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# 2016 Berkshire Hathaway Annual Shareholder Meeting

The Berkshire Hathaway annual meeting is an opportunity for shareholders and analysts to pose questions to Warren Buffett and Charlie Munger. They answered about 60 questions during the five-hour gathering.


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2 Opening Comments
Capital Intensive Vs. Non-Capital Intensive Businesses
Berkshire's Insurance Businesses
3 The Internet and Amazon's Effect on Berkshire
Is Coca-Cola Immoral?
Utility Business and Renewables
4 Derivatives and Banking
Effects of Low or Negative Interest Rates on Berkshire
5 Railroad Volume and Value Declines
Presidential Election
Valeant and Sequoia Fund, Importance of Integrity
S&P 500 Index vs. Hedge Funds
6 Role of Directors at Berkshire, Diversity
Share Buybacks, Outlook for Cash Flow at Berkshire
Chemical, Nuclear, Biological and Cyberattacks
Macroeconomics, Anchoring of Views in Investment Decision-Making
7 Thinking Ahead of the Crowd
Due Diligence on Acquisitions
Ajit Jain
8 3G Cutting Fat or Muscle
American Express
Investing in Cattle
Incentive Compensation
9 Crude Oil Price Effect on Economy
Ted Weschler and Todd Combs Managed Portfolios
Managing Cash Balances at Berkshire
Special Charges for Restructuring
Search for Happiness
10 2017 Annual Shareholders Meeting
Time Index of Meeting Webcast


Tens of thousands of people travel to Omaha each spring to hear the wisdom and insights of Warren Buffett and Charlie Munger at the annual shareholders meeting of Berkshire Hathaway. This year, for the first time, the meeting was webcast, so in-person attendance declined a bit from the record 45,000 at the 50th anniversary meeting in 2015. However, Buffett, Munger and Berkshire Hathaway delivered a great in-person experience as usual for the 35,000 in attendance.

These are my notes rather than a transcript. Related topics are grouped together and I have put my thoughts and comments in brackets to distinguish them from the comments of Buffett and Munger. This report includes URLs to more information; the webcast is available at Yahoo.com. An appendix lists the time and topic of each question in the webcast, not all of which are covered in these notes. Noted there in bold are a few highlights of the day. Listen to a bit, or a lot, of the webcast for a better sense of the personalities involved.

The format of the meeting is question and answer. Shareholders and investment analysts pose questions to Warren Buffett and his longtime business partner, Charlie Munger, in two 2 1/2-hour sessions covering about 60 questions. They answer in clear-thinking and entertaining ways that hold attention and keep shareholders coming back year after year.

Berkshire Hathaway is one of the larger holdings in the Brown Advisory Flexible Equity Fund. Buffett and Munger are significant influences on the investment approach used in managing Flexible Equity Strategy portfolios.

> Buffett and Munger celebrate good business and investment practices, the potential for human achievement, high ethics and decency to one's fellow man.

## BERKSHIRE HATHAWAY

In the 51 years since Buffett took control, Berkshire Hathaway has grown from a small, economically challenged textile company to one of the largest U.S. companies with almost 400,000 employees and an equity market capitalization of $345 billion. Berkshire is the fifth most valuable company in the U.S. after Apple, Alphabet (aka Google), Microsoft and Exxon, and is just ahead of Amazon and

Facebook. Berkshire earns the third most in annual profits after Apple and JPMorgan Chase.

Berkshire is extremely decentralized, with just 25 employees at its corporate offices overseeing about 90 separate operating companies. Berkshire's largest business is property and casualty insurance, with GEICO the most recognizable brand. Highly recognized noninsurance businesses within Berkshire are Burlington Northern Railroad (BNSF), Fruit of the Loom, Dairy Queen, See's Candies and Duracell (added in 2016). Berkshire holds a $130 billion equity portfolio, with large holdings in Wells Fargo (Berkshire owns 9.8% of the shares outstanding), Kraft Heinz (26.8%), Coca-Cola (9.3%), International Business Machines (8.4%) and American Express (15.6%) among others.

Berkshire's share price and shareholders' equity per share have compounded at an amazing pace that is twice the 9.7% annual rate of the Standard & Poor's 500® Index since Buffett took control in 1965. Even after Berkshire became a large enterprise, shareholders' equity and share price have continued to outpace the market averages with gains, respectively, of roughly 10.1% and 8.3% annualized in the last decade compared with 7.3% for the S&P® 500.

Buffett and Munger celebrate good business and investment practices, the potential for human achievement, high ethics and decency to one's fellow man. By listening to Buffett and Munger, you get a course in business, investing and decision-making, with material reaching across eight decades of experience. The course is more about how to think than about what to think, but in my experience of more than 30 years of tracking them, if you disagree strongly with Buffett or Munger, you'll likely come around to their point of view if you think about it some more. The meeting also serves to ingrain the culture of Berkshire with shareholders and employees. Readers seeking to know more about their approach are encouraged to study Buffett's annual letters to shareholders, available at *www.berkshirehathaway.com* and the book *Poor Charlie's Almanack*, a collection of speeches and presentations by Munger.

