

Pasadena, California. May 9, 2007

Brief speech about why Warren Buffett (WB) and Berkshire Hathaway (BRK) have been unusually successful.

Before jumping into the Q&A session at the annual shareholders meeting, **Charlie Munger (CM)** briefly examined some of the factors that he thought were responsible for what he calls the “lollapalooza” effect, which is basically the confluence of several factors acting in the same direction that creates an effect that is greater than the sum of parts effect. He discussed the following factors:

-Warren Buffett

- His mental aptitude
- His extreme interest in business and investments since an early age (10 yrs)
- His early start in the field
- Decision making heavily concentrated in the mind of one individual as opposed to committees or a group of individuals; benefits of concentrating decision making in the best mind/ decision maker
 - “Hard to think of great committees that have been successful”;*
 - “No accident that Singapore has a better record than the US” (in per capita GDP growth and development)*
- Intelligent, rational, objective decision making as opposed to decisions based on “nuttiness” (such as envy, revenge, or extreme ideology, etc.)
 - “Get more in life by being a little more rational”*
- Involved in a reinforcing activity (investing)
 - Involves tangible rewards
 - Able to keep improving and learning
- Picking up main ideas from all disciplines
- Education & Learning
 - One of the best “learning machines”, in a field in which continuous improvement was possible
 - The earlier Warren Buffett would never have gotten into currency trades. But, he has keeps learning. [CM stressed the importance of learning and getting good at learning. He calls it “*learning the method of learning*” and calls this skill as important to leave school with, not just getting good grades. CM continues to feel that the top schools are not yet learning enough from Buffett and his successes. He also stressed the importance of staying away from “nuttiness” such as envy, revenge...”Buffett never spends any time on such nuttiness”
 - “Never get the idea that the world is unfair. Every tough stretch is an opportunity to learn”*
 - “Irish Alzheimer’s is when you have forgotten everything except the grudges”]*

-BRK Culture

- Wonderful to be trusted
- Rather than depend on checklists for compliance, Berkshire and Buffett have followed a “*seamless way of trusting the right people*”

Q&A Session

Q: Why has the BRK model not been repeated or imitated yet?

CM:

- World grew up believing in a different model with backing from academics
- BRK model too simple,: people think how can you be an expert?
- BRK model too difficult: don’t attempt to replicate
- Current institutional system has different rewards and hence different behaviors

Q: What is your view on commodities and commodity investments? What about BRK’s recent investment in steel via Posco?

CM:

-Not particularly interested in commodity businesses but even commodity businesses can be attractive at a price
-BRK's Posco investment not purely commodity based; It has a hi-tech component that creates a competitive advantage for its niche products

Q: What do you think of the private equity deals of late? Is there a trend and what are the long-term implications?

CM:

-Of course there is a trend
-As the LBO funds get larger they go after bigger deals and businesses
-Unlike LBO funds that have to resell at some point, BRK never sells the businesses it buys
-Endowments believing in the tooth fairy; have been fine thus far but the party is bound to end sometime
 -Greed cycle typically starts with good returns, then envy sweeps through (Yale trying to follow Harvard's footsteps) because of human nature
 -One can predict what can happen by looking at the early venture capital funds from the dot com days
-A big recession is one example of an environment that can affect these private equity deals
-There has been a misuse of statistics when it comes to depicting the returns of private equity funds

Q: What is your opinion on USG's issuance of stock at current levels? Why do managements issue stock below intrinsic value of a business?

CM:

-Hmnnnn...wondering whether to duck the question or give the correct answer!
-This is a foolish thing to do by managements....some of them went to Business School!

Q: Thoughts on the backdating of options?

CM:

-It's regrettable

Q: Why is Kansas Bank Surety (KBS; a Wesco subsidiary) a wonderful business?

CM:

-Because KBS knows its niche very well and knows what it knows and doesn't know
-Has shown underwriting profit, year after year >> a good business

Q: Are we all hard-wired a certain way? What is your take on the nature versus nurture argument?

CM:

-Argue that nature is way more important than given credit for
-Nothing on earth could have me succeed in basketball or swimming
-Recognize your talents... *"A man is a prisoner of his talents"*

Q: What are your thoughts on the current energy policy?

CM:

-None..will leave that to the experts

Q: What are your thoughts on distributing the excess capital at BRK and Wesco?

CM:

-BRK will only consider a distribution when it can't find prospects that can generate a dollar in value for every dollar that it currently holds
-Wesco doesn't have the same prospects that BRK does, so it could distribute capital on hand if the majority of shareholders so choose...but the majority ("the cult") doesn't seem to want that at this point. They want us to allocate the capital appropriately

Q: Has the Board at BRK added any value? Could you give us a specific example?

CM:

- The Board is merely a safety net if I go crazy and Warren does not do anything about it ☺!!
- We have a Board because we are required to have one!
- Would we have a Board if it was not required by law? No!

Q: Is there a checklist that we can use to learn the method of learning?

CM:

- There is no standard checklist that I can supply..you have to create your own. Using a checklist is very important as it helps bring the problem areas to the fore.
- One suggestion is to “invert” everything and look at an issue from that perspective
- I have also tried to figure out what I don’t like and to avoid it..and that has worked wonders for me.

