issue, both parties hate each other so much that neither one of them can think rationally. And I don't think that helps either.

WARREN: It is kind of interesting that the Federal government spends or raises, well, say $3.5 trillion or something like that. And do we have a concern that everybody has about—let's say, fairly steady in the 18% or so of GDP plus or minus a couple of points—but $3 trillion plus is spent on healthcare and everybody wants the best and it's perfectly understandable. But it's a big number compared to the whole federal budget.

I mean there's some overlap and all of that, but if you talk about world competitiveness of American industry, it's the biggest single variable where we keep getting more and more out of whack with the rest of the world. And it's very tough for political parties to attack it, yet it basically is a political subject.

CHARLIE: It's deeply immoral. If you have a group of hospital people and doctors, there's a feasting like a bunch of jackals on a carcass of some dying person. It's not a pretty sight.

WARREN: Tell them about that group out in California that—

CHARLIE: Oh yeah, this is Redding; This is one of my favorite stories. There are a bunch of very ambitious cardiologists and heart surgeons in Redding and they got the thought that really what a heart was, was a widow maker. So every patient that came in, they said, "You've got a widow maker in your chest and we know how to fix it" and so they recommended heart surgery for everybody.

And of course, it involved a huge volume of heart surgery and they got very wonderful results because nobody comes through heart surgery better than the man who doesn't need it at all. And they made so much money that the hospital chain, which was Tenet, brought all its other hospitals, "Why can't you be more like Redding?" This is a true story and it went on and on and on, and, finally, there was some beloved Catholic priest and they said, "You've got a widow maker in your chest". And he didn't believe them and he blew the whistle.

WARREN: He was a priest. You can see why he didn't believe them.

CHARLIE: At any rate, well when you got a routine, you just keep using it, you know. If a heart is a widow maker, it's a widow maker. Later I met one of the doctors who threw these people out of the medical profession and I said to him, "In the end, did they think they were doing anything wrong?" He said, "No Charlie, they thought that what they were doing was good for people."

That is why it's so hard to fix these things. The delusion that comes into people as they make money and get more successful by doing God-awful things should never be underestimated. And a lot of that goes on and you've been under such gross craziness and you thought, well, at Wells Fargo, it looks like innocents. You don't have a whole trouble with this incentive system. But if the heart surgery rate was 20 times normal or something, you'd think you'd notice if you're running a hospital. But they did notice and they wanted the other hospital to be more like it.

WARREN: They had a terrific success ratio. Okay, Gregg?

[06:01:22]
GREGG WARREN: Thank you, Warren. As you look forward in taking into consideration some of the headwinds faced in the US-based utilities, including weaker electricity demand growth; as increasing energy envisage the impacts demand distributed generation, which hits vertically integrated utilities doubly hard as they face both declining energy sales revenue and increased network cost of support reliable delivery; and third, higher interest rates, which would increase borrowing costs, what are the key attributes that Berkshire Energy would be looking for in future acquisition candidates?

In particular, are there advantages or disadvantages attached to, say, transmission assets relative to generation assets that would make you favor one over the other?

WARREN: Yeah well generation assets have inherently more risk because some them are going to…

CHARLIE: Be stranded.

WARREN: Be stranded and yeah, and obsolete. Now the question is how they treat stranded and all that sort of thing. We, on the other hand, more of the capital investment is in the generating assets. So that tends to be where a good bit of the capital base is.

We like the utility business okay. I mean, the electricity demand is not increasing like it was as you point out. There are going to be stranded assets. If they're stranded because of rank foolishness, then they will probably be less inclined—or the utility commissions will be less inclined—to let you figure that in your rate base as you go forward, as opposed to things that are more societal demands are changing. But we still think the utility business is a very decent asset. The prices are very high, but that's what happens in a low interest rate environment.

I'd be surprised if 10 years from now we don't have significantly more money in not only wind and solar, but we'll probably own more utility systems than we own now. We're a buyer of choice with many utility commissions. In fact, if you'd put up the slide, there's a slide which shows something about our pricing compared to other utilities. And Greg Abel and his group have done an extraordinary job. They've done it in safety. They've done it in reliability. They've done it in price. They've done it renewables. It's hard to imagine a better operation than it exists at MidAmerican Energy. And people want us.

