



1 May 2010

## **2010 BERKSHIRE HATHAWAY ANNUAL SHAREHOLDERS' MEETING**

**“My ideal business would have incredible pricing power. It would also have a monopoly or near monopoly position.”**

**- Charles Munger**

We made the annual pilgrimage to Omaha, Nebraska to attend the 2010 Berkshire Hathaway Annual Shareholders' Meeting. As usual the Question & Answer session with Warren Buffett (age 79) and Charlie Munger (age 86) lasted a marathon six hours and covered topics ranging from the Goldman Sachs SEC Investigation, business valuation, the state of the current economy to the eventual future of human civilisation without Oil.

A record of c37,000 people attended the meeting this year at the Omaha Qwest Centre. The questioning has improved significantly over the past couple of years with the new format of questions being moderated by Carol Loomis (Fortune Editor), Becky Quick (CNBC reporter) and Andrew Sorkin (New York Times). Warren was at his best with his one-liners and Charlie with his one-words.

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

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

The meeting opened with the annual Berkshire Hathaway film produced by Susan Buffett Jr (Warren's daughter) and featured Henry Paulson, The Simpsons, the cast of Desperate Housewives, baseball player Alex Rodriguez, Bill Gates and of course Warren and Charlie to name just a few.



## **Q&A Session**

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

**Buffett:** You all know my partner Charlie, I can see and he can hear so it works very well.

[Buffett then introduced the board who were in attendance in the front row (including Bill Gates, a Berkshire Director).

Buffett began by satirically announcing the eleven best words that he heard anybody say to describe the money market environment in late 2008]:

**"If it doesn't loosen up soon this sucker could go down."**

- **George W Bush (September 2008)**

**Buffett:** I haven't heard anybody summarise the situation in 2008 so aptly. (laughter)

**Buffett:** What we are seeing in our businesses is that, what was a sputtering recovery a few months ago, seems to have picked up steam in March and April 2010. Our businesses that serve broad industry are seeing a pretty good uptick - **It is a long way from what we were seeing a couple of years ago, but what was very spotty of the recovery a couple of months ago has turned into stronger trends recently.**

Here at Berkshire, we focus on the operating earnings of our business and do not report EPS (earnings per share) on a quarterly basis. There was a very interesting study that was published a few months ago where thousands of earnings reports were studied and instead of taking EPS out to the penny (which is customary for reporting) they took it out one further digit. Of course if you go one further digit and its 4 it will be rounded down and if its 5 it will be round it up. From this study it was found that there was a statistically impossible low number of 4s in the earnings number. What was happening was that when companies got the 4/10th of a cent, somehow, someone in the accounting department managed to find a way to add an additional 1/10th of a cent to earnings so that they were able to round up. This was not an accident and here at Berkshire we do not provide investors with earnings guidance and 'whisper numbers' to the market as we believe that this form of behaviour increases the likelihood of management teams behaving poorly and not focusing on the long-term objectives of the business. Charlie, what do you think?



**Munger:** I agree with you.

(Laughter)

**Buffett:** He is the perfect vice chairman!

**Q:** Warren, every year at the meeting you tell your Managers that if they lose money for Berkshire you will be understanding, but if they lose a shred of reputation for Berkshire you will be ruthless in your reaction. Clearly Goldman Sachs has lost reputation because of the SEC's allegation. Could you please comment on your reactions to the SEC's allegation?

**Buffett:** I think there has been a misrepresentation of the nature of that transaction. I would like to take a little time to go through this transaction first and then we will get to the question.

[Buffett then spent an unprecedented 30 minutes of the meeting explaining the role of Goldman Sachs in the scandal. Goldman's top executives appeared at a hearing before a Senate committee last week, with both Democrats and Republicans accusing the firm of marketing securities it knew were likely to fail and contributing to the 2008 global financial near-collapse.]

