

Study Visit to Berkshire Hathaway by MBA Students from Terry College of Business at the University of Georgia

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This document is a transcript of some questions asked by the students and Warren Buffett's answers.

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Opening Remarks by Warren Buffett

Everyone has the potential to achieve their dreams. The point is to get out of each of us what we are capable of producing. I will invite you to play a game. Suppose that when this class ends, you have one hour to pick a classmate that you will own 10% of his or her earnings for the rest of their life. Besides picking the one with the richest father (laughter) you would choose the person who is most effective. I would predict that you would not necessarily pick the student with the best grades or highest IQ. Instead, you would look for someone with the most integrity and intelligence. Think about the person that has a 300 horsepower motor and operates at 300hp and compare that person to someone who has a 400hp motor but operates at 150hp. You would pick the 300hp everyday.

My point is to suggest that you should become an effective human being...the chains of habit are too light to feel until they are too heavy to break!

Highlights of the Q&A

Given the steady decline in the textile industry in the Northeast and the economically depressed nature of New Bedford and other companies in the industry what made you purchase Berkshire Hathaway at the time that you did?

Buffett: Well in 1962 I learned from Ben Graham how to assess businesses. He also had the cigar butt analogy for buying businesses...you can usually get one good puff out of it and it's free. Berkshire made a lot of money after WWII (more than Pfizer and Merck) and then it steadily went downhill. Between 1955 and 1965 Berkshire went from 12 mills to 2 mills and they bought their own stock as mills closed. We bought 100,000 shares out of 1 million in 1962 at \$7 3/8 and the company had \$10-11/share in working capital. I knew I wouldn't lose money because of the working capital. It was losing money but it was also liquefying assets by closing mills.

Seabury Stanton was running Berkshire at the time and I went to go visit him. We had an agreement that Berkshire would tender \$11-1/2 for my shares of the company. At this point, I could not buy any stock as I had inside information. A few weeks later I received a letter from Old Colony Trust containing a tender offer of \$11-3/8. Early the following week, Seabury tendered the stock at 11 3/8. As result, I began buying more Berkshire. Other family members of Seabury Stanton sold their shares to me and I gained controlling interest in the company. The family members weren't very happy with Seabury either really. We ran the mills until 1985. .

See's Candy is an example of low rate of return on capital expenditures individually yet the company as a whole makes loads of money because of the great brand of See's. We bought See's in 1972 and every year since then we have raised the prices the day after Christmas and it never hurt the business. When we invest we ask one question, how long do you have to wait to raise the prices? If you are an airline today and you try to raise your prices, an

hour later, you will be lowering them because of competition. Not the case with a good brand like See's. If I were to give you a \$100 million, I'm not going to, but if I did, you could not damage the See's brand in the minds of 30 or so million Californians. Only See's can do that. Their brand is their promise to provide the quality and service that people have grown to expect.

Mr. Buffett, you have described Berkshire Hathaway as your masterpiece painting, a masterful business entity that has compounded shareholders equity at 21.5% per year since you have taken over. You have described your work as being a capital allocator and that it has been a joy for you to do that work all your life. In July 2006 you allocated all the Berkshire Hathaway shares you accumulated to the Bill and Melinda Gates Foundation and four other foundations. This act was enormous in its scope, brilliant in execution, and magnanimous in its goal. It now becomes the Bill and Melinda Gates Foundations' job to allocate \$15,000,000 each and every business day because of your donations. In your mind which part of this incredible act was most important or most concerning to you and why?

Buffett: I actually gave the stock away 15 years ago in my mind, created a trust mentally. When my wife died, I was forced to do something. Soon after I discussed my plans with Bill and Melinda they gave me an original copy of Adam Smith's Wealth of Nations. In the first chapter Adam Smith talks about "Specialization of Labor", which talks about markets and allowing countries to specialize and work on what they are good at. Mike Tyson doesn't try to run Berkshire, and I don't try to get in the ring with Mike Tyson. This is how I look at philanthropy. I started looking for people that were younger, smarter, more experienced, and doing it with their own money. I looked for people that had similar goals, who would do the best with the money. In effect, I outsourced the handling of my philanthropy. It was a no brainer.

In the Fortune article, I stated that business is a game that I love because I get to hit the easy pitches. Ted Williams had written a book about hitting and he said to succeed in baseball, you had to wait for the best pitch. See's Candies to me was an easy pitch. It is not like Olympic diving, where one could do a simple dive perfectly, but score lower than someone who might have made a big splash attempting a more difficult dive. In diving you are judged on the degree of difficulty.

