

---

---

# Ruane, Cunniff & Goldfarb Investor Day<sup>1</sup>

*May 16, 2008 – St. Regis Hotel, New York City*

---

---

**Bob Goldfarb:**

Good morning, and welcome to our Investor Day. We're going to follow the same format that we have in recent years, which means that the day is going to consist strictly of questions and answers, and we'll take questions until 12:30. We have to vacate the room by one o'clock, but we'll be around between 12:30 and one o'clock to meet you and respond to any questions that you might still have for us.

There is one restriction I'm going to ask. If there are any journalists or Internet bloggers in attendance, we ask that this meeting be off the record. We prepare a transcript of the meeting for our clients and shareholders, and we prefer that all of our shareholders and clients receive the transcript at the same time and in full.

Before we begin taking your questions, I'd like to introduce our team. On my far left is Greg Steinmetz. Next to Greg is Jon Brandt, then David Poppe, who is President of our firm and co-manager of Sequoia. Rick Cunniff is on my right. As most of you know, he's our co-founder. To his right is Greg Alexander and to Greg's right is Joe Quinones, who runs the operations side of our firm as well as that of Sequoia.

Finally, I'd like to introduce the rest of our team who are seated in the front of the room on my left and to your right. In alphabetical order, they are Girish Bhakoo, Andy Ewert, John Harris, Jake Hennemuth, Arman Kline, Trevor Magyar, Tom Mialkos, Terence Paré, and Chase Sheridan. I'd also like to introduce Jon Gross who is our Director of Client Services. With that, we're ready for your questions.

**Question:**

I noticed that you trimmed your stake in Wal-Mart and increased it in Target. I was wondering if you might talk about Target, its position and why you like it so much.

**David Poppe:**

What I would say is we bought most of the Target before we sold any Wal-Mart. Sequoia still holds Wal-Mart.

Interestingly, I think if you look over the last seven years since 2001, Wal-Mart and

Target have almost identical EPS growth rates. I think going forward, both are likely to have pretty good EPS growth rates. Right now, Wal-Mart might be a little bit better positioned in that its business is more oriented to food, commodities and staples.

**Bob Goldfarb:**

One difference between the two companies is that Wal-Mart has allocated a fair amount of its capital to opening stores abroad, whereas Target is strictly in the United States. I would say generally we have a preference for companies that do have foreign exposure, but in this case, Wal-Mart has failed to demonstrate to date that they can earn the kind of return on investment abroad that they've been able to earn in the United States.

As some of you may know, they've exited a couple of countries. Germany was a particularly expensive exit. They exited Korea. They've put a fair amount of money just recently into a struggling Japanese chain, and it's going to be a turnaround. Terence or David — how would you describe the return on investment, on ASDA, for example?

**Terence Paré:**

The return on ASDA has not been great. Part of the reason that Wal-Mart's returns overseas are less attractive in places like the UK than they are in the US is that they don't have the same kind of structural advantages there that they have here.

One of Wal-Mart's big edges is its ability to get goods from the supplier to the store very, very efficiently. It's harder to do that in countries like the UK. Is just not easy to get around. Wal-Mart's edge here, which is their superior logistics courtesy of our highway system, just doesn't exist in a lot of other areas. Their big differentiator is just not as important over there as it is here. I don't think they will ever be able to get the kind of returns overseas that they get in the US, but they'll do okay.

**Bob Goldfarb:**

I would also say in the case of ASDA, for one, it's hard to earn a comparable return on capital because they paid a significant premium over book when they bought ASDA. If you open

---

<sup>1</sup> Remarks have been edited for clarity.

stores de novo as has been Target's M.O., you are building at book value. It's just easier to earn a decent return on book if you are not paying a multiple of book at the start.

I'd also say — hopefully without offense to Wal-Mart — that Target has a remarkably strong management team with no holes, as far as I'm concerned.

**David Poppe:**

I agree with that. We own a lot of retailers; so we meet a lot of retailers. Without denigrating any other retailer, I think Target's management is as smart as that of any company that we follow, probably the smartest retail management that we know.

**Bob Goldfarb:**

So I give the management nod to Target. Some of that may erode. Bob Ulrich, who was a master merchant, has just retired. Marketing and merchandising geniuses are rare in retailing. But Gregg Steinhafel, his successor, seems extremely capable. He has big shoes to fill, but we think that he can fill them.

**Question:**

Would you please comment on the effects of the housing crisis on Mohawk and what effect the European operations or replacement market might be having on the company?

