Notes from the Meeting Dr. George Athanassakos and Ivey MBA and HBA students had with Mr. Warren Buffett
Omaha, NB, February 27, 2015, 10:00 am - 12:00 pm

Question #1:
How do you pick winners (the right people)? How do you know they are the right fit for your company?

Answer #1:
I believe there are always winners but picking the right winner for my company is a challenge. I know an individual who is definitely going to outperform the S&P but he's the last guy on earth I'd want my daughter to marry. So first and foremost, you have to feel good around them, you must enjoy their company, like a friend or a family member. If you feel good around them, it means they have characteristics you admire and are moving in the direction you want to associate with. These people represent who you'd like to be and you may perceive them even as better than yourself. You can admire their behaviour or intellect but always judge them as a human being if you want to be their friend. These people do 10 things for every 1 thing you ask for; they go above and beyond what you expect of them. You want to associate with first-class people (like William Ruane, one of the classiest individuals).

Question 2#
What is your personal definition of 'success'? How has it changed over the course of your career?

Answer#2:
The saying goes that success is about getting what you want, while happiness is about wanting what you get. For myself happiness is more important. My goal was always financial independence; working for myself and finding a job where I admire the people I work with. I was interested in being in a position to control the decision making process. At age 25, I had enough money to live off of. I had two children and the equivalent of roughly $2M in today's money. Everything since then has been surplus.

As you move along in your career, you always want to consider your inner scorecard – how you feel about your own performance and success. You should worry more about how well you perform rather than how well the rest of the world perceives your performance. The success of Berkshire has always been more important than my own personal success in terms of financial returns. The most important takeaway is that you should always try to be a good person.

Question#3
How do you develop conviction for contrarian ideas? How do you perceive risk?

Answer#3:
At Berkshire we have certain filters that have been developed. If in the course of a presentation or evaluation part of a proposal or of an idea hits a filter then there is no way I will invest. Charlie has similar filters. We don't worry about a lot of things as we only have to be right about a certain number of things – things that are within our circle of competence. A great example is the Nebraska Furniture Mart that you visited this morning. Mrs. B took cash because she didn't understand stocks. It is important to know what I can do. I have no idea which company will dominate in the auto industry in the next 5 years so I don't pick. I prefer simple things in my circle of competence. Good decisions scream at you. For example in 2008 you shouldn't have been afraid just because assets were cheap. In your entire investment lifetime you may have 6 times when this happens and it is 'raining gold'.

With regards to risk, the Berkshire portfolio suffered a 2% loss once and had 1% losses twice in our history. This was all in 1974 and 1975 when we sold assets cheap to buy other assets cheaper. Stocks are riskless if held over a long time frame as you are simply giving up purchasing power now for later. Cash is the risky asset. Risk in stocks is not what the companies will do. Traditional finance teaches that Beta is a measure of risk but volatility isn't risk. Risk is loss of purchasing power. Volatility declines over a long enough timeframe. It is individuals that make investments risky. In our report that is due out tomorrow I talk about how risk needs to be rethought. People think stocks are riskier than bonds, which is not true for a long time horizon.

Question#4:
Have you ever made money on someone else's ideas?

My preference is for my own ideas. I prefer to find good companies trading at fair prices. You can make money on cigarette butt investing but this works better with small amounts of money and was more effective years ago. You can't build businesses out of cigar butts. I don't read analyst reports and, although I get served up many ideas I don't seek outside ideas. I stay within my circle of competence. Berkshire's AUM means the universe of potential investments is smaller even though good, attractively priced ideas are often poorly covered. For instance, recently I did screening of the Korean market and found a few interesting opportunities.

I used a 1950s (1951) Moody's manual by sector. There was some good stuff in the back on page 1433. Western Insurance was a company that I looked at. It had an EPS of $29 and the high price was $13. Nobody showed me this. So I checked it out with insurance brokers and it checked out OK so I bought into the company.

All in all, I prefer to read "raw" financial reports and talk to industry representatives.

Question 5: Both you and Mr. Munger are writing down your 50–year visions. What are these visions going to be?

Over the past 50 years, we've always focused on buying companies that are scalable. With the companies that we've acquired, we believe we have created something very scalable. We also have the right form, culture and business to grow at a reasonable rate over time.

Question #6:
How do you feel about income inequality?

Answer #6:
Income equality will get worse but the term income inequality is in itself flawed because implies that equality is something we should aspire to. We should aspire towards equal opportunity. But as capitalism moves forward, the bottom 10% or 20% will find themselves further and further behind. This is because society has become much more specialized. Back in the farming days, the income difference between someone with an IQ of 150 vs. someone with an IQ of 80 would not have been disastrous, since most people could do farm work. Then we moved into manufacturing, a bit more specialized, but still okay. Now the market structure is giving more advantage to people with particular skills. Take the example of boxing. Before the advent of TV, the best boxers may be getting six thousand dollars per fight. Now we have Manny and Mayweather, who will be fighting for hundreds of millions. Someone came along and invented TV, and then someone figured out how to promote the fight and make money.