Philanthropy is the opposite of investing with degree of difficulty. Philanthropy deals with trying to solve the toughest problems in society, so you expect to fail very often. I personally don't like failing, so I'd rather let someone else do it. I wouldn't personally enjoy working on something where I couldn't get any feedback on how I was doing and in fact, expected the project to fail. My lifespan is 12 years now and I should be able to add tens of billions of dollars to my "donation" in that time. I am going to stick with what I love doing and I am glad others will work on giving the money away.

I'm just lucky to have been in the right place at the right time. Another place, another time, I wouldn't have been as successful. Society enabled me to make my money and my money

should go to society.

You have said that the last 50 or so years were a unique time for investing in American securities markets—numerous mis-pricings. Do you believe that something like this will happen again? And if you were 26 today and you had only a \$1,000,000 how would you generate the 50% returns that you said you might do with smaller amounts of capital?

Buffett: Attractive opportunities come from observing human behavior. In 1998, people behaved like frightened cavemen (referring to the Long Term Capital Management meltdown). People make their own opportunities. They will be frozen by fear, excited by greed and it doesn't matter what their IQ, degrees etc is. Growth of 50% per year is with small capitalization, not large cap. The point is I got rich looking for stock with strong earnings.

The last 50 years weren't unique. It's just capitalizing on human behavior. It's people that make opportunities when others are frozen by fear or excited by greed. Human behavior allows for success if you are able to detach yourself emotionally.

In 1951, I got out of school at 20 years old. At the time there were two publishers of stock information, Moody's and Standards and Poor's. I used Moody's and went through every manual. I recently bought a copy of the 1951 Moody off of Amazon. On page 1433, there's a stock you could have made some money on. The EPS was \$29 and the Price Range was from \$3-\$21/share. On another page, there is a company that had an EPS of \$29.5 and the price range was \$27-28, 1x earnings. You can get rich finding things like this, things that aren't written about.

A couple of years ago I got this investment guide on Korean stocks. I began looking through it. It felt like 1974 all over again. Look here at this company...Dae Han, I don't know how you pronounce it, it's a flour company. It earned 12,879 won previously. It currently had a book value of 200,000 won and was earning 18,000 won. It had traded as high as 43,000 and as low as 35,000 won. At the time, the current price was 40,000 or 2 times earnings. In 4 hours I had found 20 companies like this.

The point is nobody is going to tell you about these companies. There are no broker reports on Dae Han Flour Company. When you invest like this, you will make money. Sure 1 or 2 companies may turn out to be poor choices, but the others will more than make up for any losses. Not all of them will be good, but some will and those will make you rich. And this didn't happen in 1932, this was in 2004! These opportunities will be there in the next 30 years. You'll have streaks where you'll find some bad companies and a few times where you'll make money with everything that you do.

The Wall Street analysts are brilliant people; they are better at math, but we know more about human nature.

In your investing life you will have several opportunities and one or two that can't go

wrong. For example, in 1998 the NY fed offered a 30-year treasury bonds yielding less than the 29-½ year treasury bonds by 30 basis points. What happened was LTCM put a trade on at 10 basis points and it was a crowded trade, they were 100% certain to make money but they could not afford any hiccups. I know more about human nature; these were MIT grads, really smart guys, and they almost toppled the system with their highly leveraged trading.

This was definitely a good time to act.

When looking at other countries Mr. Buffett, do you look at the country's overall financial status or do you look at the financials of that specific company in a foreign country? You mentioned investing in Korean companies – do you ever look at the state of the country you are investing in?

Buffett: We care about the country where the company is run. There is a disadvantage being outside of the US. A few years ago we were looking to invest in either PetroChina or Yukos in Russia. We ended up picking PetroChina because the political situation was more stable. It turned out to be a good decision. I care about the country and the geopolitical environment I am investing in.

The whole company was selling for \$35 billion. It was selling for one-fourth of the price of Exxon, but was making profits equal to 80% of Exxon. I was reading the annual report one day and in it I saw a message from the Chairman saying that the company would pay out 45% of its profits as dividends. This was much more than any company like this, and I liked the reserves. If it were a US company, it would sell for \$85 billion; it's a good, solid company. I don't understand the Chinese culture like I understand the US culture. However it said right in their annual report that they will payout 45% of their earnings as dividends, basically they say if they make money they will pay it out. I invested \$450 million and its now worth \$3.5 billion. I decided I'd rather be in China than Russia. I liked the investment climate better in China.

