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BERKSHIRE HATHAWAY'S 2014 ANNUAL MEETING

The first weekend in May marks an important event for us here at the Commodari Antinori Group: *Woodstock for Capitalists*. Of course, we are referring to the Berkshire Hathaway Inc. annual shareholders' meeting. As longstanding shareholders and admirers of Warren Buffett and his partner, Charlie Munger, we have been making the trip now for well over a decade.

This year was a special treat for us because it marked the first time that a client *finally* took us up on our open invitation and decided to make the pilgrimage with us. Sadly, until this point, we suffered only rejection. Hopefully, momentum carries into next year as more of you decide to join us for what will be the 50th anniversary with Buffett at the helm of Berkshire. As this year's brave guest can attest, "*you really have to see it to believe it. It's like a cult.*"

This year, the meeting was held on May 3rd and attracted an estimated 38,000 people. As usual, the dynamic duo of Buffett and Munger fielded questions on various topics well into the afternoon. As is tradition, we share with you here some of the most interesting questions – and answers – brought up during the meeting.

BERKSHIRE UNDERVALUED… SPIN-OFF UNITS TO UNLOCK VALUE?

- Warren said he and Charlie devote considerable effort to explain which of their businesses see a significant discrepancy between carrying value and the true value of the business – intrinsic value. Gave as example, GEICO which is carried at $10 billion but is worth well over $20 billion.
- He pointed to big undisclosed balance sheet values in their railroad, insurance and utility businesses and said that they added up to some pretty big numbers.
- Buffett said they were willing and eager to buy stock at 120% of book value. With book value being close to $230 billion now, that means they think that at $45 billion over that figure they are getting a bargain in relation to intrinsic value.
- He added that they would never try and put out an exact number because they don't know an exact number and it changes over the quarters and years.
- Buffett said they only believe in repurchasing shares when they can be bought at a discount to intrinsic value. Said that the 120% of book value is a loud shout out as to a figure that is very significantly below intrinsic value or they would not use it to repurchase shares.

- He pointed out that the best reason to buy back shares is because they are undervalued. Said if you buy a dollar bill for $0.90 you are doing shareholders a favor.
- Munger said they were not in the game of ballooning up their stock price so they could gain an advantage for themselves. "Over the long-term, our system will work pretty well and the stock will eventually go beyond intrinsic value if we like it or not."
- As for breaking up Berkshire, Buffett quickly dismissed the idea.

BERKSHIRE'S SIZE, FUTURE GROWTH & COST OF CAPITAL

- Buffett acknowledged that size is an anchor to performance and that they could not earn the same returns on capital today as they did in the past. "It's just not doable." He joked that he wished he had Archimedes' lever so that he could move the world!
- Buffet explained that Berkshire's cost of capital was what could be produced by their second best idea and that their best idea had to exceed that.
- Concluded that the real test over time is whether the capital that they retain produces more than a dollar of market value as they go along. He said if they keep on putting billions in and those billions are worth more in terms of present value than what they put in, they will continue doing it.
- Buffet joked that he had never seen a CEO who wanted to do a deal and then had the CFO come in and say it didn't exceed the cost of capital.
- Munger said they just don't use a term like "cost of capital" – it's a silly idea taught in business schools. The phrase "*retain to create more value*" is the best description.

WHY NOT INCREASE LEVERAGE TO INVEST?

- Buffett said that 40 years ago, had they been faced with interest rates prevailing today, they probably would have gone out and borrowed money.
- He added that today, they dislike the idea because they operate a very conservatively leveraged company and suddenly changing course would cause the existing bondholders to now own a lower rated bond than what they originally bought.
- Buffett said that taking on more debt would cost very little, but they did not actually have good places to put it right now as evidenced by the $25 billion of excess cash they have now.

IDENTIFYING YOUR CIRCLE OF COMPETENCE

- Buffett said it was a question of being self-realistic and thinks they have been reasonably good at identifying the perimeter of that circle of competence.
- Buffett said being realistic in appraising your own talents and shortcomings is not innate, but pointed out that some people seem a whole lot better at it than others and that he certainly knew a number of CEO's that have no idea where their circle of competence begins and ends.
- Buffett said the ability to know when you are playing a game in which you are going to win and when you are playing outside of that game is a huge asset.
- Munger believes it's not that difficult to figure: "if you are 5'2", you don't have much of a future in the NBA. If you are 95, you probably shouldn't try and act a romantic lead part in Hollywood and so on and so on." He added, "competency is a relative concept, and what most of us need to get ahead is to compete against idiots. Luckily there is a large supply."