Another big factor that affects income inequality is the tax code, which is largely skewed to favour the super rich. The top 400 gross income earners based on their tax returns pay less than 20% tax.

So the market system doesn't really address inequality. However, it is the best system that we have.

Question #7:
How would you characterize the state of corporate governance today? Do activist investors bring value to shareholders?

Answer #7:
If I were solely interested in attracting money as a new money manager, I would call myself activist investor as they are very popular now. As the numbers of activist investors grow, these managers are having more and more trouble finding companies to be active in. On the other hand, the self-cleansing method of management in companies has continuously failed.

One problem with activist investors is that they are sometimes only looking for a "pop" in the stock, so I personally do not like the short term horizon of some activists and would only back a small handful of activist investors.

The activist phase has not reached its peak yet and will be with us until activist funds stop making money. Wall Street pushes great ideas until they are silly. It is important to remember the limitations of ideas and once there are too many activist investors there will be problems.

Question #8:
With the rise of social media and constant information it seems students are losing the ability to sit down, think, and formulate their own thoughts like you have in the past. We prefer short bits of information to novels. Can you talk about whether you view this as a problem and the impact that deep and independent thought has had on your career?

Answer #8:
A good part of our success is that we spend a lot of time thinking. At Berkshire, we don't have any meetings or committees, and I can think of no better way to become more intelligent than sit down and read. In fact, that's what Charlie and I mostly do.

The teaching of efficient markets produces a disadvantage for students and a big advantage for those who read and try to find value. It personally give me an edge when other people are not paying attention to reading and thinking, and are instead on their phones. It means that I gain knowledge from reading a few 10-K's while others are tweeting what they had for breakfast.

I've seen a lot of change in my lifetime, especially among how people spend their time.

Question #9:
What are questions investors should ask but usually don't when evaluating companies

Answer #9:
Start by looking at 7-8 companies in the industry and ask the management typical due diligence questions. Also, ask the management of each company which competitor they would be willing to put their net worth in for the next 10 years. Then ask which of their competitors they would short. This will provide important insights into the industry that even those who work their whole life in the industry would not realize.

On a personal level, I recommend that people do this with the network of people they know.

Among your friends, who is one person you most want to emulate and who would you want to be least like. You can approach this by thinking about which of your peers you would want to own 10% of for the rest of their lives and which ones you would like to short. Then identify the qualities that make you want to emulate them and try to internalize those qualities. Do the opposite for the friends you would want to short. You are currently still young and can get rid of your bad habits, "The chains of habit are too light to be felt until they are too heavy to be broken".

Question #10:
Mr. Buffett, given Burger King's recent acquisition of Tim Hortons, can you comment on the potential for US companies to continue inverting into Canada?

Answer #10:
The primary reason for Berkshire being involved with 3G Capital was because they are good and trustworthy individuals, not for the tax benefit. The most federal income tax that Burger King has ever paid was approximately $30 million but their earnings are in the neighbourhood of $12 billion so the tax shelter benefits are negligible. Further, given that Tim Hortons earns 2x as much as Burger King and that the Canadian Government had to approve that the acquisition was a net benefit to Canada, this acquisition was not a typical tax inversion. That being said, to prevent further inversions in the future, I would not be surprised if corporate tax law in the United States were changed to prevent these inversions in the foreseeable future. However, as a result of numerous wealthy and influential individuals and organizations lobbying for preferential treatments the obstacles preventing such tax changes are large.

Question #11:
You mentioned Mrs. B earlier, and in your annual letter last year, you mentioned students like us could learn a lot from Mrs. B – what do you think are the top lessons we can learn from Mrs. B?

Answer #11:
Think about how improbable it is that a women walks out of Northern China, can't speak a word of English, and just out of proceeds of that $2,500 that she saved from selling used clothing for 16 years, she built a store worth close to $1B. There must be something to learn from that, because she didn't invent anything. She didn't have any money, store or training. Yet she won. Sam Walton is another example, compared to Sears in the late 1960s - 100 stores in Chicago, probably 20 million credit card customers, first call on every piece of real estate, unlimited financial resources, yet someone with a pick-up truck in Arkansas beat them.

Charlie and I love to read biographies, and what we like to ask is "what makes these people succeed and what makes the ones that fail?" I use Sears as an example to show the ABCs of failure – Arrogance, Bureaucracy and Complacency. And Sears had them all. When you build an organization that has been incredibly successful, you have to work extremely hard to fight off arrogance, bureaucracy and complacency.

One thing that Sam Walton and Mrs. B had in common is they had passion for the business. It isn't about the money, at all. It was about winning. Passion counts enormously; you have to really be doing it because you love the results, rather than the money. When we buy businesses, we are looking for people that will not lose an ounce of passion for the business even after their business is sold. And getting in bed with people like that is what it's all about.

Question #12:
In your 2013 essay, you stated that you were optimistic about the future of the US economy, in particular with regard to the role that women play in the economy. Could you expand on your thoughts from that essay?