## OPENING COMMENTS

After welcoming the attendees and introducing Berkshire's board of directors, Buffett gave a quick review of first-quarter earnings. The earnings had just been released, and Buffett shared them so that all attendees would have the latest public information.

Buffett then presented a table (shown on page 7) of the after-tax earnings of Berkshire separated into earnings from operations and capital gains on investments running from 1999 through 2015. Buffett described the table as showing what Berkshire is all about—trying to grow the normalized operating earnings power every year on a per-share basis. Reported earnings don't grow every year due to the business cycle and occasional outsized insurance losses (2001), but the progress over time is clear. Buffett and Munger think about how they can grow profits over many years through allocating their retained earnings to the best use from investing in their current businesses, acquiring new companies, or investing in their securities portfolio. Shares outstanding grew only 8.2% during this period compared with a 25-fold increase in operating earnings, a sevenfold increase in investment earnings and a 15-fold increase in total earnings. [Though barely used so far, share repurchase is also a tool in the Berkshire box for growing earnings and value per share.]

Berkshire is unusual among public companies—it doesn't manage quarter to quarter, provide earnings guidance or have budgets at the parent company, although many of the subsidiaries do.

## CAPITAL INTENSIVE VS. NONCAPITAL INTENSIVE BUSINESSES

Noting Berkshire's acquisitions and investments in capital-intensive businesses in recent years, the first questioner asked whether Berkshire (Buffett) had changed its investment approach. Buffett explained that the investments in capital-intensive businesses are a result of Berkshire's growth—a problem resulting from their prosperity. The ideal businesses require little capital, but these aren't as available at the $20-billion to $30-billion size that Berkshire needs. When Berkshire was much smaller, it focused on businesses like See's Candies, which is a wonderful example of a noncapital intensive business. Increasing size forces Berkshire into larger, more capital-intensive businesses like Burlington Northern and Berkshire Energy. These will produce good but not the extraordinary returns of a See's. Munger added that when circumstances changed, they had to go to "Plan B," which gives them satisfactory rather than extraordinary results.

To a question on the acquisition of Precision Castparts, Munger noted another adjustment in their approach. PCP is a business that requires a good manager, and it has an outstanding one in Mark Donegan. Berkshire prefers no-brainer businesses that an idiot could run, but it has gotten pretty good at spotting excellent managers too.

## BERKSHIRE'S INSURANCE BUSINESSES

The first of several questions during the day on insurance focused on why Berkshire had sold its investments in Munich Re and Swiss Re. Buffett referenced his annual report, in which he had said he didn't think the reinsurance business would be as good in the next 10 years as it had been in the previous 10. He noted two negatives: 1) Low interest rates affect the return that can be earned on insurance float [money from the insurance premiums that is held and invested by insurance companies to pay future claims] and 2) More capital had come into the industry from financial players, pushing up insurance supply, while demand hasn't risen.

An insurance analyst noted that GEICO's insurance results had dipped compared with competitor Progressive Direct and asked if Progressive's use of in-vehicle technology to determine driving habits and price accordingly was allowing it to pull ahead of GEICO. Buffett commented that GEICO's growth in the first quarter was not as high as previous quarters. Severity of claims has risen due to distracted driving, and GEICO raised prices. Progressive has shown less effect from these headwinds than others, but he didn't expect those trends to continue. On growth, Buffett noted that GEICO has quintupled its volume under Berkshire's ownership {since 1996], profitably growing beyond both Progressive and Allstate. Buffett expects to pass State Farm, the largest auto insurer, around the time he turns 100.

## THE INTERNET AND AMAZON'S EFFECT ON BERKSHIRE

The shift in how companies and customers reach each other brought on by the Internet is huge. Amazon has done a terrific job exploiting it. Berkshire doesn't make any decision that doesn't include that trend. It doesn't affect Precision Castparts, but does affect other businesses at Berkshire. They think very hard about what the long-term future will look like with every business and investment decision they make. They haven't figured out how to out-Bezos Bezos. [Jeff Bezos is the founder and CEO of Amazon.] If he owned a bunch of shopping malls, Buffett would think quite hard about what they would look like in 20 years. Munger added that Berkshire's biggest retail operations (furniture and jewelry) are so strong that they will be among the last to be affected by Amazon.

GEICO insurance was slow at first to the Internet but got there fast once it saw the benefits and how much customers liked it. The answer to a later question revealed that Berkshire's commercial insurance operations are testing if customers will come directly to Berkshire through the Internet like they do on the personal side with GEICO. Munger thinks Berkshire, on a net basis, has been helped rather than hurt by the Internet.

