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# BERKSHIRE HATHAWAY'S 2016 ANNUAL MEETING

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Like salmon feverishly swimming upstream to spawn or geese flying south for the winter, each year, the first weekend of May compels thousands of value investors to gather in Omaha, Nebraska to attend the Berkshire Hathaway annual shareholders meeting.

This year the meeting was held on Saturday, April 30<sup>th</sup> and, despite having been streamed live on the Internet – a first for Berkshire – attendance was still 40,000 strong. Because there is always some new insight to learn or value to reinforce, 2016 marked the fifteenth consecutive year that at least one of us has attended the meeting.

On that note, as is our tradition, we have compiled what we consider to be the most interesting questions and answers from this year's meeting. We hope that you enjoy the read and, perhaps, we will see you in Omaha next year!

### HOW TO LOOK AT STOCKS IN A WORLD THAT PLACES EMPHASIS ON SHORT TERM SPIN

- Buffett said that you don't have to really worry about what's going on in IPO's and the like. He went on to say that people win lotteries every day so there is no reason to be jealous about it.

“If they want to do mathematically unsound things and one of them occasionally gets lucky while the millions that contributed to the winnings do not, it's nothing to worry about.”

- He said all you have to do is figure out what makes sense and remember that when you buy a stock, you should get yourself in the mental frame of mind that you are buying a business and, if you don't get a quote on it for five years that is fine. “You don't get a quote on your farm every day, every week or every month...you don't get it on your apartment house...and if you own a McDonald's franchise you don't get a quote on that every day either.”
- He added that you want to look at your stocks as businesses and think about their performance as businesses. “Think about what you pay for them as you would think about buying a business and let the rest of the world go its own way. You do not want to get into a stupid game just because it's available.”
- Munger added that you want to look for people that you could trust when dealing with stocks and bonds but admitted that more than half the time people will fail. He said “if you just listen to you elders, they will lie to you and spread a lot of folly.”

- Buffett concluded by saying that many problems are caused by envy. He said you should not get envious of someone who won the lottery or bought an IPO that went up. “All you have to do is figure out what makes sense and follow your own course.”

### SHAREHOLDER REPURCHASE PLAN

- Buffett admitted that despite Berkshire stock coming fairly close to 1.2x book value, they did not buy back any stock. He said that clearly in his view, Berkshire’s stock is worth significantly more than 1.2x book and its value has moved up.
- He added that he has mixed emotions on the whole thing because he loves the idea of buying stock at 1.2x book or a little higher. “It’s a sure a way of making money but I do not like the act of buying stock from my partners at a price that is less than it is worth.”
- Buffett said that the odds were extremely high that at 1.2x or less, they will buy a significant amount of stock. “It’s like having a savings account that if you take it out, you will get \$1, but if you leave it in, you will get \$1.20.”
- Munger added that on Wall Street it has become fashionable and quite common to buy back stock at very high prices. They will not.
- He spoke of pattern recognition and said that it was important to recognize what you can’t do. “We’ve generally have tried to swing only at things in our particular strike zone.”
- He admitted that in the investment business, you do not need the IQ that you need in certain other activities in life. What is needed, he said, is to have emotional control. “We see very smart people do very stupid things. It’s a self-destructive behavior.”
- Munger said that there are a few simple tricks that work well provided you have the temperament that has a combination of both patience and opportunism.
- He added that another factor that accounts for Berkshire’s success is that they are simply trying to behave well. “There are a lot of people that make lots of money and everyone hates them because they do not admire the way they made the money.”
- He said Berkshire would not work as well if all they were was shrewd. “We treat people fairly and use wisely and it works!”
- Munger concluded by sharing the words once used to eulogize his great grandfather; “none envied this man’s success so fairly won and wisely used.”

### THINKING AHEAD OF THE CROWD – A MENTAL FRAMEWORK

- Buffett said that he owes a great deal to Ben Graham in terms of learning about investing and to Charlie in terms of learning about business.
- Said he spent a lifetime looking at businesses and seeing why some work and why some don’t work. “Yogi Berra said you can see a lot just by observing and that’s pretty much what Charlie and I have been doing for a long time.”

### INTEREST RATES AND THEIR EFFECT ON ASSET VALUES

- Buffett pointed out that going from a zero to -0.5% interest rate is really no different than going from 4% to 3.5%. “It has a different feel to it obviously if you have to pay 0.5% to someone. But, having your base rate reduced by ½ point, although significant, is not dramatic. What is dramatic is that interest rates are where they are and have been for longer than I would have anticipated”

- He added that the nature of things is that you will pay more for a business when interest rates are at zero than if they are at 15%. “We don’t get too exact about it because it isn’t that exact a science. But, very cheap money makes me pay a little more for a business than when money was at, what we previously thought, were normal rates. And very tight money would cause me to pay somewhat less.”
- Buffett admitted that these are unusual times and he paid a little more for Precision Castparts because rates are around zero as opposed to 6%. He said “I try not to pay too much more, but it has an effect and, if rates continue like this for some time, it will have an enormous effect on asset values.”
- Munger pointed out that we never had negative rates before, so nobody knows anything about it. “None of the great economists who studied this stuff and taught it to our children understand it either, so we just do the best we can. Our advantage is that we know we don’t understand it. If you’re not confused, then you haven’t thought about it correctly.”