[Buffett then discussed his firm belief in *caveat emptor* (let the buyer beware) and stated that he doesn't give a thought to who is on the other side of a transaction as he doesn't care]. **"If I have to care about who is on the other side of a transaction that I was entering, then I shouldn't be doing this transaction as it means I don't know what I am doing".**

[Buffett basically believes that Goldman's hadn't engaged in improper activity and shouldn't be blamed for the losses of its clients].

**"Banks that lost money should bear the consequences of the risks they took. It's a little hard for me to get sympathetic with a bank that made a dumb bond deal"**

**"We love the investment in Goldman and I would expect that there is no question that the allegation alone has caused the company to lose some reputation - However, I don't think that the allegation of something fits my definition of losing reputation."**

**"The accusation of impropriety is not enough to ruin a reputation under my definition - if this changes we will reassess at that time"**

**Buffett's advice on efficiency "Get it right, get it fast, get it out and get it over"**



**Q: What do you now think about Berkshire's large investment in Goldman?**

**Buffett:** Ironically, this has probably helped our investment in Goldman in certain ways. We have a \$5bn of preferred stock that pays us \$500m every year. Goldman has the legal right to call this preferred stock at any time at 110% of the par value. So anytime they want Goldman can send Berkshire \$5.5bn and they can stop paying Berkshire \$500m a year. If we got the \$5.5bn in we immediately would put it in very short-term securities making about \$20m. If someone has invested money at these cash rates when Columbus landed on our shores they would have just about doubled their money today. (laughter)

So every day that goes by that Goldman does not call our preferred is money in the bank for us. It has been pointed out that our preferred has been paying us \$15 per second so as we sit here, tick, tick, tick, \$15, \$15, \$15 - I don't want those ticks to go away, I just love them (Laughter). Even when I am sleeping at night we are making \$15 per second from this investment - I sleep very well!

I think Goldman's would like to get rid of that preferred now. I think what is happening to Goldman's will effectively delay the calling of our preferred for some time. So the ticks will go on (laughter) and we will be getting \$500m a year instead of \$20m a year.

**Munger:** I agree with all of that, but I also believe that every business should decline a lot of business that may be perfectly legal - In other words I don't believe that the standard of business should be 'what is legal', the standard of business should be different.

I don't think there is an investment bank in America of any consequence that did not take too many scuzzy customers and did not make too many scuzzy deals. (applause)

**Buffett:** Our experience with Goldman has gone back 44 years - through these years we have done more business with them than any other investment bank. We don't hire them as investment advisors - we are in the business of making our own decisions. When we are trading with Goldman's, they could very well be shorting the stock that we are buying or buying for their own account something that we are selling. Goldman's do not owe us a divulgence of their position any more than we need to show them our positions. We are acting in a non-fiduciary capacity and they are acting in a non-fiduciary capacity.



**Q: What are your thoughts on the financial Bill that Congress is working on?**

**Buffett:** Charlie, It's 1,550 pages so you take the first 1,500 and I'll take the final 50. (laughter)

**Munger:** I don't believe that anyone in America right now, including the people in congress know what is going to happen. Now I haven't read the whole Bill but I am reasonably certain that no one in Washington has either. (applause & laughter)

I believe that the system should be changed as to take away investment flexibility from the banks.

**Buffett:** Charlie, I know you haven't read all 1,550 pages but would you vote for it today?

**Munger:** No, I simply don't know enough about it and I don't believe that anybody really does.

I would reduce the activities permitted by the banks. We shouldn't have complex investment banks that you couldn't understand even if you were a partner in the business. The investment banks should have a much simpler and safe business model. If you give human beings the flexibility to take unlimited risks and credit, they will go plum crazy - and of course they did.

**Q: Could you please discuss Berkshire's position on the proposed derivative regulation in congress and specifically will Berkshire be required to post additional capital for its current derivative positions?**

**Buffett:** I don't believe that Berkshire will be required to post additional security for its historical contracts. If however, the regulation changed and Berkshire was required to post capital for historical contracts, we would of course comply.