The nature of capitalism is that someone is always trying to take away your profits by doing better in some way. Berkshire is well-situated for change because it is not wed to any industry that is all they know or have ever done. They view themselves as capital allocators who can go anywhere that makes sense. They are constantly asking, "What is the best next move we can make with our capital?"

## IS COCA-COLA IMMORAL?

Buffett was asked how shareholders could take pride in Berkshire's investment in Coca-Cola, and if Coca-Cola wasn't an immoral company given the health effects of the calories in its namesake product. Buffett explained that people confuse the number of calories consumed with the source of the calories. As he has at prior meetings, Buffett noted that he chooses to get about one-quarter of his 2,700 caloric needs each day from Coke—that makes him one-quarter Coca-Cola. However, if he consumed 4,000 calories per day, it wouldn't matter where he got them; he would eventually run into trouble. Statistical studies sometimes confuse cause and effect, Buffett said, giving a memorable example. There are 45,000 women over the age of 100 but just 10,000 men. You could look at that and say [wrongly] that the best thing Buffett could do to improve his longevity would be to have a sex change.

Munger called it a ghastly error to measure the disadvantages of something without also considering its advantages—it's a stupid and immature way of thinking. We ought to have a law that people can't cite the disadvantages of something without also citing the advantages. If humans need so much water and so many calories of energy per day, what's the harm in combining the two with some flavoring and carbonation to get a bit more pleasure?

## UTILITY BUSINESS AND RENEWABLES

Does Berkshire Energy intend to get to 100% renewable generation? Buffett explained that utilities are by and large regulated at the state level and that changes in generating capacity, whether for coal, gas or renewables, have to go through the public utility commissions. For Berkshire's Iowa utility, the state has been marvelous at encouraging renewables. PacifiCorp, Berkshire's western utility, has not had as much support from the six states it serves.

The U.S. government has encouraged renewables through tax credits of about 2.5 cents per kilowatt hour. Berkshire has the capital to put into renewable generation and can take full advantage of these credits on its consolidated tax returns. The benefits of lower carbon emissions are reaped by all, so it is entirely proper for the government to incentivize them with tax policies.

Buffett compared Nebraska's electric rates with Iowa's. The part of Iowa that Berkshire Energy serves has low electric rates because of wind power. Consequently, Iowa is attracting new businesses, like computer server farms. Nebraska, Iowa's neighbor to the west, is a public power state. The utility there doesn't have to earn a return for investors, and its generating capacity can be financed with tax-free debt. Yet, Nebraska's power rates are higher than Iowa's.

### DERIVATIVES AND BANKING

When asked how to analyze financial companies like Bank of America, which have derivatives on their books, Buffett said that the move to collateralization of derivatives has somewhat reduced the risks they pose to financial institutions. Still, he views books of derivatives as potentially dangerous. He believes that Bank of America and the other financial companies Berkshire has invested in have done a conscientious job valuing and securing the derivatives on their books, but he couldn't say they had it exactly right.

The complexity of some derivatives make them extremely hard to value. Two parties to the same derivative may value them completely differently, especially with the profit incentives involved. The risk with derivatives is that a major discontinuity in markets can create enormous losses for the system. Buffett is not troubled by what Bank of America and Wells Fargo do in derivatives [given the nature, culture and capital of the organizations]. Yet among the 50 largest banks in the world, there are probably only a handful he would invest in. Berkshire itself won't get into trouble on derivatives because it doesn't enter into contracts that would require it to ever post collateral.

Munger commented that they are in somewhat of an awkward position criticizing derivatives, with Berkshire likely to make $20 billion on just a few contracts they did some years ago. However, the financial world would be a better and safer place without derivatives altogether.

A questioner asked about the trading level of credit default swaps (CDS) on Berkshire debt: Is there an opportunity for Berkshire to make some money by writing some of these themselves? Buffett explained the CDS arise because Berkshire had guaranteed some debts of other issuers. Some of the buyers of the Berkshire guarantees then wanted a hedge against Berkshire, so some bankers wrote CDS on Berkshire. Buying those CDS makes no sense to Buffett, because the writers of those swaps are inferior credits to Berkshire, but these institutions have rules they must follow. No, Berkshire wouldn't bother with trying to earn a little extra writing CDS on itself and it is not even sure that it could. It certainly couldn't do so without posting collateral, which they would never do anyway.

> Brands like Coca-Cola and Heinz are very durable if they adapt to change and don't stand still.

Asked if bank regulation and the investment banking component at Wells Fargo was a concern, Buffett explained that the U.S. policy since 2009 has been to raise capital requirements and tighten regulatory oversight for all banks and even more so for large banks. This has pushed returns on equity down, making banking a less good business but not a bad business. He is attracted to the large general banking business at Wells Fargo rather than the smaller investment banking business there. Wells Fargo is the largest public investment that Berkshire has. Buffett thinks Wells Fargo has the most upside relative to its downside among the holdings in Berkshire's investment portfolio.

