2013 Berkshire Hathaway Shareholders Meeting

Omaha, Nebraska, May 4th 2013.

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This was my eighth visit to Berkshire Hathaway Shareholders' meeting (dubbed "Woodstock for Capitalists" by Buffett). It is a unique event. The highlight continues to be the 5 hour question and answer session hosted by Buffett (82) and Charlie Munger (89) the Chairman/CEO and Vice-Chairman respectively of the Omaha based conglomerate.

The whole of Omaha, a small, normally sedate, city (with about 800,000 people in the greater Omaha area) , is in party mode for the week-end and there are a huge number of other meetings, seminars and events organised either by Berkshire's local subsidiaries or by other groups of shareholders. The weather is usually sunny but this time there were snow storms in the area. In fact, my former UCD B. Comm. classmate Fergal Mulchrone, who was due to fly from Chicago to Omaha on Friday morning on a flight that was cancelled showed his characteristic determination by hiring a car and driving the seven hour journey.

On Friday evening Bruce Lyster, (to whom I had been articled as a trainee Chartered Accountant in Price Waterhouse many years ago), Fergal and I joined a group of long-term US investors for dinner. The mood was very positive. The **A shares** were **up from $123,000** at last year's dinner **to $160,000** this year. Some of them had bought their shares below $1,000 and some below $50. The quarterly results to the end of March had been released a couple of hours previously and they were excellent - showing an increase in book value of 5.5% over the quarter.

Regular readers will know that on Saturday I usually join the "line" outside the CenturyLink Centre before 6.00am. As I was recovering from a short-term illness Bruce and Fergal volunteered to do the queuing. In the event, Bruce secured great seats for us all in the 20,000 seating main arena. I strolled in at about 7.45am. Given that the local newspaper reported that 35,000 attended this year, the seats in the main arena were at a premium and Bruce has definitely earned a sleep-in for next year! At 8.30 the hour-long "movie," produced by Buffett's daughter Susie, was the usual entertaining and often humorous collage of cartoons featuring Buffett, Munger and Gates, interviews with them and with others and advertisements for products made by Berkshire subsidiaries.

After that, Buffett announced the first quarter results and then it was time for the question and answer session. The format has improved over the years. As well as coming from the floor, about one question in four is asked by analysts who cover the stock and about the same number are asked by three journalists from CNBC, Fortune and the Wall Street Journal who pick them from thousands emailed by shareholders. Neither Buffett nor Munger see the questions in advance.

This year's innovation was to include a **"Bear" among the questioners**. Doug Kass of Seabreeze Partners who is short on the stock (effectively betting that it will go down) had responded to Buffett's invitation in his annual letter saying he would ask very tough questions and this challenge was accepted by Buffett. Prior to the meeting Buffett had, tongue in cheek, suggested to Kass that he try to knock 10% off the Berkshire share price during the meeting. In the event, Buffett and Munger easily handled Kass's questions although I did feel that Munger, clearly a little put out by the implied criticism, was a little short with him on a couple of occasions.
Scribbling furiously, I recorded 64 questions. As usual I've picked out a few of those that I thought most interesting but in reality I could have written up another 20.

Bill Miller, a well known investment manager, commented on the recent consolidation in **the US airline industry**. He said that four players now controlled 90% of all US flights and overall profitability had improved. He asked whether Buffett would consider investing in an airline. Buffett's answer was a very definite "No". Yes, the industry was consolidating but in some industries, even two competitors could ruin it for each other. Airlines had very low incremental costs per seat with very high fixed costs. The

temptation to sell the last seat at a low price was very high. It was a capital intensive, commodity-like business. The industry had been a death-trap for investors since Orville took off. If there had been a capitalist at Kitty Hawk, he "should've shot them down".

A shareholder said that as an Omahan he was thrilled that Buffett bought the local **newspaper** but not as an investor. Why did Buffett buy such a small business?

Buffett's answer was that Berkshire would get a decent rate of return on the newspapers. They paid a cheap price relative to earnings and were prepared for profits to fall over time. Nevertheless, the after tax return looked to him like it would beat 10%. At maybe $100m in pre-tax earnings the newspapers wouldn't "move the needle" for Berkshire but it was "real money". He then asked Munger whether he had anything to add. The response was: "What you're saying is that it's an exception, and you like doing it". Buffett reply was a cheerful: "I'm sorry I asked!"