I don't think that it makes sense for capital requirements to be retrospective. The derivative contracts that we have were negotiated and priced on the basis of no capital lodgement. If we were required to retrospectively lodge collateral for our historical derivatives contracts, we feel that we would be due substantial money because in negotiating those contracts there was one price for collateralised contracts and another price for uncollateralised contracts.



If I had a house for sale that had two prices, furnished for \$120k or unfurnished for \$100k and you decided to buy the house unfurnished for \$100k. Then Congress comes along later on and says that all houses need to be sold with furniture and, by the way, that's retroactive, then I would need to supply the furniture to the guy I sold my house to and would want something for it as the \$100k price that the sale was negotiated on was for an unfurnished house.

Charlie, what do you think?

**Munger:** I agree - I have nothing to add.

**Q: Does National Indemnity have value beyond CEO Ajit Jain?**

**Buffett:** The company has competitive advantages beyond other companies. Ajit has maximised those advantages, but he also has a staff of about 30 people who would make the Jesuits look quite liberal in terms of what they let their membership do. Ajit runs an extremely disciplined and focused operation. Losing Ajit would be a huge loss, but the reinsurance company would continue to get business. As for Berkshire's float, it seems to keep growing and is at about \$60bn now. I thought that I was ready to quit at \$20bn and considered that the apex. I don't think that \$60bn can grow appreciably at a fast clip from here, without an acquisition.

**Munger:** Well I agree with you and have nothing to add.

**Q: How does the situation in Greece compare to the deficits-debt situation in the United States? What will likely happen with the Euro?**

**Buffett:** The past conservatism of the United States gave it wonderful credit, and the country used that credit to help rebuild countries after wars, which was a good thing.

You always want to distinguish between countries borrowing in their own currency and countries forced by the world communities to borrow money in other currencies. Borrowing under other currencies doesn't allow countries to pump out more money to deal with their credit problems, and that can cause failures. Greece has its own sovereign budget, however it doesn't have its own currency - it has the Euro. Therefore it is unable to print currency in order to pay off debts. The Euro was an experiment, and the world may be seeing a test case played out.

**"I am not forecasting disaster, but I don't know how this movie will end. I try not to go to movies like that."**



As long as the United States borrows money in its own currency, there will be no possibility of a default as we can just print more money [this would eventually lead to high inflation], but having countries buy US debt is another thing.

The events of the world over the last few years makes me more bearish on all currencies going forward.

**Munger:** Generally speaking we are agnostic about currencies in terms of relative values.

The US does not have as good a credit rating as it once did. The US is closer to trouble than it has been in my lifetime!

**Q: What is the greatest challenge to the U.S. economy in relation to other countries, and what does that mean for investments?**

**Buffett:** The biggest threat in my mind is massive nuclear or biological attack. Over 50 years, the chances of that occurring are pretty high. Over one year, the chances are pretty low.

The United States has made incredible progress and the system is remarkable, allowing fairly ordinary people to do extraordinary things and that game isn't over. The country today probably doesn't know its own potential anymore than someone in the 17th century knew his potential. If China and India do well it does not mean that we do not do better - this is not a zero sum game. I would be perfectly content if Berkshire was forced to limit its opportunities to the United States. (applause)

**Q: How did the people whom Buffett is considering to succeed him as chief investment officer fare during 2009?**

**Buffett:** They did well - none of them used any leverage at all. That position is less urgent than the CEO successor. If I die tonight there would be a new CEO in place within 24 hours. But an investment successor can wait, it can be a leisurely process. They can wait a month, they can wait two months, Coca-Cola and Proctor & Gamble aren't going anywhere in a hurry.

There are some very able people who would like very much to be managing money for Berkshire. The company has the most distinctive culture of any company in the country. It took a long time to build, and Charlie and I love it. Charlie?

**Munger:** The one that I am the most familiar with returned a little over 200% in 2009 with a leverage of zero.



**Buffett:** I did just have a physical and came out fine. My doctor isn't here today so I will tell you that it drives him nuts because I eat like I do and he can't find anything wrong - he wants to believe me. [Warren then opens another Cherry Coke and continues eating See's Candy which gets a good laugh from the crowd]

**Munger:** I am not the most optimistic of the two people up here, yet I am quite optimistic that the culture of Berkshire will outlast greatly the life of the founder.