INTRINSIC VALUE

- Buffett said his mentor, Ben Graham, did not conceive of intrinsic value nor did Graham get too specific about it in terms of calculations. Buffett traces the origins of this concept to Aesop.
- Said the intrinsic value of any business – if you could foresee the future perfectly – is simply the present value of all the cash that will be distributed in that business between now and judgment day.
- Buffett noted that in 600 B.C. Aesop wrote that a bird in hand is worth two in the bush and that this definition has not been improved on very much by business school professors. He joked that Aesop wanted to leave us something to play with over the next two thousand years so he didn't spell it all out!
- Said the key question is how sure you are that there are two birds in the bush? How far away you deem the bush to be? What are interest rates? Etcetera, etcetera.
- Graham emphasized quantitative factors for those birds while Philip Fisher focused on qualitative factors. Buffett said that early in his career he emphasized Graham's approach. Later, he met Charlie who convinced him to think more about qualitative factors. "Charlie was right."
- Buffett added whether you buy a McDonald's franchise or General Motors, the real question is whether or not you would have to put more cash into that business after you buy it. "It's really all about cash-in-cash-out, when, what discount rate."

BUYING INDEX FUND INSTEAD OF BERKSHIRE STOCK

- Buffett pointed out that upon his death all his shares will go to five different foundations distributed over the ten years after his estate is closed. He added that the trustees holding those shares have been instructed by him not to sell any shares until they had to be sold.
- In terms of his wife's situation, Buffett said it was not a matter of maximizing capital, but rather total 100% peace of mind on something that cannot get a bad result.
- Buffett said buying an index is not designed to get even larger amounts of capital. He said for the part he cares about maximizing, he has instructed the three trustees to hold Berkshire and not sell a single share until it had to be sold. "That's good for twelve years after I die as to my best advice as to what I want them to hold."

DISCLOSURE OF EXECUTIVE COMPENSATION & SUCCESSOR'S PAY

- Buffett said that the next CEO is entitled to a lot and how much they accept is an interesting question.
- They are following the SEC rules on corporate officers required to be in the proxy statement. Said there are people in companies like Comcast who make a lot more money than those listed in the proxy statement. Buffett thinks shareholders of Comcast would be hurt by listing what top anchors at a subsidiary like CNBC were paid.
- Buffett believes there is good reason for not publishing salaries of Berkshire's top ten managers. Pointed to his time at Salomon Bros. where virtually everyone was dissatisfied with what they made. "The absolute amount didn't matter, it was relative to others." The jealousy that broke out was a problem.
- He feels shareholders are paying a significant price to look at proxy statements every year. Said that no CEO looks at proxies and some competitor's salary and thinks "I'm worth less." Corporate CEOs would be paid a lot less money if proxy statements hadn't revealed how much others were being paid.
- Munger said they don't want to add to the culture of envy in America. "Our practices are envy dampeners."

ASSET BUBBLE AND INTEREST RATES

- Buffett said that he has been surprised how well things have been going and have worked thus far, and added that "it was a really interesting movie because nobody knows how it will end."
- Buffett admitted to not knowing the answer.
- Munger added that nobody in Japan would ever have anticipated that interest rates would have gone down and stayed there for twenty years and nobody would have expected common stock to have gone down and stayed down for twenty years. He pointed out that these events were very confusing to the economic profession and that if you were not confused, it's probably because you don't understand it really well.
- Munger acknowledged that "at Berkshire there were not that many long-term bonds being bought."
- Buffett reminded the audience that in 2008 people were saying that cash was king, but pointed out that it was "only king if you used it and the dumbest damn thing if you were not going to use it." Said people usually cling to cash at the wrong times.
- Buffett said a zero interest rate environment has had a huge effect both at rejuvenating the economy and in terms of asset prices. "It has not in my view produced a bubble, but that doesn't mean it can't produce one." He added we were not in a bubble situation, but admitted the current situation was unusual.