Buffett does not have a great attraction to investment banking as a business. His investments in the industry started as preferred stocks with appealing coupons and conversion rights [Salomon Brothers in 1987 and Goldman Sachs in 2008], rather than as direct equity purchases.

### EFFECTS OF LOW OR NEGATIVE INTEREST RATES ON BERKSHIRE

Low interest rates affect Berkshire because it always has money to invest. A quarter-point difference doesn't sound like much, but on $60 billion [Berkshire's cash balance], it is still painful. Low interest rates are a problem for retirees, pensions or anyone that has relied on fixed income investments. Low rates also raise valuations for business acquisitions. Nobody knows much about negative interest rates. For 2,600 years going back to Aesop, a bird in the hand has been worth two in the bush. But with negative interest rates, one in the hand is worth 0.9 in the bush. Compared with anyone who thinks they understand negative interest rates, Buffett and Munger have an advantage in knowing that they don't understand them.

A later questioner asked if the float generated in Berkshire's retrocessional insurance business was less valuable given low interest rates. [In retrocessional insurance, Berkshire assumes the known future payment liabilities of another insurance company and receives a discounted amount of cash in exchange.] Low interest rates hurt the value of the float generated, but even in periods of low interest rates, they will occasionally get chances to do good things with the money. Berkshire is willing to pay some small amounts now for money it can't really employ in order to have it available when something good comes along—like the deals Berkshire struck in 2008-09 when others were forced to sell assets at low prices or raise capital at high cost.

### RAILROAD VOLUME AND VALUE DECLINES

Asked if the decline in railroad traffic is cyclical or secular and if it affects the value of BNSF, Buffett acknowledged the decline in coal volume is secular, but there are cyclical elements to it too. Coal accounts for about 20% of BNSF traffic. The recent volume drop in coal is steeper than the secular decline rate due to mild weather and stockpiles built up by utilities that are being drawn down. The secular decline is due to competition from natural gas and renewables.

So far as railroad valuations, the stock market was very enthused about railroad shares a year or so ago, so the stocks are down. But Berkshire doesn't mark BNSF to the price of other railroads. Buffett loves the BNSF business and the price Berkshire paid for it in 2010. Coal volume will decline over time, but it will be replaced by other goods.

### PRESIDENTIAL ELECTION

Would Trump or Clinton be better for American business and Berkshire? Buffett predicted Berkshire will do fine whoever wins. Business has done well in the U.S. for 200 years. Business adapts to society, and society to it, and manages to take care of itself across various regimes, tax rates, regulations, and national or world events. Businesses are the engine of a market economy that has produced wonderful outcomes for the U.S. standard of living. Real per capita GDP has increased six times in Buffett's lifetime. The system works great at producing but falls short in distribution, Buffett said.

### VALEANT AND SEQUOIA FUND, IMPORTANCE OF INTEGRITY

What are Buffett and Munger's thoughts on Valeant Pharmaceutical and the Sequoia Fund's investment given Buffett's involvement in Sequoia's formation? Buffett gave some background: In 1969, when he was wrapping up his investment partnership, his partners asked him where they should put their equity money. Buffett recommended two people whose ability and integrity he admired: Sandy Gottesman of First Manhattan and Bill Ruane, who formed the Sequoia Fund to accommodate the Buffett Partnership limited partners. Ruane passed away in 2005. The succeeding manager at Sequoia, who is no longer there, had an unusually large position in Valeant that he became overly entrenched with. [Valeant shares have declined more than 90% from their high.] The record at Sequoia was exceptional, and even now, after much pain from Valeant, it is still better than the S&P 500 Index over its history.

The flaws in the Valeant model illustrate a principle Buffett learned from Peter Kiewit, which is to look for people who have intelligence, energy and integrity. If they don't have the last be sure they have the first two. In investing you develop pattern recognition as you see some things over and over. Some things look extremely good in the short run but frequently come to a bad end. For example, you see chain letter schemes over and over on Wall Street--they aren't called that but that is what they are.

Munger [whose criticism of Valeant in early 2015 attracted negative attention to it] said Valeant was a sewer that deserved its opprobrium. The investment team at Sequoia Fund as reconstituted is good and trustworthy.

### S&P 500 INDEX VS. HEDGE FUNDS

Buffett has a wager with Protégé Partners, a hedge fund-of-funds manager, that the return of the S&P 500 Index will exceed that of the hedge funds selected by Protégé over a 10-year period. [Buffett, who began his career as a hedge fund manager, sees two disadvantages with modern hedge funds that go beyond the skills of the managers: 1) high fees reducing net returns to the investor and 2) excessive growth in the assets managed by the successful managers either reduces their ability to produce high returns or inhibits their willingness to seek them in the future.]

The progress of the bet is reported at each annual meeting at the end of the morning session. After falling behind in the bear market during the first year of the wager in 2008, Buffett's S&P 500 side of the bet surged ahead through 2015, as shown in the table on page 8. The winner of the bet, which runs through 2017, will donate the $1 million proceeds to a charity of their choosing.