**Q: Could you please discuss the rationale for your recent shift from investing in businesses that require very little capital to operate, to businesses that require large amounts of invested capital each year?**

**Buffett:** Ok, it is clear that you understand the situation quite well. We are putting big money into good businesses from an economic standpoint. But they are not as good a businesses as the ones that we were allocating capital too when we had much less money. Looking at See's candy, It has about \$40m of required capital in it and makes more profit than this capital requirement annually (that is a 100% return on invested capital). Now if we could make anything like this return on another \$40m invested in the See's candy businesses we would be down there this afternoon with a cheque. Unfortunately, wonderful businesses don't soak up capital and this is one of the reasons that they are wonderful. We can't find the See's candies that will soak up the amounts of capital that we are generating every year - if we find them we buy them right away. Therefore, we think that it makes sense to start buying businesses that require lots more capital but generate a lower but respectable return on that capital. This is working quite well for us I think, but it can't work brilliantly. The world is not set up so that you can invest tens of billions of dollars and get huge returns - it just doesn't happen.

We try to spell this out to our shareholders all the time. We are still generating more than \$1 of present value for every \$1 of capital invested therefore we will not pay the capital out.

See's Candy is a wonderful business but it is not growing. It doesn't translate itself around the world like the Coca-Cola business. Coca-Cola is a terrific business as it is able to grow around the world and continues to allocate large sums of capital while generating high returns on that capital.

We don't know how to continue to allocate these vast sums of capital and generate exceptional returns. I hope we don't disappoint you in putting significant amounts of capital out to work generating good returns. But if anyone expects brilliant returns from here we just don't know how to do it. Charlie?



**Munger:** Well I am just as good at not knowing as you are. (laughter)

**Q: How can children be taught financial responsibility, so that we avoid the financial mayhem of the last three years?**

**Buffett:** We'll see financial mayhem occasionally because people will do crazy things. What happened occurred in part because of conventional wisdom coming out of business school. Good financial habits early in life are incredibly important.

**Munger:** I am yet to hear a single apology from education institutions for their part in the financial crisis. I think there are a lot of fine educational institutions in the U.S. One of the ones I admire the most is McDonald's. McDonald's teaches young people how to make money and responsibility far better than most education institutions in America. I think we all owe a lot to McDonald's and it is not appreciated enough.

**Q: When will Berkshire's subsidiaries start hiring again?**

**Buffett:** Berkshire will hire people when they have something for them to do. The carpet business is down 6,000 people from its peak. There is no reason to hire people if there is nothing for them to do. The country also needs a good safety net for people who don't have work, and currently there is significant unemployment. That will change, though not quickly. But Berkshire should not be the social safety net. Charlie what do you think?

**Munger:** I agree with all that. I think if Berkshire becomes the social safety net in order to increase human hope, then this would actually cause us to decrease human hope.

**Q: What kind of risk does inflation pose in the U.S.?**

**Buffett:** I am always worried about inflation. Since I was born in 1930, the dollar has depreciated by well over 90% but we have obviously done ok - so inflation isn't necessarily the end of the world. I think the prospects for significant inflation in the US and around the world have significantly increased. I think the responses taken were justified but I also think that weaning ourselves from the medicine was harder than solving the original illness and the medicine has been massive dosages of debt. I don't see any way that countries running high deficits to GDP don't have a significant depreciation in their currency over time. If I had to bet my life on their being either high inflation or low inflation in the U.S. over time, I would bet high inflation.

Your money can be eroded by inflation but your talent cannot be - Invest in yourself. If you are the best brain surgeon in Omaha you will always do well.

Charlie?



**Munger:** Well again I agree (laughter)

**Q:** Why have you invested in debt over the past 2 years and not equities in general? Why did you lend Harley-Davidson money rather than buy their common stock when it was \$12, today they are \$33. You would have had a much greater return from the common stock?