A shareholder (interestingly from China) asked whether the **US dollar** would continue to be the **world's reserve currency**. Buffett's answer was that he thought the dollar would be the reserve currency for some decades. The US and China would be two super powers but he didn't see the dollar being supplanted for many years. Munger commented that there are advantages to the country that has the reserve currency. "If you lose that, you lose some advantage". England "had a better hand" when it had the reserve currency. If the US eventually lost it, it wouldn't be that significant. "Every great leader is no longer the leader over time. It's true that we're all dead in the long run." I thought this an interesting discussion. Irish investors in US stocks always worry about the currency risk especially now with such a huge US deficit. Perhaps we are overstating that risk in the medium term?

Some of the reported 35,000 Berkshire shareholders who attended the event.

Buffett was reminded about an article he wrote in 1999 for Fortune Magazine about **corporate profit margins**. At the time he said 6% was the historically normal level and he was asked how concerned he was now that the current figure was 10%. (The questioner was wondering whether profits and therefore stock values might fall.)

Buffett commented that the 10% did include the growing overseas earnings of US corporates but said that he thought the percentage profitability would trend downwards. US companies had bounced back well from the precipice of 2008 but there hadn't yet been significant increases in employment levels or pay rates.

Munger remarked that just because Warren thought something years ago didn't make it "a law of nature" and he wouldn't be surprised if "that 6% turns out to be the low side".

A shareholder from Kansas wanted to know whether the Federal Reserve was doing **too much** in the way of **quantitative easing** and "how do we stop". Initially Buffett suggested he pass the question to Munger as he had answered the same question on CNBC. Munger replied that he had no idea how the US would reverse the process but it was going to be difficult. Buffett then said that it was always easier to buy than to sell. Quantitative easing had the potential to be inflationary but currently the money was sitting in banks rather than "hitting the market". He would guess that at least some Fed members would like to see more inflation. He added that when the market gets a signal that buying ends and selling starts that could be a shot that would be heard around the world and cause anyone holding securities to "re-evaluate their hand".

On **"not ruining the children"** a shareholder from Forth Worth, Texas, said that he often heard people quoting Buffett when he said that he wanted to leave his children enough that "they could do anything they wanted but not just do nothing". Buffett's response was to say that he had "loosened up" a little since he said that. He said that parents' behaviour ruined more children than the amount of any inheritance. He said that "you are your children's natural teacher" and "they learn about the world through you". What children see their parents doing is very important.

There were a number of questions on the **internet and social media**. In relation to the impact of social media on Berkshire's subsidiaries he started by saying that half the people in the audience could answer the question better than him. He went on though to explain that Geico's (direct motor insurance) business had started with direct mail and moved over time to TV, then to phone, then to the internet and now on to social media. He had thought that the internet would only affect young people but it has affected everyone. He said that it would be a terrible thing to put him in charge of social media but that "Charlie would be worse." He asked Munger whether he would like to defend himself and the response was : "I don't understand it for a very good reason. I avoid it like the plague".

Buffett was also asked his view of **Bitcoin**. He said that of their $49 billion in cash they weren't moving any of it to Bitcoin. He said that the truth was he didn't know anything about it and while that normally wouldn't stop him from saying something he wouldn't in this case. He was congratulated on joining **Twitter** the previous day (@warrenbuffett if you would like to follow him). He said that he had written an article on why women were the key to America's future prosperity and he was advised that putting it on twitter would bring it to a wider audience.

Buffet was asked whether he would **invest in the Eurozone** and whether he **trusted ECB policies**. He said that he had done some bolt-on acquisitions in Europe and they would look at good businesses in any of the 17 Euro countries. He said that Europe wasn't going away but that Euro Monetary Union had a major flaw. The EU had synchronized a currency, but not much else. There were different governing bodies, different cultures but "they'll fix it in time". "Nature finds a fatal flaw, and so does economics, and it found the flaw in the EU". The often outspoken Munger then took the opportunity to have a swipe at **Greece**. Letting Greece into the EU was a lot like "using rat poison as whipping cream" - an exceptionally stupid idea. It wasn't a responsibly capitalistic country. It was a place where people didn't pay taxes and it had committed "fairly straight fraud" to get into the EU. Buffett tried to finish up this topic on a positive note by emphasising that they would be delighted to buy a good business in Europe. Munger (who also had a go at Italy later in the meeting) was determined to have the last word on this: "I hope you'll call me first if it is in Greece".