Buffett gave more detail than usual in explaining the logic for his side of the bet this year, focusing on the fees for hedge funds, which can run 2% of assets managed plus 20% of the profits. He gave an example using the 18,000 people sitting in the main arena of the meeting. Imagine splitting the group into two halves that together own all the shares of U.S. businesses. Half of the room takes the low-energy, low-fee route of sitting passively with their investments, owning a piece of everything. This group gets the index result.

The other half takes the high-energy,

high-fee route of hiring advisors and consultants to advise them on how to rearrange their portfolio from time to time, and then they trade among themselves. Together and on average, this group also gets the index result but faces fees for advice and the costs of the periodic rearrangement as they trade among themselves. There are a few winners who beat the averages in this group, but most have earned less than the average. [The bigger the fees, the farther the group's average result falls below the index result.]

Buffett would make this bet again and again, but few people, endowment funds or pension funds choose the index approach. No investment adviser is likely to say just buy the market and sit tight.

Munger added that there are some skilled managers who beat the averages after fees over time, but really just a few. Wall Street makes more money with salesmanship than with investment skills.

### ROLE OF DIRECTORS AT BERKSHIRE, DIVERSITY

[This question and answer begins at 4:05 in the webcast and is one of the best of the day.]

Buffett looks for directors who are business savvy, shareholder-oriented and have a special interest in Berkshire. These are the only criteria. Post-Warren Buffett, his son Howard Buffett, will become the nonexecutive chairman of Berkshire. Having a nonexecutive chairman and a board that clearly recognizes and embraces Berkshire's culture will make it easier to replace any successor management that proves not to fit the unique culture at Berkshire and the requirements of the job—if the culture of Berkshire itself doesn't reject them first.

Directors aren't serving for the money at Berkshire. [Berkshire's highest paid directors earned $7,000 in 2015 plus meeting expenses, compared to $300,000 to $500,000 typically at other large public companies.] Other companies sometimes look for directors who will reflect credit on the companies [or create a certain mix]. Not so at Berkshire. Buffett wants directors to walk in the shoes of shareholders. Diversity is not one of his criteria in evaluating businesses for Berkshire to buy or in selecting directors at Berkshire.

### SHARE BUYBACKS, OUTLOOK FOR CASH FLOW AT BERKSHIRE

Buffett loves the idea of buying back Berkshire stock at a significant discount to intrinsic value, although he doesn't particularly enjoy the act of buying out his partners at a low price. Odds are that Berkshire would buy a lot of stock at 1.2 times or less book value per share. If they run out of ideas for deploying capital, the buy point could move up to ease the pressure to do something. Buffett doesn't want a too-full wallet to act like a too-full bladder so far as resisting the urge to go!

Buying back stock for less than it is worth is good for shareholders, but the price should be demonstrably less than the business value. Munger commented that some companies buy stock as a fashion statement without considering price—that's like saying you're going to buy a business and don't care about the price. Berkshire's approach is superior.

A later question about the outlook for cash flow ties back to share repurchase as a check on whether the allocation adds value. Berkshire generates about $20 billion per year in new cash to invest from retained earnings and growth in insurance float. Buffett explained that their goal is to add to the normalized earnings power per share of Berkshire by how they invest these retained earnings. Munger added that Berkshire had a pretty good system for doing this—it generates a torrent of cash flow, which it dispenses year after year as it keeps learning how to do it better. Buffett added that repetition year after year could handle the occasional mistake. [The stock buyback acts as a backstop, helping ensure that retaining and reinvesting earnings will create value over time.]

### CHEMICAL, NUCLEAR, BIOLOGICAL AND CYBERATTACKS

Asked what worries him, Buffett responded that the only threat to Berkshire's economic well-being is the threat to society from chemical, nuclear, biological and cyberattacks. No other problem is remotely like the threat of such attacks from rogue people or rogue states. The desire of fanatics and psychotics to harm others has always been around. But the threat has become much greater with 7 billion people compared with just three, and with nuclear bombs compared with just stones and spears. The threat is overwhelmingly a government problem, and it has been a top priority. Something bad will happen someday—we've been lucky so far. Anything that has a chance of happening will happen if given enough chances.

### MACROECONOMICS, ANCHORING OF VIEWS IN INVESTMENT DECISION-MAKING

How do macroeconomic views play into their decision-making? Is there a risk of anchoring their decisions to a particular view? Buffett said that Berkshire executives read a lot and know the issues in the global economy, but they aren't trying to predict what will happen on a macro level. They focus on the microeconomic factors of the businesses that catch their attention. Microeconomics is what they do; macro is what they put up with. Buffett joked that they can't be anchored to macro views if they are ignoring them. Munger added the biggest risk of anchoring is with your previous decisions, and they try hard to avoid that. If you disagree with someone, you need to be able to argue their side as well as your own side to make a good judgment.