**Buffett:** Well, I think I have the same question (laughter)

There are different risk profiles obviously. I knew enough about Harley-Davidson to know that it wouldn't go broke, so I knew enough to lend them money but I didn't know enough to buy the stock. The truth is that I do not know whether Harley-Davidson's equity is worth \$33 per share, \$20 per share or \$45 per share - I just have no view on that. I just can't work out what is going to happen in the motorcycle industry with margins and sales. I like a business though where the customer tattoos your brand name on their chest - this type of business appeals to me (laughter). I just don't know how to value that.

If I think I can make money with a simple decision of whether I think Harley Davidson will go broke or not and lend them money, as opposed to trying to work out where the motorcycle industry is going and whether margins are going to be squeezed to buy the equity, I will go with the simpler decision.

Ben Graham wrote about this in 1934 in Security Analysis. He said that you usually get a better return from a junior security over a senior security, but you sleep better at night with a senior security. Charlie?

**Munger:** I have nothing to add.

**Q:** Who would you want running Goldman if Lloyd Blankfein wasn't there anymore?

**Buffett:** I really don't put any thought to that as he is there - there are a number of people in Wall Street that I think would make a terrific successor. Charlie?

**Munger:** There are plenty of American CEOs that I would like to see gone. (laughter).

**Buffett:** Ok, on that note moving right along - I thought Charlie was going to name names for a second there.



**Q: I recently joined a new organisation and I now realise that for me to succeed there I will need to change the culture of the organisation. How do you change the culture of an organisation?**

**Buffett:** I think it is hell of a lot easier to build a new organisation around the culture than it is to change a culture of an existing organisation. (applause) It is really tough to change the existing culture of an organisation and I like that about Berkshire. It would be almost impossible to change the culture of Berkshire as it is so engrained within the organisation. If you had any choice in the matter I would much rather start a new culture. Charlie?

**Munger:** Well I am quite flattered to say that a man would be in an organisation where he wants to change the culture and he is asking us how to do this. In your position my failure rate has been 100%. (laughter)

**Q: From a small child - Good morning Uncle Warren and Uncle Charlie. I have to call you uncle as I am from India and we call everyone older than us uncle. India's economy has been growing at 7-8% per annum. At this rate it will surpass US GDP by 2043. My question is why aren't you investing in India?**

**Buffett:** First of all, you need to start calling us Great Uncle (laughter).

Good question - we have connections there obviously (through Ajit). In the insurance field there have been very strict limitations on what a non-Indian owned company could do. As of yesterday, I agreed next March to go to India to see Iscar who would like more capital to expand. We do not rule out India as potential opportunities for direct investment or marketable securities. People in India will be living a lot better than they are now in 20 years time, so will China and so will America.

**Munger:** The one problem that India presents is that its governments are plagued by paralysis.

**Q: Could you please discuss the Kraft deal?**

**Buffett:** Kraft was stupid to sell its pizza business and buy Cadbury. The company's stock is now valued at less than the sum of its component parts. They gave away the stock for much less than its intrinsic value. In a stock deal everyone only looks at what they are paying and not what they are giving up.



**Q: Mr. Buffett, you commonly refer to the U.S. tax system as inefficient as you are paying a lower tax rate than your assistant. How do you think the tax system should be changed?**

**Buffett:** Well, you could have a wealth tax. Also, if you want to give away all of your money like me it is a terrific tax dodge (laughter). In my tax return that I just filed, in the contributions line, I have a carried forward tax credits of over \$7 billion that I haven't got a deduction for (laughter). I welcome anybody else who would like to follow my tax dodge example of giving away all their money, they will save a lot of taxes that way.

**Munger:** Well I think that those who are overly concerned about Warren's low taxes can be rest assured that he will eventually pay a 100% tax.

**Q: Could you please discuss how you were able to build conviction in the BYD investment?**

**Munger:** If the BYD opportunity came along five years earlier, Berkshire would not have been able to invest. This investment shows that the 'Old men' are still able to learn and expand their circle of confidence.