In July, the owner of Yukos, Mikhail Khodorkovsky (at that time, the richest man in Russia) had breakfast with me and was asking for my consultation if they should expand into New York and if this was too onerous considering the SEC regulations. Four months later, Mikhail Khodorkovsky was in prison. Putin put him in. He took on Putin and lost. His decision on geopolitical thinking was wrong and now the company is finished. PetroChina was the superior investment choice. 45% was a crazy amount of dividends to offer but China kept its word. I am never quite as happy as I am in the US, because the laws are more uncertain elsewhere, but the point is to buy things cheap. Russia is just a bad geopolitical environment. On the other hand, China has kept their word on paying the dividends. In fact, when the dividends check comes in, it is calculated out 10 or so decimals, these guys keep their word. I don't know the tax laws in China, but you can buy a good business cheap. At Berkshire Hathaway, you have to spend hundreds of millions of dollars to move the needle. We have a problem of finding things worth investing in.

In respect to Africa how would you find above average stocks given the information costs and limitations in Africa? What is your best advice about obtaining acceptable information?

Buffett: There aren't too many companies in Africa that are big enough for Berkshire to look at, except for maybe DeBeers, Anglo-American, or SAB Miller. Also, there isn't a lot of information on these companies. I know South Africa has stock information available. The key is to get good information.

In comparison, Korea has plenty of information available. There is Kissline online. Within seconds I can get Korean Stock Exchange Information, Annual and even quarterly information. I'm not sure if the same is available online for South Africa. This is OK because I don't need to win every game, just the ones I play.

I have three mailboxes in my office – IN, OUT, and TOO HARD. I was joking with the MIT students that I should have a TOO HARD bin and they made me one, so now I have it and I use it. I will only swing at pitches that I really like. If you do it 10 times in your life, you'll be rich. You should approach investing like you have a punch card with 20 punch-outs, one for each trade in your life. I think people would be better off if they only had 10 opportunities to buy stocks throughout their lifetime. You know what would happen? They would make sure that each buy was a good one. They would do lots and lots of research before they made the buy. You don't have to have many 4X growth opportunities to get rich. You don't need to do too much, but the environment makes you feel like you need to do something all the time.

How would you define your character? And what portion of your character do you believe contributed the most to your success?

Buffett: The important qualities you need are intelligence, patience, and interest, but the biggest thing is to be rational. In '97-8, people weren't rational. People got caught up with what other people were doing. Don't get caught up with what other people are doing. Being a contrarian isn't the key, but being a crowd follower isn't either. You need to detach yourself emotionally. You need to think about what is going on around you. Being in Omaha helps me in that regard. When I was in NYC, I had 50 people whispering in my ear before noon. It's hard sometimes, like when the Internet craze hit. Nobody likes to see their neighbor doing stupid things and getting rich. It was like Cinderella's ball, I think I'll just have one more dance, it's not midnight yet. Sounds simple – but it is hard to leave the party. The problem with stocks is they don't have clocks. You don't know when it will be midnight so you can leave the party. My partner Charlie Munger and Tony Nicely at Geico are always rational. 160 IQs can say stupid things that sound good. People do silly things, whether they have 120 IQ or 160. You can always improve your rational thought. Rationality is the only thing that helps you. One thing that could help would be to write down the reason you are buying a stock before your purchase. Write down "I am buying Microsoft @ \$300B because..." Force yourself to write this down. It clarifies your mind and discipline. This exercise makes you more rational.

What is your opinion on exchange-traded funds and how to do you accurately judge them?

Buffett: ETF's are a fairly low cost way to get into a market or industry. We don't hold any and never will. I recommend index funds for people who don't want to spend time studying the market. They are good for 95% of the population. If you don't bring anything to the game, you shouldn't expect to win.

How do you hope to tackle administrative costs when it comes to Aids treatment in Africa?

Buffett: Bill and Melinda Gates can tackle these issues better than I can. I work on giving them more money so they can have more to work with. I am better suited to raise the capital, let others do the work they are good at. We can do a lot more with private charities than the government can. We judge our success on how intelligent we attack a problem rather than success or failure. Bill Gates regards every human life as valuable; we in the US need the help much less than other countries do.

The inheritance or estate tax has continued to be debated on Capital Hill, yet your position has not changed in the fact that you feel this tax should be maintained. Could you please share your views on why legislators should not change this tax law?

Buffett: Well it's not a death tax. 2.2 million people die in the US and out of that only 4,000 estates will be taxed. The federal government collects \$30 billion in tax revenue per year from estate taxes and a high percentage of the heirs of these estates will receive \$50 million or more.