### THINKING AHEAD OF THE CROWD

[This section begins at 4:49:56 of the webcast and is a highlight of the day.]

Asked the influences that have let them be so far ahead of others in business and investing, Buffett said Benjamin Graham greatly influenced his thinking about investing, and Charlie Munger had influenced how he thought about business. Further, Buffett has been around a long time looking at and thinking about businesses—why some work and others don't. Pattern recognition plays a role. In investing, you need emotional control more than a superior IQ and the discipline to only swing at pitches in your particular strike zone. Avoid self-destructive behavior like over-leveraging to try to make more.

Munger said a few simple tricks combined with the temperament to sit patiently waiting for the right opportunity had carried Berkshire a long way. He said Berkshire works better by trying to maintain an ethos of achieving success fairly and using it wisely.

### DUE DILIGENCE ON ACQUISITIONS

Berkshire doesn't send teams of lawyers and accountants in to perform "due diligence" on acquisitions. There are a few basic things on their list to check but not that many. The mistake they worry about is having the wrong expectation for the future economics of the business. Checking every lease and contract closely doesn't get at that. Assessing the manager is incredibly important, but a checklist doesn't drive that, judgment does. Negotiations that drag out blow up. Spotting bad apples doesn't come from looking at the documents. Munger said business and human qualities count for far more than checking some old lease term. How many people checked their spouse's birth certificate before getting married? It's the same idea with due diligence.

### AJIT JAIN

Noting that Ajit Jain had been named to oversee General Re, a questioner

**Berkshire Hathaway After-Tax Earnings ($, in Billions)**

| YEAR | OPERATIONS | INVESTMENTS & DERIVATIVES | TOTAL EARNINGS |
|---|---|---|---|
| 1999 | 0.67 | 0.89 | 1.56 |
| 2000 | 0.94 | 2.39 | 3.33 |
| 2001 | (0.13) | 0.92 | 0.79 |
| 2002 | 3.72 | 0.57 | 4.29 |
| 2003 | 5.42 | 2.73 | 8.15 |
| 2004 | 5.05 | 2.26 | 7.31 |
| 2005 | 5.00 | 3.53 | 8.53 |
| 2006 | 9.31 | 1.71 | 11.02 |
| 2007 | 9.63 | 3.58 | 13.21 |
| 2008 | 9.64 | (4.65) | 4.99 |
| 2009 | 7.57 | 0.49 | 8.06 |
| 2010 | 11.09 | 1.87 | 12.96 |
| 2011 | 10.78 | (0.52) | 10.26 |
| 2012 | 12.60 | 2.23 | 14.83 |
| 2013 | 15.14 | 4.34 | 19.48 |
| 2014 | 16.55 | 3.32 | 19.87 |
| 2015 | 17.36 | 6.73 | 24.09 |

Source: Berkshire Hathaway

asked if this indicated anything about Buffett's eventual successor. Buffett said there are no tea leaves to read into that appointment. It just made sense for Ajit to add oversight of Gen Re to his other reinsurance responsibilities at Berkshire. He praised Ajit highly, saying there is no limit to what talented people like Ajit can accomplish. Munger added the corollary to Buffett's praise for the able: By and large, you can't fix the unable.

A later questioner asked if there is another Ajit Jain in the house at Berkshire. Buffett answered there are a lot of people who have created billions of dollars for Berkshire, but not another Ajit. Having an outstanding manager at a business of size is enormously important to capital accumulation. He compared the value of Ajit at Berkshire to that of Jeff Bezos at Amazon or Tom Murphy and Dan Burke at Capital Cities. Those organizations would not have happened without those leaders.

## 3G CUTTING FAT OR MUSCLE

Berkshire has invested alongside 3G Capital, which has a reputation for aggressive cost cutting. How does Buffett judge if the cutting slices into muscle as well as fat? Buffett explained that many companies have people working that aren't really doing anything or are doing the wrong things. It is best if companies never create the fat, but 3G gets at cutting what's not needed quickly to improve profits and business functions. Whether it is muscle or fat can't be judged only on unit volume. Unit volume can decline coincident with initial cuts. Getting out of discounted deals or away from bad customers that push volume without pushing profits is good. Munger added that lean companies tend to do better over time than fat companies. If you have a wonderful business, it can be a little sloppy and you might not notice it, so some really prosperous companies can end up being the fattest.

## AMERICAN EXPRESS

Asked about Berkshire's investment in American Express, Buffett noted that the payments industry is of intense interest to a lot of people. American Express will continue to face competition. Munger added that a lot of businesses aren't as good as they used to be. You have to be thinking all the time because the world changes. They will be late sometimes and wrong sometimes about the changes, as well as right sometimes. The fluidity in payments today creates more danger for the participants.

## INVESTING IN CATTLE

A young rancher asked if cattle raising was a good business to get into. Buffett had trouble hearing the question so Munger took it, and the rancher didn't get the answer he was looking for. Munger said that it was one of the worst businesses he could imagine, but somebody has to occupy the tough niches of the economy.