**Q: How do you set Berkshire's management's compensation - what metrics do you use?**

**Buffett:** First thing we do is we never engage a compensation consultant. (applause) Berkshire has seventy something businesses now and there is no one metric that we look at that can cover all of them. It is really dependent on each individual business and what the manager can actually control. We have some businesses that are capital intensive, we have some businesses that don't require much capital, we have some businesses that are very difficult to run and some that are so good that even a chimpanzee could run so it really varies for each business. I try to figure out what is the sensible way to employ someone and compensate them given the economics of the business -- this is not rocket science but does require the ability to differentiate. If we had a HR department it would be a disaster. It just requires a certain amount of common sense where I listen to them and they listen to me and we agree upon what is the measure to monitor what they are really adding to the company. Charlie, what do you think?

**Munger:** No one else is really like us which makes us kind of peculiar and we like it like that.



**Buffett:** We pay some very big money. We have managers that have made and will make in the tens of millions annually. You have got to treat people fairly, even if they don't need the money, everyone wants to be treated fairly. The number one thing that I want to pay managers for is widening the moat that separates our businesses from competitors businesses - monitoring this is the subjective part. This is what is always going through my mind when designing compensation packages.

**Munger:** Importantly, we make no headquarter charges to our subsidiaries - headquarter charges are resented in the field so we just don't do it. A number of large American corporations haven't figured this out yet.

**Q: What are the keys to Berkshire's internal compliance?**

**Buffett:** I keep repeating to our managers every year that make sure they would be happy with their actions being reported by an intelligent and rational reporter on the front page of your local newspaper for all your family and friends to read about.

If the best reason that you can come up with for doing something, is that the other guys are doing it, then it is not enough. I tell them if you think it's questionable give me a call. By saying this, no one calls me as if they have to think about it they know it must be too close to the line.

**Q: What is the most important thing that you have learnt from China?:**

**Munger:** It has some very unusual people in BYD (laughter). No other lesson is quite as important as that.

**Buffett:** I have learnt that they like Sprite better than Coke. Sprite outsells Coke 2:1 in China [One reason for this is due to a lack of domestic refrigeration in Chinese homes and Sprite tastes better at room temperature than Coke.]

I haven't learnt to eat Chinese food yet though. (laughter).

I think China is an amazing economy, there is not a question in my mind that the growth on a per capita basis is going to be amazing going forward. In 1790 there were about 4m people in the U.S. In China in 1790 there were over 200m. In China they were just as smart and hard working but for 170 years or so the US has made significantly more progress and in recent decades China is catching up whilst the potential of the Chinese is significantly improving.

**Munger:** China is setting a new record for advancement of a civilisation and it is fun to watch.



**Q: Last year you said you were down on the newspaper industry - This year has your view changed at all given the introduction of the I-Pad and other electronic reading devices?**

**Buffett:** My relatively uninformed opinion, as I am not up with all the technology, but I just have a feeling it is getting worse for newspapers as they were the only game in town a few years ago and now they are not the only game in town anymore - boy what a difference that makes to a business' economics. Since I don't understand the industry anymore (and there are plenty of things I don't understand) I cannot make an informed decision on newspaper ownership therefore I will have to sit on the sidelines for this one.

The world has really changed in terms of the essential nature of newspapers. It blows your mind how fast people are dropping newspapers. When you go back to the 1970s when Charlie and I were talking about newspapers, there was nothing that looked more bulletproof than the daily newspaper. It is no longer the essential place to get this information and therefore its primacy has withered away. The advertisers were not there because they loved the publisher of the newspaper, they were there because it was a microphone to talk to everybody in town and they had to talk to everybody in town. It is a downward spiral, the newspapers become less valuable as the advertisers float away and the advertisers float away as the newspaper becomes less valuable and the number of subscribers diminish and your ability to price advertising disappears.

**Munger:** I think that we are losing something that we have no substitute for and I think that it is very sad and I haven't the faintest idea of what to do about it.