#### INFORMATION OVERLOAD AND PSYCHOLOGICAL BIASES

- Buffett said they read a lot and are familiar with a lot of macroeconomic factors but that does not mean that they know where these factors will lead. “Micro we pay a lot of attention to. Macro we pay no attention to.”
- He added that they try and know as much about the microeconomic factors as they can before buying a business. “I like to look at the details of a business - whether we buy it or not. I find it interesting to study the species.”
- Munger said nothing is more important than microeconomics: “micro we do and macro we put up with.”

#### DEAL-MAKING AND DUE DILIGENCE

- Buffett joked that he got this question often – mostly from lawyers. He admitted that they have made plenty of mistakes, but that those mistakes are always about not making the right economic forecasts for the business in the future and never about things on some standardized list. “We made at least half a dozen mistakes and even more mistakes of omission. None would have been cured by doing more due diligence. They would have been cured by us being a little smarter.”
- He added that if they thought there were important items of due diligence that they were missing to assess the future economic prospects of a business, than they would drill down on those. “Precision Castparts had 170 plants. There will be pollution problems down the road. Those, however, will not be the factors that determine if PCP will be a good investment down the road.”
- Munger asked how many people in the room who are happily married checked their spouses birth certificate and so forth before getting married?
- He said that business quality comes across more than crossing a “T” on a lease or making sure the union contract is correct. “You can’t solve human quality with more due diligence.”

#### INCENTIVE COMPENSATION FORMULAS

- Munger said the basic rule on incentives is that you get what you reward for. “If you have a dumb incentive system, you will get dumb outcomes.”
- Buffett gave example of GEICO and said that there are two variables. One for growing the business – measured by number of policies in force - and one for growing profitably.

- Munger pointed out that other people might reward just profits. “The problem with that is that people don’t take on new business that they should take on because it hurts profit.”
- He said that a lot of the bad examples of incentives come from banking and investment banking. “If you reward somebody with some share of the profits and, the profits are being reported using accounting practices that cause profits to exist on paper that are not really happening in terms of underlying economics, then people will do the wrong things.”

### BERKSHIRE BUYING CAPITAL INTENSIVE BUSINESSES

- Buffett said that they would love to find a low capital intensive business that they can buy but admitted that it is getting harder and harder to do so.
- He acknowledged that buying businesses with high capital requirements does hurt Berkshire’s compound growth and said that it was one of the problems of their prosperity. “Today we are drawn to such investments in order to move the needle.”
- He said that the ideal business is one that takes no capital but still grows and described the earnings power and ability to re-deploy excess capital from such businesses as the “double-barrelled” effect.
- Munger said that when circumstances changed, they changed their minds. “We went to plan B and prefer it; plan B has worked just fine.”
- Buffett concurred with Munger noting that “when things are forced on you, you may as well prefer it.” He said that a sensational result became a satisfactory result and they’re quite happy – the alternative would be working with a very small amount of money.

### IMPACT ON BERKSHIRE OF SHIFT FROM PUSH TO PULL MARKETING

- Buffett says the success that Amazon has achieved in a fairly short period of time is remarkable. Berkshire’s retail and manufacturing businesses don’t make any decisions without thinking long and hard about what the next five to 10 years will look like. However, they’re not going to try to “out-Bezos Bezos” because Amazon is better at online retail than Berkshire is.
- He says that they haven’t figured out how to adjust to it or participate in it in a lot of ways. That said, Buffett believes that Berkshire is well-situated – they aren’t in a single industry and never had an industry focus. “My focus is to be a capital allocator. It’s hard to have flexibility of mind in figuring out our next best place for capital if I’m deep in an industry. I would be more worried if we owned shopping malls.”
- Munger said that, on-balance, Berkshire has been helped by the Internet. He pointed to the enormous help it had at GEICO in its ability to increase market share. “Our biggest retailers are so strong that they’ll be among the last people to have troubles from Amazon.”

### DIVERSITY AT BERKSHIRE

- Buffett said that they select folks who are business savvy, shareholder-oriented and have a special interest in Berkshire. He is not interested in people who want to make a lot of money or who are big names so Berkshire can check a box.
- He notes that no one at Berkshire has received shares via options and that the directors and executives walk in the shoes of shareholders.
- Munger said his law firm once worked for the Archbishop of Los Angeles and the senior partner suggested to the Archbishop that he

should hire someone who is Catholic. The Archbishop replied that he'd had serious surgery the year before and he didn't look for a Catholic surgeon, he looked for a good doctor. "I feel the same way about diversity."

### PRECISION CASTPARTS ACQUISITION

- Buffett said that the most important asset they acquired was the CEO, Mark Donegan whom he characterized as a one of a kind and extraordinary manager. "There are no disadvantages to him working at Berkshire as a subsidiary versus a public company and over time, there could be significant advantages."

- He added that Mr. Donegan can now spend 100% of his time figuring out the best ways to improve aircraft engines. "He never has to come to Omaha and doesn't have to waste his time on anything that isn't productive."
- Munger said that in the early years, they used to make wiseass remarks about buying a business that an idiot could manage because one day one would. He admitted that a business like Precision Castparts requires superior management that will stay superior for a long time. "I believe we have gotten almost as good at picking the superior managers as we were in the old days at picking the no-brainer businesses."



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