With that record, people want us to come to their state in many cases. But when prices get to the level they have, some utilities are sold at extraordinary prices and we can't pay up and have it make sense for Berkshire shareholders. But just because we can't do it this year doesn't mean it won't happen next year or the year after. So I think we'll get a chance.

CHARLIE: Our utilities are also not normal. The way Greg has run those things—they're so much better run in every way than normal utilities. They're better regarded by the paying customers. They're better regarded by the regulators. They have better safety records. Just everything about it is way the hell better. And it's a pleasure to be associated with people like that and have assets of that quality. And it's a lot safer. If somebody asked Berkshire to build a $50 billion nuclear plant, we wouldn't do it.

WARREN: Yeah and we have public power here in Nebraska. It's been sort of the pride of Nebraska for many decades. There are no private utility systems and it's totally public power. And those utilities have no requirements for earnings on equity. They can borrow at tax-exempt rates. We have to borrow at taxable rates—and Nebraska, it's not that much different than Iowa—and we're selling electricity across the river a few miles from here at lower prices than exists in Nebraska.

So it's an extraordinary utility and it was lucky when we got involved in. I thank Walter Scott, our director, for introducing me to it almost 17 or 18 years ago or so. But I don't think the utility business, as such, I mean—if I were putting together a portfolio of stocks, I don't think there would be any utilities in that group now. But I love the fact that we own Berkshire Hathaway Energy.

CHARLIE: But it's different; radically different and better.

WARREN: A lot better, actually. Station 7?

[06:06:50]
AUDIENCE: Hi, my name is Grant from beautiful, historic St. Augustine, Florida. I've been a fan of yours and Berkshire since I was a kid looking through the stock pages and seeing one crazy stock that traded for $10,000 a share. Unfortunately, I wasn't able to convince my parents to buy it at that point. But now I'm a shareholder as an adult and I'm here with my daughters, Mabel, who is seven and Willa who is 1-year-old, and my wife.

I voraciously read the letter every year and I love the stories from the different companies—GEICO and See's, BNSF—that kind of teach investing lessons. And this year when I was looking through the accounting information at the back, I noticed that one company—McLane—contributes a lot of revenue; a large portion of Berkshire's revenue. And to a lesser extent earnings. But I don't ever see much about it in the annual report. So I'm curious why we don't hear more about that company and are there any investing lessons like we get from See's and GEICO that you can share about that company?

WARREN: Yeah McLane—the reason you see their figures separately is because the SEC has certain requirements that are based on sales. And McLane is a company that has an extraordinary amount of sales in relation to intrinsic value or to net income.

It basically is a distributor of—well it's a huge customer, for example—of the food companies; the candy companies, the cigarette companies, that go up and down the line of anything that goes into convenience stores. But we bought it from Walmart and Walmart is our biggest customer. I can't tell you the precise volume, but, well, to get Walmart and Sam's together, you're getting up to 20% plus. But it's nationwide.

But in the end, it operates on about 6% gross margins and 5% operating expenses, so it has a 1% pre-tax margin. And obviously a 1% pre-tax margin only works in terms of return on capital if you turn your equity extraordinarily fast. And that's what McLane does. Being a wholesaler, it's moving things in, moving things out very fast, very efficiently, and it does this. It also has a few liquor distribution subsidiaries that have wider margins, but the basic line business which is $45 billion + makes 1% pre-tax on sales. But the return on capital is very decent.

But it sort of has an outsized appearance simply because of this huge volume of sales that go through it. Grady Rosier—who runs it—is exceptional. He was there when we bought it from Walmart whatever it was a dozen years ago and I've been there once. We got thousands and thousands of trucks, big distribution centers all over the country.

It is a major factor in moving goods that's wholesale. I mean if you're Mars candy or something of the sort, I mean, we will be the biggest customer. That pretty well describes the business. It's a business that earns good returns in relation to invested capital and in relation to our purchase price. But every tenth of a cent is important in the business. And moving receivables exceptionally fast and consequently, and you have payables moving big time.

So the sales are 30 times receivables and 30 times payables, you've got maybe 35 or so times inventory. I mean this is a business that's moving a lot of goods. It's an important subsidiary, but not as remotely as important as what would be indicated by the sales. It's still very important making the kind of money that shows up in the 10-K. Charlie?