**Buffett:** Charlie and I love newspapers. Charlie and I met with Lord (Roy) Thompson in the 1970s and he owned the paper across the river in Ohio. When Charlie and I met with Lord Thompson the conversation went something like this:

Buffet & Munger: Lord Thomson, have you ever been to Ohio?

Roy Thompson: Oh, no I wouldn't dream of it.

Buffet & Munger: We noticed that you increase prices for advertising in your newspaper every year – what can the advertisers do about it?

Roy Thompson: They can do nothing about it.

Buffet & Munger: Well, in that case, how do you decide how much to increase prices by each year since it is totally up to your discretion?;



Roy Thompson: I tell my US managers to price to make 40% profit pre-tax - above that I feel I may be gouging (laughter)

**Buffett:** Those days are gone.

**Q: Will an investor still get the best return from stocks over time?**

**Buffett:** Yes, I don't know where the market is going to go this week or next month or next year but I am very confident that over the next 20 years equities will outperform cash and bonds.

**Q: You started selling your stake in Moody's this year. Has your investment case for owning Moody's changed due to regulation and if so why not sell the whole stake?**

**Buffett:** Firstly, we won't comment on what we will or won't do with any position. However, I will say this. The ratings agencies have had and still have under current conditions, incredibly wonderful businesses. The pricing power is significant and certain parts of the world feel they need rating agencies. Many feel the rating agencies let them down where the rating agencies merely succumbed to the same mistakes that the rest of the world made. They couldn't see a world where residential housing country-wide could collapse. It is very hard to be contrary to the crowd. If rating agencies are not forced to change their structure in some way it is a pretty darn good business in that you can't shop pricing at a rating agency business. Charlie?

**Munger:** The rating agencies in their present form under the current structure are wonderful businesses.

**Q: How much of current prosperity do you attribute to us being able to use oil for energy? How will we survive without oil?**

**Buffett:** The discovery of oil changed the world in a very major way. Since then, we have been sticking strongly to oil. It has contributed in a huge way to the prosperity of the world. The world in my view will not be dependent on oil for the next 100 years. Don't ever give up on human's ability to innovate in ways that creates solutions to problems. If I had to pick a time in history to be born, I would pick today - the world has a bright future, ignoring the threat of nuclear or biological war, which can't be predicted.



**Munger:** I think your failing to recognise something really important. In the technology of 150 years ago they needed oil in order to advance. In our advanced civilisation, we can progress without it. It isn't that horrible to contemplate a world that goes off oil, provided that world is as rich and knowledgeable as we are now. The fact that we could not have done without the oil 150 years ago does not mean that we cannot do without the oil today.

**Buffett:** It is also important to note that the adjustment will be gradual. It is a workable adjustment in my view.

**Q: In the middle of the market decline I was too scared to invest. How do you make yourself invest?**

**Buffett:** In the business of investing I don't know what you can do about being scared. If you have a temperament that you get scared when others are being fearful, then you are not going to make a lot of money out of investing.

Think about how much more rational investing in a farm is than people who buy stocks. When you look at a farm you expect it to produce so many bushels per year, when you look at a stock people think that if it goes up its great and if it goes down its bad. We think the exact opposite. Charlie?

**Munger:** I think I developed more courage after I learned that I could handle hardship. Maybe you should get your feet wet with a little more failure. (laughter)

*Random Munger Joke: The husband asked his wife if she would still love him if he lost all his money. She responded, of course I will always love you... but I will miss you dearly.*

**Q: Should we be optimistic about the future?**

**Munger:** Yes, (long pause and laughter) However, it is much easier to get your expectations down than your results up. Manage your own expectations. I can be optimistic and I'm almost dead, so you should be fine. (laughter)



**Q: The American public definitely benefits from Mr Buffett's increased media profile and interviews. But, is it the best use of your time for Berkshire shareholders?**

**Buffett:** Probably not (laughter). I play bridge on the internet for 12 hours a week. I do a lot of things that are probably not in the best interests of shareholders.

I like doing the television interviews as it is far more difficult for a reporter to misreport what I am saying than in a newspaper article. I learned this a number of years ago from some misreported articles in newspapers. This works for me just fine.