Answer#12:
Before women and minorities were involved in the economy (i.e., pre 1920), America achieved a lot (GDP per capita increased, over a few decades, six times) with only half of its workforce. Imagine the types of gains that could be made using the full workforce. We have moved in the right direction over the past 15-20 years. My sisters have the same intellectual capacity, and have excellent personal attributes, but they never had the same opportunities being born at the same time as me, to reach the same level of success. Instead, they were expected to marry well. Even today there remains room for improvement. Only three of twelve directors at Berkshire are women. On March 5, 2015 I will release my sixth tweet ever which will have to do with an announcement related to female management.

Question #13:
What are some common traits of good investors?

Answer#13:
A firmly held philosophy and not subject to emotional flow. Good investors are data driven and enjoy the game. These are people doing what they love doing. It really is a game, a game they love. They are driven more by being right than making money, the money is a consequence of being right. Toughness is important. There is a lot of temptation to cave in or follow others but it is important to stick to your own convictions. I have seen so many smart people do dumb things because of what everyone else is doing. Finally good investors are forward looking and don't dwell on either past successes or failures but rather

look toward the future. Just look at history to see how bad things have been. We had World War 2 and a Civil War. This Country works!

Question #14
What customs have you witnessed overseas that American businesses should adopt?

Answer#14:
It is important to play with better players than you. The US is the best place to operate and you don't need to go beyond the US. It is easy to see success but it is more difficult to repeat the success. It is also important to study failure as much as you study success. In general, I find it very interesting to observe the market every day. For instance the 2008 crisis was a great movie and nobody knew how it would end. In my opinion China has changed their system to be more "US like".

Question#15
What will advance American competitiveness in the next 20 years? What are the biggest threats to that competitiveness?

Answer#15:
There is an abundance of information available these days, which is amazing. It's important to realize that everyone in this room is living a better life than John D. Rockefeller. In the next 20 years, we will be living incomparably better lives than we do now. I hesitate to think about the service my dentist provided me 20 years ago. At the same time, I'm sure that in 20 years people will feel the same way.

The drawback of growth, however, is that evil can leverage this progress to harm a significantly greater proportion of the population. I see the biggest threat to American competitiveness as represented by the acronym CNBC, namely Cyber, Nuclear, Biological and Chemical. By far the greatest threat to humanity is that of a Nuclear war. If I could allocate all my resources to effectively combat this threat, I would. Unfortunately there are very few effective channels that could effect this change.

Question #16:
Increasingly companies are reporting non-GAAP earnings that add amortization of intangible assets back to net earnings using the justification that intangibles such as software are 'non wasting' assets. Given that you have indicated in previous Berkshire annual meetings that companies try to dress up financial statements with EBITDA, could you provide your thoughts on this non-GAAP trend?

Answer #16:
This trend is seen to be more industry specific and management usually tries to convince you that some expenses aren't really expenses. It started with EBITDA. Depreciation is not only a real expense but the worst kind of expense because you pay it up front. Your plant and equipment is paid for upfront and companies record this cost over time as a non-cash expense. Amortization however may not always be a real economic expense, a strong example of this is customer relations as it doesn't diminish as fast as amortization if it does at all. Software development costs & stock options however, are a form of economic expense. When I hear companies talking about "Non-GAAP" I am very suspicious of what they do because "there really isn't only one cockroach in the kitchen."

Question #17:
What are the things that you need to be able to value a business?

Answer #17:
In order to best understand a company, you first have to understand the industry. Only focus on companies and industries you understand. Don't go outside your circle of competence. You need to know what the strengths of the company are in relation to the competition, if they have a good management team, and most importantly, what the moat is. If you don't know how many competitors the company has, do not invest in the company. Coke's moat is that it has no taste accumulation, and the moat of railroad companies are that no one can build anymore because of saturation. That is why I am currently invested in both industries.

Question #18:
You have expressed a commitment to philanthropy and have done this through the Gates Foundation and your children. Is there a particular cause that is important to you?

Answer #18:
I would ideally like to contribute to solving CNBC (Cyber Nuclear Biological Chemical) as I see it as the biggest existential threat to humans, but I have not found an appropriate vehicle to do so. In my early days, I had set up a fund to support my wife's foundation. Although she wanted to donate the excess cash that we had, I didn't want to lose the power of compounding. If I had donated $1 then, I could be giving up a $1000 in potential future donations, so it was really important to me to keep compounding my money.

I would not be efficient at all in doing philanthropy. That's why I outsource it to five foundations including the Gates Foundation and to my kids, who are a lot more passionate about solving world problems. I'd actually prefer to tackle a global issue and fail, than tackle a local one.

Money has no utility to me anymore as I am very happy with what I have but it has enormous utility to others in the world. More possessions to me would actually be a liability than an asset.

I am also trying to persuade more people to join the Giving Pledge, where individuals sign an agreement to donate more than 50% of their wealth after they die. So far, 127 people have signed up which is a great thing. The other day we got Mark Zuckerberg to sign up, which is a huge win for us because he'll go on to inspire many other young billionaires to donate their wealth, as they'll look up to him and do the same thing.