CHARLIE: You said it all.

WARREN: That was an interesting thing. Walmart wanted to sell it. They came to see us and we made a deal and the CFO came. We talked for a while, he went to the other room, called the CEO and came back and said, "You have a deal." Walmart has told me subsequently that they never had a deal that goes as fast as the one with Berkshire. I mean, we said what we would pay and it was cash, and we got it done very promptly. And they were terrific on their side.

CHARLIE: By the way, that reputation for quick and simple and doing what we promise, and so on, has helped at Berkshire time after time.

WARREN: Yeah we wouldn't have made that deal without essentially having that reputation, but they knew...

CHARLIE: We bought the Northern Natural Gas Company in one weekend and they wanted the money on Monday.

WARREN: They needed the money on Monday.

CHARLIE: Before the lawyers can complete the legal papers, we managed to do it.

WARREN: Well not only that, but I think it took some clearance in Washington and essentially, I think, I wrote a letter and said that if they decided after looking at it they didn't want to clear it, we don't do the deal. But these guys needed the money so bad, we're going to give them the money essentially based on the deal clearing. And there wasn't any reason why it wouldn't clear, but that was just a procedural problem, but most companies can't do that.

We got flexibility that really, in most large companies just doesn't exist. There's too many people that have to sign off on it or something of that sort. So the Northern Natural deal wouldn't have been made if we'd had to follow the normal time table.

CHARLIE: And so a lot of business don't.

WARREN: Yeah, absolutely. Now we're moving from one station to another, so we'll now go to Station 8.

[06:13:17]
AUDIENCE: Good afternoon Warren and Charlie. I'm John Norwood from Weston, Iowa. You guys have iron bladders.

WARREN: We won't tell you the secret to that.

AUDIENCE: I was wondering what the contraption under the table there.

WARREN: No you can come down and inspect.

AUDIENCE: All right. I have a question for each. Warren, I was fortunate to ask you a question—I think in 2011—about legacy and what you wanted to be known for a hundred years from now. And I'm kind of curious to hear what Charlie would like to be known for. I'm 52, so I guess you started doing this when I was born and I'm kind of interested in the memory from your first annual meeting.

CHARLIE: My first memory, when Warren and I got on this subject and I asked him what he wanted said at his funeral, and he said, "I want them to all be saying that's the oldest looking corpse I ever saw."

WARREN: Not maybe the smartest thing I ever said. But me, I'm very simple. I really like teaching. So basically, I've been doing it formally—and if you'd say somewhat informally—all my life, and I had certainly had the greatest teachers you can imagine. So, if somebody thought that I did a decent job at teaching, I'd feel very good about that. [Applause]

CHARLIE: Yeah and to make the teaching endurable, it has to have a better wise-assery in it. And, that, we've been able to supply.

WARREN: And for those of you who are old time basketball fans, have I mentioned that on Wilt Chamberlain's tomb it was reputed to say "At last, I sleep alone."

Okay, Station 9.

[06:15:29]
AUDIENCE: Good after Mr. Munger and Mr. Buffett. My name is ___ and I come from China. It's my first time to come to this meeting and I think I'm very lucky to have a chance to ask a question.

WARREN: We're glad to have you.

AUDIENCE: Thank you. Everyone has personal dreams and at different age, maybe dreams will come differently. And what's your dream now?

WARREN: Charlie, I will let you...

CHARLIE: I didn't quite hear that.

WARREN: Well, what's your dream now?

CHARLIE: My dream? Well...

WARREN: Let's skip the first one.

CHARLIE: Some time, when I'm specially wishful, I think, "Oh, to be 90 again." I got some advice for the young. If you got anything you really want to do, don't wait till you're 93.

WARREN: I'll do it. All right, that's the same thing I would tell students is that you can't always find it the first time or the second time. But when you go out in the world, look for the job that you would take if you didn't need a job. I mean don't postpone that sort of thing.

Somebody, I think it's Kierkegaard that said, "Life must be evaluated backwards, but it must be lived forwards." You want to sort of—Charlie said, "All I want to know is where I'll die so I'll never go there," you know—so you do want to do a certain amount of reverse engineering in life. I mean that doesn't mean you can do everything that way, but you really want to think about what will make you feel good when you get older about your life. And you—at least, generally—you want to keep going in that direction. And you need some luck in life and you got to accept some bad things that are going to happen as you go along. But life has been awfully good to me and Charlie so we have no complaints.