**Q: How do you go about learning to value companies?**

**Buffett:** Ben Graham taught me how to value certain types of companies, but these types of companies dry up very quickly [he is talking about “cigar butt investments” meaning that they could be purchased at a deep bargain price and had “one puff left”]. Charlie then taught me to look for competitive advantages and over time I have learnt more about a lot of other businesses, but you would be amazed at how many businesses I don't know anything about. The biggest thing is not how big your circle of confidence is but knowing where the perimeter is. You don't need to know about every business, however you do need to know about the ones that you put your money in.

Have a look around your own home town, which businesses would you like to own, which businesses do you think you can understand? Which do think will be around in 10-15 years time? Which businesses have pricing power and would be tough to compete with? Talk to other people about them, keep asking questions and start from a young age. Always recognise your margin of safety.

Six or seven years ago when I was looking at Korean stocks, I could see that there were a number of businesses that passed the margin of safety test, but I diversified as I didn't know much about the individual businesses and their management. This was the old Graham approach.

**Munger:** Obviously if you want to get good at something which is competitive, you have to think about it a lot, learn it a lot and practice it a lot. In this world you have to keep learning all the time because the world keeps changing and your competitors will be learning all the time. So you just have to get up each morning and aim to go to bed knowing more than when you got up. If you keep doing that for a while you will accumulate some experience good and bad, people who do that almost never fail utterly.

**Buffett:** Charlie, did you take a business course at school?



**Munger:** None.

**Buffett:** When did you start valuing businesses?

**Munger:** When I was a little boy. I can remember I would come to the Omaha club with my father and I always ran into this man who didn't seem to do any work but was quite prosperous.

**Buffett:** And you tried to emulate him? (laughter)

**Munger:** I asked my father, how the hell does he do that father? My father said - Charlie, he is in a business where he enjoys strictly no competition. He gathers up and renders dead horses.

This was an example of avoiding competition by just one strategy.

If you keep asking questions like this from a young age, you eventually learn how to value a business.

What business is working, what business is failing, why is it working, why is it failing. You need to have this inquisitive temperament - if you don't have this temperament then I can't help you.

**Buffett:** When Charlie was a lawyer and any client came in, Charlie would think about the clients business as though he owned it. In fact in many instances I think Charlie knew more about the clients business than the client did. Charlie was incapable of looking at a business without thinking about its economics from every angle.

**Q: What type of business has the best return on capital?**

**Buffett:** Generally businesses that pay you in advance that use customers capital, subscription businesses.

**Munger:** I've got nothing to add - at any rate the formula never changes

**Buffett:** If you could own one business in the world, what business would that be Charlie?

**Munger:** We could get in trouble for addressing such a subject so I won't

**My ideal business would have incredible pricing power. It would also have a monopoly or near monopoly position.**



**Q: How can I be successful?**

**Buffett:** Follow your passion. If you want to be successful you need to love what you do. If you find something that turns you on, my guess is that you will do very well at it. The beauty of it is that there is not a lot of competition out there.

There are not a lot of people out there that are going to be running faster than you in the race that you elect to run. If you haven't found it yet, you've got to keep looking.

Mrs B never went to school a day in her life. I hope you go out as we are expecting to set a record in sales today (laughter). This is the largest furniture store in the United States and it comes from \$500 capital paid in by a woman who never went to school a day in her life and couldn't read or write. She loved what she was doing.

I'll tell you a story, this is a true story. When she was well into her 90s she invited me over to her house for dinner which was very unusual. She had a very nice house six or seven blocks away from the store. I went into the house and the sofa, the chairs, the dining room table, they all had little green price tags hanging from them. She told me that they were to make her feel at home. I said to her, "Mrs. B, you are my kind of woman!" (laughter)

She loved it and loved it all her life - just think about how difficult that would have been to compete with.

**So, find your passion and don't ever let anything stop you!**

Prepared by

**VGI Partners**

Omaha, Nebraska, 1 May 2010