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## Notes From Omaha

By [Selena Maranjian](#) (TMF Selena)  
 May 7, 2002

*Longtime Fool and Berkshire Hathaway shareholder Selena Maranjian just got back from this year's annual meeting in Omaha. Here are her notes -- uncut, and unedited! Enjoy. And join in the discussion. Our Berkshire Hathaway [discussion board](#) is teeming with activity and comment from the annual meeting.*

*These notes are from the general Q&A with Warren Buffett and Charlie Munger. If you would like to read Selena's notes from their press conference, you'll [find them here](#) on our Berkshire discussion board.*

I had the pleasure of attending the May 4th annual meeting of **Berkshire Hathaway** (NYSE: BRK.A), featuring more than five hours of questions answered by Warren Buffett and Charlie Munger. The following is my attempt to reconstruct the Q&A session. It's not an exact transcription, though I've done my best to be as accurate and true to the discussion as possible. Enjoy!

BUFFETT: This is Charlie Munger. He can hear, I can see.

[A few minutes are taken up by voting for the board of directors and to accommodate a shareholder proposal that's rejected.]

BUFFETT: Insurance cost us a lot of money last year. There were some special events and we made mistakes, too. Not a record, though -- we ran into more difficulties in a period in the 1980s. We're doing okay. [Shows a slide of first quarter results.] Our float increased -- cost us nothing and produced a gain of \$1.8 billion.

[Explained amortization of deferred charges] If you don't understand this, that's okay. You can still live a happy life -- maybe a happier life. We'll put this information [on the Internet](#) before Monday, so that everyone gets a chance to see it before the market reopens. [Reviews GEICO's recent results] There was an increase in policies in force. Retention rates are also increasing, and we're working on adding more inquiries.

[The question-and-answer period begins.]





#### **QUESTION: Are you and Mr. Munger wearing [recent acquiree] Fruit of the Loom?**

BUFFETT: Yes, I am. I'm not sure Charlie wears underwear.

MUNGER: I haven't bought new underwear in a long time, [so I'm not wearing Fruit of the Loom, unfortunately].

#### **QUESTION: Regarding why they sold some stocks, like Disney, when they believe in hanging on to stocks for the long haul.**

BUFFETT: We generally sell if we need money for something else. Forty years ago, not wanting to borrow money, I'd reluctantly sell something really cheap to buy something even cheaper. Then I

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had more ideas than money -- now the situation is reversed.

We bought [the stocks we've bought] because of competitive advantages. Now we think, with the companies we sell, that the advantages and strengths may have deteriorated somewhat -- or we might have made a mistake [in buying in the first place]. Take newspapers -- we thought they were impenetrable franchises, but they now seem less so.

[Explained that their selling a stock doesn't necessarily mean they think it's doomed or bad to hold -- just that it's no longer as compelling to them as it once was.]

**QUESTION: Regarding the growth of float.**

BUFFETT: We have a longer duration of float - it has less natural erosion. It's an oil field, but we're pumping it every day. If I had to bet if it would go higher or lower in a few years, I'd bet higher. There's nothing more important to Berkshire than for the float to grow.

MUNGER: Growing float at a good clip with low cost -- it's almost impossible. We intend to do it anyway.

**QUESTION: Regarding asbestos liabilities.**

BUFFETT: Asbestos is a big part of our liability, but it doesn't really matter if it's asbestos or something else -- our liability is capped. You're right -- many companies that thought they were immune from asbestos [problems are finding out they're not]. It all may produce some opportunities for Berkshire to buy companies without their asbestos liability. We may see more companies like Johns Manville get added to Berkshire. Asbestos is a cancer on the American corporate world.

MUNGER: There's an enormous amount of fraud, with the wrong people getting money, arranging fraud. Some injured people are getting little. It's not a good situation.

In five years, I would be surprised if there was a constructive solution. It's a big mess.

BUFFETT: It's a concern today when we buy businesses because we're a big pocket. It might not have been worth it to go after a small company, but [if we buy the small company]...

We will be very careful in our insurance and acquisitions.

You might have seen Ed McMahon is suing for millions due to mold in his house. I wish I had that mold.

MUNGER: You probably do.

BUFFETT: I meant in my house.

**QUESTION: Regarding index funds and how to choose among them, and also what benchmark is best to use, since the S&P 500's P/E is high.**

BUFFETT: Take the S&P 500 index, but not all at once. [In other words, buy in installments, over time.] Be careful about the costs involved. I think people who buy those funds will do better than funds charging higher fees. You may get a higher gross return [with an actively managed mutual fund], but a lower net return [after fees are taken out].

[Buffett highly recommended [books by Vanguard founder John Bogle](#), the father of index fund investing.]

There's nothing wrong at all with not knowing how [to evaluate individual stocks?]. If you're reasonably sure that American business will do well over the long term, then invest for the long term in it.

I don't put much importance on P/E ratios, etc. It's just not that easy to understand, when to buy... you can't learn it easily. If you buy an index fund, you protect yourself from not knowing the answers to these questions.

Pick a broad index -- like the S&P 500.

MUNGER: I think [the questioner's] second worry is that common stocks may be so high that they'll not return much.

BUFFETT: But then you'd still get a return, just a smaller one. Pass the peanut brittle, Charlie. [Throughout the meeting, Buffett and Munger are eating See's candies and drinking Coca-Cola sodas -- Cherry Coke for Buffett, Diet Coke for Munger, if I recall correctly.]

MUNGER: Look at Japan, where there's a long-term negative return. Could it happen here? Yes.