Q: Are there any beliefs that you have overturned?

CM: [took some time to answer this one...]

- In the investment sphere, I hated railroads at one point—they had union issues, were regulated, had huge capital needs..in short, it was a bad business. But, recently, railroads have carved out a small competitive advantage against the trucking industry in light of the higher oil prices, advent of technology and double-decker carts increasing capacity at lower costs, lots of trade from China, , and the lower likelihood of more railroads coming online...
- Finally threw out my beliefs about this industry and bought railroads...the world changed!

Q: Given trading recent activity at BRK vs Wesco, why are equity opportunities more attractive to BRK than to Wesco?

CM:

- We don’t follow similar paths while looking at some of these opportunities
 - Reporting requirements also create some discrepancy with respect to what you see happening
 - I continue to prefer some of the better equities rather than bonds at this point
- “We are settling now for less favorable opportunities relative to the past when it comes to use of capital”*

Q: Do you have any new book suggestions for us?

CM:

- The Martians of Science: Five Physicists Who Changed the Twentieth Century*, by Istvan Hargittai
- Einstein: His Life and Universe*, by Walter Isaacson is probably the best Einstein biography I have read

Q: Given your extensive study of Ben Franklin, can you discuss any regrets that he may have had?

CM:

- Likely his choice of spouse...

Q: Do you have any recommendations for young Chinese investors? Do you have any insights into the Chinese markets for us?

CM:

- There are two exchanges when it comes to the Chinese stock markets—Shanghai and HongKong
- There appears to be some interesting opportunities in HongKong while the prices in Shanghai show some signs of gross excess—have no interest at current prices.

Q: We have seen the value of the dollar against other currencies come down over the last few years and yet there has been no rise in inflation? Your thoughts?

CM:

- Don’t have an answer...what we are seeing is contrary to what economics and theory would indicate.

Q: What are your thoughts on the Precision Steel business that Wesco owns? Would you consider selling this below average business?

CM:

-We don't sell companies just because the business is difficult—we don't play gin and rummy with our controlled businesses. Overall, keeping the good and the bad averages out, if not turning out better for us in the long run as this attitude towards our controlled businesses is what attracts good businesses to BRK's doorsteps. We don't consider Precision Steel a disaster.

Q: Given your past statements about investing in healthcare, wouldn't you consider your recent investment in J&J outside your circle of competence?

CM:

-We don't want to comment on our specific investments other than to say that we have invested in fairly decent businesses

Q: Could you give us a glimpse into the current CIO (Chief Investment Officer) search at BRK?

CM:

-We aren't looking to assign the title CIO to anyone we find—that is a media creation. All we are looking for are a few individuals to manage a few billions for us. The folks we will end up choosing won't look like standard people. We are looking for someone like Warren who can be on the job for years to come. We found Lou Simpson in the past and we are looking for someone younger who can play such a role.

Q: How is the decision made as to which company (BRK or Wesco) makes an acquisition versus another? For example, why is KBS at Wesco while See's is at BRK?

CM:

-We don't have any methods to do this...the allocation was accidental.

Q: What motivated you when you were young?

CM:

-I wanted to get independent....become a man of means so that I could undertake to do things my way.

Q: In your opinion, what are the three most problematic issues facing us?

CM:

- 1) The Nuclear Threat
- 2) Population: unmitigated growth is likely to put a strain on resources and the environment
- 3) Clash of Civilizations, especially with respect to the Middle East

Q: What were the factors that drove the Iscar (a tool manufacturing company based out of Israel that was one of BRK's largest international acquisitions) acquisition?

CM:

-We would not have bought such a company when we were younger. But time has taught us to make a stretch for the right factors such as the right people, on top of the usual criteria such as good businesses, etc. We did that with Iscar.

Q: What are the particular lessons you have learnt in the last ten years?

CM:

- I learnt many of the important lessons young
- I did not regret not making easy money if it meant going against my values although it was legal doing so

Q: Given your and Warren's ages, what are your thoughts on BRK as an investment?

CM:

-My family has around \$2 Billion invested in BRK stock—we think BRK is good enough for us and I hope after me my family holds onto the stock.. BRK operates a stable of decent and reputable businesses. Given its large base, we are not going to be up at a compound annual rate of 20% or 30% but a lot more subdued. BRK is a reasonably safe investment and I expect it to be safe long after Warren and I are gone.

Others Comments by CM:

-On Reading: There's no substitute for reading. Folks, such as a lot of the current generation, who end up multitasking endlessly are bound to end up worse thinkers. The path to wisdom is to *"get it sitting on your arse...that's the way it comes!"*

-On the Berkshire philosophy catching on: The BRK way of looking at things will become more popular over time and that will not make it any easier to make money...

-On Self-serving Bias and Envy: You will find these human misjudgments in the highest of corporate places. The problems in the sub prime area can be traced to these natural defects of human nature

-On Opportunity Cost: This is one subject where academia has done much disservice. All decisions, all of them, should be based on evaluating the opportunity costs associated with the decision

-On Insurance Business: This business is not good for most people. BRK will do way better than average. The insurance operations at BRK has been a learning machine.

-On Current Investment Banking Culture: Investment bankers earlier were better—they cared a lot on what they underwrote. That culture has gone away.