CHARLIE: What you don't want to be is like the man and they have his funeral and the minister said, "Now is the time for somebody to say something nice about the deceased," and nobody came forward, and nobody came forward. He said, "Surely, somebody can say something nice about the deceased," and nobody came forward. And finally, one man came up and he said, "Well," he said, "his brother was worse."

WARREN: Okay, we'll move to Station 10 and see if we can improve on it.

[06:18:39]
AUDIENCE: Hi, my name is Andy from Shanghai. This is my sixth year from Shanghai to here. I have to say to you two, Warren and Charlie, you are highly respected and loved by millions and millions—or even billions—globally. I have two questions today. First question: In your letters to shareholders, you said you believe EBITDA is not a good parameter to value a business. Why is that? Can you elaborate on that?

Second question: You both have very successful and happy lives with great respect. My question is to each of you in retrospect from a personal standpoint, did you have regrets in life? If there is one thing you would have done differently in your life, family, personal or business? What is it? Thank you very much.

WARREN: Yeah, I don't think you should expect us to answer that on personal, but in business, I would say I wish I've met Charlie earlier. We've had a lot of fun ever since I was 29 and he was 35. But it would have been even more fun if we'd started many, many years earlier. We had a chance to; we worked in the same grocery store, but not at the same time.

In respect to EBITDA, depreciation is an expense and it's the worst kind of an expense. You know we love to talk about float and float is where you get the money first, then we have the expense later. Depreciation is where you spend the money first and then record the expense later. And it's reverse float and it's not a good thing. And to have that enter into a multiple. It's much better to buy a business that has—everything else being equal—has no depreciation because it has essentially no investment and fixed assets and makes X, than it is to buy a company where there's a lot of depreciation in getting to X.

Actually I may write a little bit more on that next year just because it's such a mass delusion. And of course it's in the interest of Wall Street enormously to focus on something called EBITDA because it results in higher borrowing power, higher valuations and all of that sort of thing. So it's become very popular in the last 20 years, but it's a very misleading statistic that can be used in very pernicious ways. Charlie, on either one of those subjects?

CHARLIE: I think you've understated the horrors of the subject and the disgusting nature of the people that brought that term in the valuation of business. It would be like a leasing broker of real estate who has 1,000 square foot suite to be leased and he says it's got 2,000 feet in it. That's not honorable behavior and that's the way that term got into common usage. Nobody in his right mind would think depreciation is not an expense.

WARREN: Yeah but it's very much in the interest of Wall Street.

CHARLIE: Yes that's why they did it. It made the multiple seem lower.

WARREN: What's amazing is the way it's accepted, actually. But anyway, it just illustrates that all people use language and sell concepts that work to their own use and, two and twenty has the same sort of thing. I mean the number of people, the amount of money that over performed after paying "two and twenty" compared to the expense that they may have incurred, I will assure you makes for a terrible indictment of that particular arrangement. But as long as it can get sold, it will get sold and...

CHARLIE: And now they use it in the Business schools. That is horror squared. I mean, it's bad enough that the ones using a term, but when it gets so common that the business schools copy it? That's not a good result.

WARREN: Okay, Station 11.

[06:23:41]
AUDIENCE: Good afternoon. I'm Whitney Tilson, a shareholder from New York. My question is related to the one that is asked earlier about job cuts. Perhaps the only thing that makes American workers angrier than layoffs is to shut down an operation entirely and move the jobs overseas. Ask anyone in Ohio or Michigan and they'll tell you stories about companies that had been operating in those states for decades, benefiting from the educational system, infrastructure and so forth—things that are paid for by local taxpayers—but then some high paid consultants came along and showed the company how it could reduce its cost by relocating production to Mexico or China. And "poof", the good US jobs disappeared.

My observation is that most investors in corporate America today worship at the altar of maximizing shareholder value, which is code for doing whatever is necessary to boost the share price as high as possible. But in doing so, companies are taking actions that make millions of workers feel—at best, fearful and left behind—and at worst, deeply harmed by corporate America. It makes so many people so angry that I think it's testing the post-World War II economic order, which is rooted in free trade, and even the strength of our democracy. I'd argue that it was decisive in our last election.