BUFFETT: [They're having trouble opening the peanut brittle.] I must say, we have excellent packaging. The nature of butter is that it can deteriorate quickly, so the packaging has to be extraordinary...

**QUESTION: From a 12-year old from California, who's at his fifth annual meeting, regarding how 9/11 has changed their lives and investing strategy.**

BUFFETT: We've gone through wars without being too affected at home. I've long been worried about terrorist attacks. Humans have progressed enormously in how people can hurt one another. Before, if you didn't like someone, you could throw a rock at him. Now people can inflict a whole lot more damage.

It hasn't really changed my view. There are millions of people in the world who hate us. Most can't do anything about it, but the deranged have more opportunities.

Businesswise, the part of our business that it affects the most, by miles, is insurance. In the past we hadn't arranged to get paid for taking on terrorist risks and we hadn't excluded that risk. We do have some policies out there that aren't arranged as we'd want, but most have run off by now.

We've sold a lot of terrorist insurance, excluding nuclear, biological and chemical events. Some major nuclear events could wipe out the entire insurance industry. We take a few risks on nuclear, biological and chemical risks, but just a little. We can't afford to take a large loss on it.

Most don't realize it, but the World Trade Center became the largest workers' com. loss. It wouldn't have been so if it had happened at a ballgame.

We have to be vigilant in how much risk we let aggregate in our policies. Now we have to attend to man-made aggregations of risks.

The social consequences are far greater than the business ones.

MUNGER: To the extent that 9/11 has caused us [the nation, I think] to be less weak and sloppy, [it's a benefit]. We now face reality with more intelligence. Tightening of immigration should have happened years ago.

BUFFETT: Insurance isn't rocket science. You have to be sensible, know probabilities.

**QUESTION: Regarding the relative P/Es of banks vs. the S&P 500. They seem to be near 30-year lows relative to the S&P 500.**

BUFFETT: People always want a formula that will make them a lot of money. You just want to estimate a company's cash flows over time, discount them back, and buy for less than that.

I wouldn't want a single yardstick like relative P/E. We look at banks. We'll probably buy some in the future, but we've known them to fail, too. Someone once said there are more banks than bankers.

MUNGER: You may be asking the wrong people. I think we've failed at understanding banks. We missed opportunities due to fear.

BUFFETT: Banks have earned a lot more than we thought they would. They've done it ways that wouldn't have thought prudent 20-30 years ago.

MUNGER: We've done poorly with banks. Worse than that, we haven't changed.

**QUESTION: How do you ferret out fraud, and what books do you recommend?**

MUNGER: You're asking for a lot if you want a way to avoid the frauds of the world. They're sophisticated. Partly it's a matter of gaining experience in life. I think there are whole fields you can avoid... The guy who defrauds us will not be the kind who defrauds others. It'll be a small person in a small office...

BUFFETT: ...carrying a biography of Ben Franklin. [That's a joke, referring to Munger's deep respect for Ben Franklin.]

Among those who talk about EBITDA (earnings before interest, taxes, depreciation and amortization) and those who don't, there are more frauds among those who do. Either they're trying to con you, or they're conning themselves.

Many companies -- **Wal-Mart** ([NYSE: WMT](#)), **Microsoft** ([Nasdaq: MSFT](#)), etc. -- never mention

EBITDA. Telecoms -- they're spending every cent they have -- there's no EBITDA. You get depreciation by laying out money first -- the worst kind of expense. It's the opposite of float, where you get money at the beginning and pay out at the end.

It amazed me how many people use EBITDA. It's amazing how many frauds look like frauds. We've spotted them. They tell you things that can't be true. They have a smell about them.

MUNGER: [Robert Maxwell](#) of England was known as "the bouncing Czech" -- yet Salomon was pursuing business with him, with me and Warren on the board. It shows you how much influence directors have.

We didn't stop First Normandy, with me, Warren and Lou Simpson on the board. An embarrassing episode. We protested, but were told "the underwriting committee approved it."

**QUESTION: Regarding what process Buffett uses when he buys companies after talking to management for just an hour or two, and whether he talk to suppliers and customers, and does background checks.**

BUFFETT: That's a good way to go about it and we've done a fair amount of it before. There's a good book about it -- Phil Fisher's [Common Stocks, Uncommon Profits](#).

The custom picture framing business was explained to me -- I knew nothing about it. I'd gotten pictures framed -- and got robbed. It's a small business. Craig Ponzio [of Larson-Juhl, the U.S. leader in custom-made picture frames] built an enormously successful business supplying some 18,000 framing businesses. He told me the business, gave me some numbers, and came out to see me two days later. We shook hands, he got his money. I've not been to their headquarters yet [-- I should do that soon]. Most businesses you can understand quickly -- except those you'll never understand. If you talk to a company's customers, suppliers, etc., you still won't know more about its future prospects.

MUNGER: We wait for the no-brainers. We're patient. We're so peculiar that a good number of businesses prefer dealing with us.



BUFFETT: I read of a major company -- it did 10 acquisitions, each with a lot of due diligence. All did not live up to expectations. Despite the quote unquote help of investment bankers and the like. They were buying what was being sold to them. It was fulfilling myths businesses have about themselves [presumably that they should be captains of industry, making deals left and right, acquiring other companies].

People come to us for a deal that's sure to close. Employees worry when their company is on the block -- [sealing a good deal reassures everyone].

MUNGER: Someone once defined hell [for the legal realm] as endless due process and no justice.

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