We have to ask ourselves what is the proper tax policy for our society. Let me illustrate with a game. Imagine 24 hours before your birth a genie comes to you and lets you design the world into which you will come. You define all of the political, economic, and societal facets of the world. But there is one catch. You have to draw a ticket from a pool of 6 billion. On this ticket will be your characteristics in this world, i.e. if you are born in the US or Bangladesh, if you are male or female, black or white, retarded or normal, etc. What would you do? You would design a world with rules that would initially foster abundance.

A world that produces lots of output where everyone is productive. You would create an abundant society. Secondly, you would want justice. You would want the output to be spread out. You would design a world where there was freedom from fear, freedom from fear of old age. You would want equality of opportunity, a market system, and that the best people were in the right places. You would want a world that would take care of the people who got the bad tickets. This has nothing to do with religion, I'm agnostic. At the time that I was born, the odds were about 50 to 1 that I was born in the United States. I won the ovarian lottery.

You would make sure all of the lucky tickets are incentivized to keep working. Also you

would want others to have equality of opportunity, not equality of outcome though. One bigger thing would be a good system of the rule of law. You would also want to make sure you have people in the right places according to their talents. You would also want to help others that have no opportunity. I could set it up so that my descendants would not have to work for ten generations. So I would end up effectively taking my descendants out of the pool of proactive people. The descendants of wealthy people could potentially become welfare recipients. Lots of families (I won't name names) create dynasties where society contributes to them just because they are part of the "lucky sperm club". Instead of using food stamps, they would have stocks and bonds. The estate tax modifies the ability to create a family dynasty that takes the descendants out of the work pool, the group of productive citizens.

We all participated in the ovarian lottery, it's probably the most important thing we have ever done. In fact, you all are in business school, you are pretty smart and you have a bright future ahead of you; if you had the chance to trade in your lottery ticket for the chance to pick 100 tickets of which you would have to take one. Would you do it? I would argue you should not. Out of the 100, only 4 or 5 would be born in the US. Out of that only not many would be headed on the path you are headed down. So we are part of the top 1% in society, we are pretty lucky. My descendants are part of the top 1 tenth of one percent of society. This means that you are in the luckiest 1% of the world.

Early on in your career you bought some land and then rented this out to some local farmers? Why didn't you pursue this type of investment in real estate?

Buffett: I made an initial investment farm real estate when I was 14. Someone else handled the whole transaction; I just bought 40 acres. A guy would farm the land and harvest X number bushels of soybean and sell it for \$X per bushel at the market and say here is your check. I did virtually nothing for this investment. I had no idea if he actually harvested what he said he did, or if he sold the bushels he said he sold, or for that matter what price he sold it at. It's kind of like the guys who kept all his cows in with a big herd. As they are taking them to market, the owner of the big herd says, sorry but all of your cows died. How would you know which cows were yours?

In 1980 with the S&L crisis, land was selling for \$2,000 an acre. Well, an acre produced 120 bushels of corn or 45 bushels of soybeans. At a couple dollars a bushel, this was basically \$80 an acre in revenue. At the time with the interest rates, you would pay \$150 per acre in interest. So you were taking in \$80 and paying out \$150, it just did not make sense. The bankers went crazy lending money at \$2,000 an acre prices for farms at 10% interest rates to produce \$80 an acre in crops. Well after a bunch of people lost big time, the FDIC took control of the farms and ended up selling them at \$600 an acre, which at the time was a good deal. The FDIC took over hundreds of farms because people went crazy and lost their shirts.

The S&L's lost their fundamentals and the Government owned \$100 million worth of properties they needed to dump at a low cost. This was an opportunity to make some

money, however I still don't like farms because they are too passive. I still don't like farming. My son likes farming, I don't.

Mr. Buffett it has been well documented that you don't manage your managers. Do you possess a strong intuition about people or do you have a process when you evaluate the management of companies that you are looking to possible purchase?

Buffett: Good question. The question I ask is will they still work after they have sold their business? Do they love the money or the business? If it's the business, then we have a deal. If it's the money, and that's ok, it's just not what we are looking for. I don't have to identify all of the ten's out there; I just have to make sure the ones I make deals with are tens. I can't look at the class and say, "You're a 6.5. You're an 8." I just need to find a few 10s. Do I have an intuition when judging a business owner? Sometimes. People give themselves away; I don't know what it is. We don't have any contracts at Berkshire; people stay because they have a passion for their business and I don't want to screw that up. Not much changes at 65 years old. I have 40 CEO's working for companies owned by Berkshire. Since 1965, not one of them has left Berkshire Hathaway. If I told Lou Simpson of Geico to be at the office at 9am and he could only get one hour for lunch, he would leave. I don't need to identify every ten out there, just the ones we invest in.