**Terence Paré:**

The housing market is not being kind to Mohawk at all. The residential replacement business in the US which is the bulk of their business here — people are just not spending as much money on their houses, sprucing them up for sale, or sprucing them up after they buy them. So Mohawk is suffering significantly from that. It's suffering from slower markets in Europe as well, although that is a little spottier.

The good news is that the nature of the business is such that even when times are difficult, it still produces a lot of cash. It is able to ramp down production facilities for the most part without really causing any incremental cost downstream.

That is, you can essentially turn a carpet mill off and then turn it back on a month later without really incurring any additional cost other than having to bring people back after

you've laid them off. So the nature of the manufacturing process is such that Mohawk can hold up pretty well under low demand.

On the commercial side of the business, they've been fortunate in that commercial construction in the US has been good, surprisingly so and continues to be good this year — so far. What happens in 2009 is anybody's guess. But so far, commercial has really been giving them a little wind at the back of their sails.

They are benefiting as well in the commercial market in carpet because when they bought Lees a few years ago, they got into the carpet tile business. And carpet tile is a significantly growing business for them. Still if you add it all up, 2008 is going to be tough, and 2009 could be tougher.

But this is a business that's been through downturns before. They are better positioned now due to the Unilin acquisition, because they are getting some benefit from slightly stronger economies in Europe and all of their businesses are producing a lot of cash, and management has been finding smart things to do with it. So it's not going to be great for them over the next 18 months or so. But this is a kind of business that was built to do well in hard times, relatively. So I think we'll be okay.

**Question:**

Last year you talked about the attractiveness of Knight Transportation in light of a difficult trucking industry, and you compared it to the railroads. Gas prices are continuing to increase. What does that do in terms of Knight's ability to outperform the rest of the trucking industry?

**Greg Steinmetz:**

First I will address the question of the railroads. Knight operates in regional hauls. They are about 500 miles. The railroads aren't economical on such short hauls. They are very economical when you cross the country. That doesn't mean that Knight isn't affected. To some extent trucks that used to haul goods across the country have to find something to haul and some of them are looking into the regional markets. That, combined with the fact that a lot of trucks were sold two years ago in anticipation of more expensive engines coming because of

new emissions requirements, has put a lot of trucks out on the road looking for goods to haul.

Knight's ability to outperform is what it always was — Knight has the ability to make a lot more money than almost all other truckers because it's just more cost-disciplined. It can then take that money and deploy it in ways that other trucking companies can't because it has a regional model that lends itself to taking a lot of trucks that can be deployed profitably whereas the others — they might add a lot of trucks, and not find decent freight to put on them because they are not as close to the customer as Knight is.

So long term, we think Knight is going to be just fine. They have about 27 dry van terminals now. They are going to take it up to at least 60. Also, they have recently added some other businesses. These include a refrigerated business and a brokerage business. That should give us a lot of growth over the long run. But we're going to have to be patient with it.

**Question:**

Sequoia's stake in Berkshire seems to be smaller. Could you talk a little bit about Berkshire?

**Bob Goldfarb:**

I think my response a year ago was that we'd taken it down to 25 percent of the portfolio. And that really hasn't changed this year. It may be a tad under 25 the last week or so simply because of the decline in its price relative to that of our other holdings. But there's been no change in the percentage invested in Berkshire since we met here a year ago.

**Question:**

Now that you've reopened the fund to new investors, how far do you anticipate expanding? And are you going to build on the companies you already own, or are you going to expand into more areas?

**Bob Goldfarb:**

Our appetite for money in Sequoia is going to be a function of the undervalued securities that we find to buy. Some of these may be securities that we already own. Others hopefully will be securities that we add to all the portfolios including Sequoia. So, the ceiling on what we take in, in terms of funds in Sequoia, is going to be our ability to put that money to work

productively. If we find that we can't, and cash is building up excessively, then we'd have no choice but to close it down again, at least temporarily and hopefully not for another 26 years.

**Question:**

In the mid-nineties, I know the fund committed a fair amount of capital to regional or commercial banks. Obviously, valuations of those types of companies have come down pretty dramatically in the credit crunch. I'm just curious in light of your expertise in that sector whether you have a particular view on banks. Buffett and Munger have been buying Wells Fargo. I think at the Berkshire meeting, Munger made some comment, which for Charlie was optimistic, about prospecting, and smaller banks may be a good opportunity.

**Jon Brandt:**

We've definitely owned banks in the past and maybe we should be looking at some midsized and smaller banks. Given the amount of money that we're managing, the smallest banks probably couldn't make a difference. We're trying to look at companies that have a \$1.5 billion market cap and over.