## INCENTIVE COMPENSATION

[This section begins at 5:33:00 of the webcast and is a highlight of the day.]

How to design incentive compensation across all of Berkshire's different types of businesses? What should Buffett's successor's compensation look like? Munger took this question, explaining that they adapt to the reality of each situation across the various businesses. Incentive systems produce what they reward. They focus on what they want and simple designs that are clear to everyone. Buffett described the GEICO incentive program, which covers 20,000 employees, as focusing on the two variables that matter to

| CALENDAR YEAR | S&P 500 INDEX | PROTEGE HEDGE FUNDS |
|---|---|---|
| 2008 | -37% | -24% |
| 2009 | +26% | +16% |
| 2010 | +15% | +8% |
| 2011 | +2% | -2% |
| 2012 | +16% | +6% |
| 2013 | +32% | +12% |
| 2014 | +14% | +6% |
| 2015 | +1.4 | +1.7 |
| **Cumulative** | **65.7%** | **21.9%** |

Source: Berkshire Hathaway

him: the growth in policies in force and the profitability of seasoned business. It perfectly aligns the goals of the organization with the goals of its owner, and it's simple so everyone understands it. It's not just growth in profits, but profits and growth in the business. The easiest way to grow profits short term is to slash all the expenses that lead to long-term growth in the business. That would not be the result they are looking for.

Berkshire doesn't have a coordinated approach across all 70 of its businesses. Instead, Berkshire tries to figure what is right for each business based on its nature. Some businesses are capital intensive and others are people intensive. Berkshire has different approaches for each.

Buffett has written to the board of directors on how to compensate and incentivize his successor, but this is not for disclosure now.

The bad examples of compensation come from banking and investment banking, where payouts have been based on profits as reported rather than real profits. Pyramiding to boost payout to CEOs is another bad example. Proper compensation is not as complicated as the world tries to make it, but compensation consultants don't get paid for conceiving simple proposals. Munger asked rhetorically to imagine trying to run a household that had incentives for bad behavior.

### CRUDE OIL PRICE EFFECT ON ECONOMY

How do the swings in the price of oil affect the economy and monetary policy? Buffett answered that the U.S. is a net buyer of oil so the price drop should be good overall, but there are positive and negative impacts that hit at different times. The oil regions suffer and the contraction in capital values hits immediately. The consumer benefits, but the benefit comes week by week with each fill up.

### TED WESCHLER AND TODD COMBS MANAGED PORTFOLIOS

Berkshire hired two younger investment managers a few years back to manage parts of Berkshire's investment portfolio. A questioner asked about any differences between them and Buffett's approach to investing. Buffett replied that they had each been a great fit for Berkshire. Differences are that Buffett is looking to invest billions, while Weschler and Combs are looking to invest $500 million at a time. They both manage about $9 billion for Berkshire; one has about eight holdings, and the other, about 14. They are more knowledgeable than Buffett on some of the more recently created businesses in the economy.

> Buffett's extra wealth doesn't have much utility for him so he wants it to go where it can do the most good. He believes more in individual giving than corporate giving.

### MANAGING CASH BALANCES AT BERKSHIRE

Asked if Berkshire could be more aggressive in managing its cash balances, Buffett responded that Berkshire has excess cash throughout its operations. With interest rates so low, it doesn't really matter which pocket the cash is in. If rates move higher, they can sweep the excess cash up for some higher investment return. This would not include the cash at Burlington Northern or Berkshire Energy, because they have issued nonguaranteed debt (by Berkshire). On its investment cash, Berkshire doesn't stretch for a few extra basis points in return for the sacrifice of liquidity because Berkshire may call on that cash at a moment's notice. Berkshire doesn't encourage its businesses to pay slower in order to lower its working capital. It prefers to have better relations with suppliers instead of beating them up over payment terms. Munger added that it is hard to beat up your supplier for better payment terms when you are rich and your supplier isn't.

### SPECIAL CHARGES FOR RESTRUCTURING

Berkshire hasn't taken and won't take restructuring charges in its earnings reports like many other companies do. Munger compared the practice to killing your mother to get the insurance money. [It's a bad practice in running a company and in reporting to shareholders.]

### SEARCH FOR HAPPINESS

Asked if they would have done anything differently in the past to be happier in their lives today, Buffett said he does exactly what he wants to do. He associates with the people he likes, eats what he likes, etc. He decided pretty early in life that his favorite employer was himself and that had worked out OK. If he were doing his business life over again, Buffett half-joked that the only thing he would not do is to start out with a textile company. Munger regretted that he didn't wise up sooner in life about some things, but the blessing of that is he still has a lot of ignorance to work on.

Asked about the source of their

optimism and sense of humor as they view the world and go through life, Buffett responded that such an outlook simply reflects the way he is. Munger said if you see the world as it actually is, it's bound to be humorous in its ridiculousness.