Answering a question about **US competitiveness** Buffett said that the biggest issue the US had was the **cost of healthcare**. It was 17.5% of GDP and most of their competitors paid 9.5-11.5%. He added that "there are only 100 cents in a dollar", if you give up 7 cents on the dollar, that would be a major problem for American competitiveness. He was careful to say that he wasn't talking about who pays for healthcare, although that is a big issue in the US. He pointed out that people used to talk about General Motors' competitive disadvantage on labour costs against Toyota. He said that if the competitive disadvantage were steel it would get a lot more attention. The US system works, but the number one problem for American business was healthcare costs. (Out of curiosity, I downloaded a World Health Organisation report on the 2010 figures and Ireland was at 9.2% and the UK 9.6%. In the US 53% of the spend was by government compared to 69% in Ireland and 84% in the UK.)

Buffett batted back the questions as well.

Answering the same question on Competitiveness Munger said that it didn't do any good that the US had grossly **swollen financial and derivative markets**. It was crazy that Caltech or MIT graduates were going into finance. He said that he agreed on healthcare but he found the other 'more revolting".

There were a number of questions along the lines of **"What could go wrong post-Buffett?"** Buffett dealt well with all of these. The important thing was preserving the culture and they were confident that that would continue. The board were all agreed on who the new CEO should be. The businesses they had bought would continue to be good businesses. The trains would be running and people would still buy Geico insurance. Munger added "I want to say to the many Mungers in the audience do not be so stupid as to sell these shares". Buffett replied "That goes for the Buffetts here too".

Doug Kass (the bear who is short the stock) said that it appeared to him that in the old days Buffett did detailed analysis but now had **less "research intensity"** and the idea for the Bank of America investment had come to him in the bath. In response to this and a follow up question on what **quantitative metrics he used** to judge a stock, Buffett responded that you had to love doing something to do well at it and the passion adds to your productivity. The bathtub "wasn't the central factor" in the Bank of America decision. They don't look at stocks, instead they look to see whether they would buy the business. He had learnt a lot about banking since he first read "Biography of a Bank" over 50 years ago. They looked at different numbers for different business. He didn't do some precise PE ratio or book value calculation but he did have some idea what the company would look like in five year's time. Munger said that people who have high IQ's want mathematical answers but that was the wrong approach. You need to know how the company functions. In the case of the railroads they have a fair idea what they will look like in 5/10 years. They found the car industry fascinating but found it very difficult to predict its future. He asked Buffett whether he uses a computer to screen anything and the reply was "we don't really use screens but we are screening everything".

Buffett was asked whether Bill Gross was right talking about the **New Normal** i.e. lower stock market returns in the future. His answer was that Charlie and he didn't pay any attention to macro forecasts. People will do very well owning good businesses if they don't pay too much. If they try to time it they will do well for the broker and not themselves. Munger disagreed. He said that they were in a different situation to others in that they had a lot of money which they needed to invest. He was inclined to agree with Bill Gross. If you were a busy surgeon deciding whether to work a little longer or retire now he would suggest working a couple of more years. Buffett asked him whether it would be worse than the last ten years and Munger said that he thought that was "a conceivable outcome".

The next day I reflected on the meeting and decided it was the best one I had attended. I felt that Buffett and Munger had been as energetic and enthusiastic as I could ever remember. This was the first meeting I had attended where all the business units were doing well and it was particularly encouraging to see the progress being made in the big three of Insurance, Railroads and Energy. Buffett had made a good case that the company's huge size, previously thought of as limiting returns, could be an advantage in some market conditions. They had also presented a much clearer view of the post-Buffett era than they had ever done before. After such a positive meeting I felt the share price could only go up further.

On the way home, I also thought about the **mixed signals** I was getting from them. While they often said that they couldn't forecast the short term future they were very optimistic about the US and Berkshire in the medium term, felt that carefully chosen equities (buying businesses in their parlance) or an index fund was the **best protection** against inflation and said that bonds were not the place to be at the moment.

On the journey, I also read that well known investment manager **Seth Klarman** is **returning shareholder capital** for only the second time, and is concerned about market levels. He saw "a market relentlessly rising in the face of challenging fundamentals - recession in Europe and Japan, slowdown in China, fiscal stalemate and high unemployment in the U.S. which is the riskiest market of all." Klarman refers to a report from Gluskin Sheff that 30% of the market's current value is due to Fed action, and predicts that "once Bernanke shuts off the faucet", there will be a fallout. Buffett and Munger's response to this would be to say that what happens in the short term is not that important and if you invest in good businesses, the short term share price shouldn't matter to you. This, I think is the **hardest lesson to learn**. Most of us are much younger than Buffett and Munger but we would still be devastated if the market were to fall by 30% or more.

For anybody interested in attending next year's meeting it is on May 3. There cannot be too many more of these extraordinary events.

Stephen Cloonan