Machiavelli said that a man could be feared and loved. But one might want to be more feared than loved. Do you agree with this? Has there ever been a situation where you had to be more feared than loved?

Buffett: I don't believe in fear as a manager. Ben Graham, Don Keough, and my dad are the people I have worked for and they never tried to get people to respond by fear. Certain industries may be conducive – platoon operators maybe – but even then, if you turn back and desert your buddies...I don't operate like that. I don't like this life. Probably certain circumstances call for it: operate this way for a policeman. I believe the most powerful force is love and that is the most effective way of dealing with people. I would not want to live a life where people are afraid of me. People don't operate well under fear. Some circumstances where mutually assured destruction is the end result, fear is good. But not at Berkshire Hathaway, love is way better to operate. By the way, how did Machiavelli do? There is no religion of Machiavelli 500 years later, is there?

Sometimes we learn more from our failures than our successes. What do you consider your greatest mistake or failure?

Buffett: I have made lots of failures of omission more than failures of commission. Things that I understand, there have been a few, a couple that cost \$10B. If a business was selling cheap and I did not buy, I consider that a failure. As Charlie would say, I was sucking my thumb on that one. I made a terrible deal buying Dexter Shoe. I did not learn much from it either. I bought it for \$400M, but the biggest mistake is that I gave up stock that is now

worth \$3B.

You're going to make mistakes. You can't play in the game without making any mistakes. I don't think about it, I just move on. Most business mistakes are irreversible setbacks, but you get another chance. There are two things in life that you don't get another chance at – marrying the wrong person and what you do with your children. Business, you just go on. It's a mistake to dwell on mistakes, it's unproductive. It's like Mark Twain's story about the cat that sat on a hot stove – he never sat on a hot stove again, but he never sat on a cold one again either.

Talking about values and morality, is there a moral connection to whom you give your money to and why?

Buffett: Charlie and I went to Memphis to look at a chewing tobacco company. In the end, we decided we didn't want to own it. We would buy stock in a tobacco company, but we didn't want to own it.

A good example is Charlie's favorite company, Costco. They are the #3 distributor in the US of cigarettes, but you wouldn't avoid buying it because of that. You'll drive yourself crazy trying to keep track of these things. Our philosophy is that it's impossible to grade marketable securities, but we'll buy the stocks without any problems, but we just won't be in certain businesses.

My view is that energy production should move to nuclear. It's clean, cheap and safe. Coal emissions are bad for the environment; however it's still a good company. It's impossible to grade marketable securities on moral activity. Berkshire Hathaway has and will buy what trades, but will not buy companies that engage in certain behaviors. PetroChina owns 40% of the oil in the Sudan that is government owned. If they did not own it, someone else would. Also, you have to keep in mind, if PetroChina did not buy it its possible the Sudan would own 100% of the oil rights and that's not so good either.

I find it funny that people find time to protest PetroChina for ownership of the Sudanese oil, but with the \$300 billion or so of imported goods from China, these same people don't protest Chinese goods. They protest investment in Chinese companies though.

Besides the type of management that you look for, when you look at financials you make decisions rather quickly. In regards to the financial information and the business overall what factors do you look at?

Buffett: We make quick decisions because we have filters before we get to the point of making a decision.

Filter #1 – Can we understand the business? What will it look like in 10-20 years? Take Intel vs. chewing gum or toilet paper. We invest within our circle of competence. Jacob's

Pharmacy created Coke in 1886. Coke has increased per capita consumption every year it has been in existence. It's because there is no taste memory with soda. You don't get sick of it. It's just as good the 5th time of the day as it was the 1st time of the day.

Filter #2 – Does the business have a durable competitive advantage? This is why I won't buy into a hula-hoop, pet rock, or a Rubik's cube company. I will buy soft drinks and chewing gum. This is why I bought Gillette and Coke.

Filter #3 – Does it have management I can trust?

Filter #4 – Does the price make sense?

Since 1972 we have made no change in the marketing, process etc. Take See's candy. You cannot destroy the brand of See's candy. Only See's can do that. You have to look at the brand as a promise to the customer that we are going to offer the quality and service that is expected. We link the product with happiness. You don't see See's candy sponsoring the local funeral home. We are at the Thanksgiving Day Parades though.

The End