### 2017 ANNUAL SHAREHOLDERS MEETING

The 2017 meeting will occur on Saturday, May 6, 2017 in Omaha, Nebraska. Omaha is a nice weekend getaway with a number of attractions in addition to the annual meeting events. Make your plans now if you would like to attend. Hotels and planes fill up early. Alternatively, the meeting is likely to be webcast again, as it was this year.

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**Time Index**
**Berkshire Hathaway Annual Meeting Webcast**
**April 30, 2016**

All questions come from the webcast on Yahoo!
http://finance.yahoo.com/video/2016-berkshire-hathaway-annual-shareholders-180000156.html.

| Time | Discussion Topic |
|---|---|
| 00:00 | Webcast Begins – Yahoo! Commentary |
| 27:45 | Meeting Begins with Introductions and Opening Comments |
| 42:22 | Capital Intensive vs. Non-Capital Intensive Businesses |
| 47:29 | Precision Castparts |
| 53:00 | Warren and Charlie's Search for Happiness |
| 55:53 | Sales of Stock in Reinsurance Companies Munich Re and Swiss Re |
| 1:02:43 | GEICO's Underperformance vs. Progressive Direct in 2015 |
| 1:07:55 | Amazon and the Internet's Effect on Berkshire |

| Time | Discussion Topic |
|---|---|
| 1:14:49 | Is Coca-Cola Immoral? |
| 1:23:20 | Future of Berkshire Energy |
| 1:32:50 | Banking and Derivatives |
| 1:40:28 | Effect of Low or Negative Interest Rates on Berkshire |
| 1:44:20 | Railroad Volume Declines |
| 1:47:49 | Children, Investing and Short-Sighted Media |
| 1:53:20 | Solar Energy Policies in Nevada |
| 2:02:15 | Berkshire's Long-Term Outlook on Oil |

| Time | Discussion Topic |
|---|---|
| 2:04:33 | College Tuition Costs |
| 2:08:41 | Donald Trump, the Presidential Election and Outlook for Business |
| 2:14:28 | Norfolk Southern and Canadian Pacific Proposed Merger |
| 2:17:35 | Thoughts on Tougher Environment for Banks Since 2008-09 |
| 2:23:15 | Activists Who May Try to Break Up Berkshire |
| 2:27:40 | Berkshire's Leasing Businesses |
| 2:30:45 | "If You Had a Silver Bullet, Which Competitor Would You Take Out?" |
| 2:33:24 | Valeant and Sequoia Fund |
| 2:42:15 | S&P 500 Index vs. Hedge Funds |
| 2:54:49 | Break for lunch – Yahoo! Commentary |
| 3:57:41 | Online Opportunity for Berkshire's Commercial Insurance Businesses |
| 4:00:22 | Berkshire's Culture Post-Buffett |
| **4:05:04** | **Role of the Board, Diversity in Berkshire's Leadership [A highlight of the day.]** |
| 4:12:00 | Buying Back Shares of Berkshire Stock |
| 4:20:18 | Nebraska Furniture Mart |
| 4:23:40 | Chemical, Nuclear, Biological and Cyberattacks |
| 4:33:15 | Lubrizol |
| 4:35:32 | Anchoring Risk in Decision-Making |
| 4:40:31 | Potential Conflict in Personal Investing vs. Company Investing |
| 4:45:29 | Outlook for Berkshire's Cash Flows |
| **4:49:56** | **Influences in Learning to Think Ahead of the Crowd [A highlight of the day.]** |
| 4:57:45 | Acquisition Due Diligence |
| 5:05:20 | Ajit Jain and Potential Successors |
| 5:11:25 | Berkshire Hathaway's Credit Rating |
| 5:12:28 | 3G Capital: Cutting Fat or Muscle |
| 5:18:53 | Van Tuyl Group (Berkshire Automotive) Acquisition |
| 5:22:15 | Negative Interest Rates and Valuation |
| 5:27:22 | American Express and Reassessing Investment Decisions |
| 5:31:00 | Cattle as a Business |
| **5:33:00** | **Incentive Compensation [A highlight of the day.]** |
| 5:43:05 | Burlington Northern Railroad |
| 5:49:00 | Crude Oil Price Effect on Economy |
| 5:52:32 | Managing Working Capital and Cash at Berkshire |
| 5:57:45 | Restructuring Charges at Berkshire |
| 6:00:05 | Berkshire Credit Default Swaps |
| 6:05:07 | Ajit Jain |
| 6:10:53 | State of the Real Estate Market |
| 6:13:18 | Todd Combs and Ted Weschler |
| 6:16:43 | Cash Balances at Operating Companies |
| 6:18:45 | IBM |
| 6:20:17 | Buffett's Sense of Humor |
| 6:38:05 | Annual Meeting of Shareholders Business Session, Shareholder Proposal on Climate Change |
| 7:10:34 | End of Webcast |

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