So my question to you is, do you think that businesses should consider factors outside of pure economics on making these types of decisions? What obligations—if any—do they have to their employees and communities in which they operate? And lastly, if a Berkshire CEO came to you and ask for your approval to close a US operation and relocate it overseas to save money, what questions would you ask beyond the economics of this decision? Thank you.

WARREN: Well the truth is, in certain cases, production that would otherwise, that formerly had been in the United States has definitely been supplanted by production that come from other parts of the world, originally. I was there when Fruit of the Loom was called Union Underwear and bought by Graham-Newman Corp. in 1955, I believe, and it was probably all domestic then. And the truth is, if it was all domestic now, it wouldn't exist.

We had the same thing happen with Dexter Shoes. It was a wonderful company and skilled workers, and in the end, we sold the shoes at a price that yielded what it costs us. They were not competitive with shoes from around the world. A trade, I would argue, both ways—export/import—massive trade should be and is, actually, enormously beneficial for both the United States and the world, I mean.

Greater productivity will benefit the world in a general way. But to road kill—to be the textile worker in New Bedford that was put out of the job, eventually, to be the shoe worker at Dexter that have been put out of work, I mean—it would be no fun to go through life and say, "I'm doing this for the greater good and so that shoes and underwear was offered 5% less," or something. And the American public will actually never know.

So what you need is two things, in my view. You got an enormously prosperous country. You got almost $60,000 of GDP per capita. It's unbelievable. Six times what it was when I was born in real terms. So we've got the prosperity and that prosperity is enhanced by trade. We were only exporting 5% of our GDP back in 1970 and I think it's around 12% or something like that.

Now we're doing what we do best, but we need an Educator-in-Chief, who is logically, the President. I don't mean this specific president. I mean any president that's been around for decades, has to be able to explain to the American public the overall benefits of, essentially, free trade. And then beyond that, we have to have policies that take care of the people that become the road kill in process because it doesn't make any difference to me, as far as I'm concerned, if my life is miserable because I've been put out of business by something that's good for 320 something million people in some infinitesimal way, and it's messed up my life when I've tried to live in the proper way.

So we have got the resources to take care of those people. The investors I don't worry about. I wrote about this a few years ago. The investors can diversify their investments in such a way that, overall, trade benefits them and they don't get killed by a specific industry condition. But the worker, in many cases, can't do that. You're not going to retrain some 55-year-old worker in New Bedford who may not even speak English in our textile mill or something. I mean if they get destroyed by something that's good for society, they get destroyed unless government puts in some policies that takes care of people like that.

And we've got a rich society that can do that and we got a society that will benefit by free trade. And I think we ought to try to hit both objectives of making sure that there is not road kill. And at the same time, we get 320 million people get the benefits of free trade. Charlie?

CHARLIE: Well I don't quarrel with that and we have unemployment insurance for that exact reason. But I'm afraid that the capitalist system is always going to hurt some people as it modifies and improves. There is no way to avoid it.

WARREN: Yeah well capitalism is brutal to capital if you're in the wrong businesses. And like I say, you can diversify those results. Capitalism is brutal to people that had the bad luck to be skilled or developed their skills for decades, but a very rich society can actually—if it's beneficial to society overall—it can take care of those people.

The bill that was passed a couple of days ago reduces my taxes, you know, by 17%. Is that needed by the government or anything?

CHARLIE: I wouldn't start spending the money.

WARREN: No, but that was—no, I agree. I don't think—who knows what happens with the bill. But to have that happen—and I think if you poll a thousand people in Omaha that were walking through a shopping center as to whether my tax is cut by some very large sum because it passed—I don't think many people would have the faintest idea what happened in terms of the coverage of it and all of that took place.

It's probably more like $57,000 or $58,000 of GDP per capita, a family of four, $230,000, but nobody should be road kill in this...

CHARLIE: Otto von Bismarck said there are two things that nobody should have to watch, one is the making of sausage and the other is the making of legislation.

WARREN: Well, I would say that somebody ought to watch. Anyway, we've hit the magic hour of 3:30. We'll reconvene at 3:45 to have a formal shareholders meeting and that may take a while, so you're welcome to stay and watch that or you're welcome to shop and I might even have a small preference of that, but do whatever you wish, okay.