WHAT COMPANY THEY MOST FEAR?

- Buffett does not see a big competitor to Berkshire. He noted that private equity firms are buying businesses and that leverage is cheap – so they were competing with Berkshire. That said, he cannot see anyone who has a model, or is trying to build a model, that is going after what they are trying to achieve.
- Munger said that the Berkshire model as it is now constructed "has legs and will go a long time." He added that they had enough advantage over most big businesses which eventually stop going well and said he thinks Berkshire will be o.k. because "the people up here are no longer that important."

COMPETITIVE ADVANTAGES

- Buffett said that all businesses should constantly be looking at what could mess up their business models.
- Said they look at all of their businesses as subject to change and pointed to GEICO as an example. He described them going from offering their services to government employees by mail in 1936, to telephone solicitation, internet and today, social media. "Along the way they stumbled when they went to adapt however and almost went broke."
- Buffett admitted that change is going on all the time in all of their businesses and that is why they want managers that are thinking about change and what is going to be the business model of the future. "We know our businesses will not look the same in 10-15 years."
- Said Berkshire's businesses generally deal from strength and are generally not subject to rapid change. He added that slow change could be much harder to perceive and lull you to sleep easier than when rapid change is clearly in sight.
- Buffett guaranteed that he would make mistakes in the future, but that they do not make large bets that will ever cause Berkshire real anguish.
- Admitted that you are not going to make a lot of decisions without making some significant mistakes. He added that occasionally, they work out very well however and pointed to his foolish purchase of a Baltimore department store in 1966. "Fortunately for us, we were able to do other things with the money as we went along."

- Munger said that in addition to the desirability of removing your ignorance piece by piece there is another trick which is, scrambling out of your mistakes. Said they have been quite good at both.

SHOULD WE BE THINKING MORE ABOUT INFLATION?

- Buffett said inflation would hurt most businesses and that there were certain assets that if highly leveraged would benefit from it.
- Buffett setup an inflationary scenario by asking people to imagine that drones are set loose all over the United States and drop $1 million in every household. He said this would be wildly inflationary and that the trick under these circumstances would be to find out you have $1 million dollars before anyone else.
- Buffett said you do not create wealth by creating inflation. He pointed out that under lots of inflation, EPS would go up and so too would the intrinsic value of companies, but the value of those investments in real terms would go down.
- Munger pointed to the hyper-inflation experienced in Weimar Germany between 1921 and 1924 and said people who owned stock in things like Berkshire got through and prospered but practically everyone else owning assets like bank deposits, life insurance policies, etc. got wiped out.
- Munger added that it was not a good thing to let things go too far and doesn't like this huge confidence that all you have to do is continue printing money and spending it. Said we can handle a little bit of subpar growth for a stretch of time but it would be quite dangerous to let the whole damn thing blow up because a bunch of crazy politicians were printing money.

FINANCIAL LITERACY

- Buffett thinks the earlier good financial habits are learned the better. Said they are such a powerful force in everyone's life and digging yourself out of the hole that financial illiteracy can cause can take the rest of your lifetime.
- Said you want to talk to people about it at a very young age and pointed to there being a big problem with adult financial illiteracy. Said hard for kids to be smarter and have better financial habits than their parents unless schools intercede.
- Munger thinks schools were not at fault and places most of the fault with the parents. Said the most powerful example is the behavior of the parents.

CORPORATE TAX RATES

- Buffett said that anyone that thinks American business is not doing well should just look at corporate profits. "Anybody who thinks corporate taxes are too high should look at a chart of corporate taxes as a percentage of GDP since WWII. It's come down from 4% of GDP to 2% of GDP."
- Said American business earnings on net tangible assets are basically the envy of the world and that American business have extraordinary returns on net tangible assets.

PEFORMANCE YARDSTICK

- Buffett said they pointed out in 2012 report that they do worse in very strong years and better in poor years and said that if the market continued to advance, their streak of five year wins would end.

- Buffett said when you have five strong years in a row, Berkshire will not beat the S&P and that would be true in the future. Said that there were only two years in last 40 that the market was up more than it was up last year.
- Said will underperform in very strong up years, more or less match in moderate up years and do better in flat or down years. “Over any cycle, we will probably outperform but there were no guarantees.”

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