But I think you're right. It could be a good area to prospect in. Greg Alexander noted a couple of years back that there has been a fair amount of disintermediation of some of the best assets. We've noticed over the last few years that many banks have a larger percentage of their lending assets in areas like construction lending and maybe some other asset classes that we didn't even realize were so dodgy like home equity lending, where Wells has stubbed it toe a little bit, although it is still an excellent bank. So we will keep an open mind towards the banks and try to find some that have stayed away from trouble. It's a good suggestion.

**Bob Goldfarb:**

Warren Buffett made a very valid point, which is that a number of banks, certainly the money centers but a lot of the regionals as well, were earning money from activities that in retrospect, at least, they shouldn't have been engaging in at all.

So in many cases, it's going to be very difficult for them to return to their previous peak earning power. But if the price is right

relative to what should have been peak earning power if they were underwriting conservatively, we'd certainly be open to them.

**Question:**

I noticed that you initiated positions in Martin Marietta Materials and Vulcan Materials. I was wondering — is that part of a cohesive strategy, a sense that perhaps in the new administration there will be greater infrastructure spending? And if that's completely off base, I'm wondering if you could discuss those purchases briefly.

**Chase Sheridan:**

It's not part of a greater strategy. It's based on the economics of the companies themselves. I'll talk a little bit about the quarry operators — Martin Marietta and Vulcan. First of all, Martin Marietta and Vulcan produce aggregate. It's used in infrastructure; it's used in nonresidential and residential construction projects, as railroad ballast — anything you need rock for, it's used.

The great thing about this business is that it's simple — there's no risk of technological obsolescence. It's hard to find substitutes at \$10 per ton, which is about the cost of rock these days. For Martin Marietta, they have over 50 years of reserves in the ground beneath their feet and Vulcan has 43.

Let me give you an example of why we like these businesses. The key is really in their pricing power. The weight of rock is very high relative to its cost to transport, and that leads to the markets' being very local in nature.

Truck transportation — which is the most common form of transportation for rock and also the most expensive — can reach as high as 30 cents per ton per mile. That means that if you have a job 30 miles away from my quarry, by the time you deliver that rock to your job, you've more or less doubled its cost.

By the same token, if you have a job next door to my quarry and the nearest competitor is 30 miles away, I can double my price before you have an economic incentive to go somewhere else. Ideally, I would have quarries blanketing a growing metropolitan area. So for any job in that area I would be more likely to have a quarry that is closest to that job

and I could price according to my transportation advantage.

If you draw a circle with a 30-mile radius around a typical Martin Marietta quarry, that circle will contain a competitor's quarry only about as frequently as it does another Martin Marietta quarry. Vulcan's quarries fall into a similar competitive pattern. Other large aggregate companies face local competitors significantly more often than both. If you increase the radius of that circle — just to give you simple metrics — but if you increase the radius to 50 miles, Martin will have on average only three competitors within that 50 mile radius, and a typical US quarry will have five. And that's impressive since Martin Marietta has only 197 — as of the end of 2007 — producing locations out of thousands of producing locations in the US.

It also helps to be in growing markets. Both Martin Marietta and Vulcan established footprints in growing metropolitan areas through acquisitions over the years. Between 1995 and 2002, Martin acquired 62 companies. Vulcan has also been an active acquirer. Notably, they acquired Florida Rock for \$4.2 billion in 2007. They are still integrating it.

So why does being in a growing market help? Well, population growth helps in two ways. First, it spurs demand for rock. Second, it raises the barriers to entry because quarries are unwelcome in populated areas. Nobody wants explosions shaking the walls of their house. Nobody wants oversized trucks clogging their roadways.

So it's extraordinarily difficult, these days, to obtain a permit for a new green field quarry in a growing metropolitan area in America. The barriers are very, very high. That difficulty in permitting means that Martin and Vulcan both know who their competition is and where their competition is for a very long time into the future — say at least the next five years.

It also means that their competitors in that area understand that permitted rock in a growing area is an increasingly scarce resource, and they will price accordingly.

Finally, with population growth, commercial and residential construction will cover potentially competitive quarry sites over the course of time due to sprawl. So your

transportation advantage in those markets grows over time.

The bottom line is that in difficult times, which we are in today, we're seeing precipitous declines in volumes in the rock business. But even in this environment, these firms have still shown an ability to raise prices. Martin Marietta just raised their expected price increase for 2008 to six to eight percent. Vulcan is expecting eight percent in 2008.

Just to give you an idea of the market dynamics, in 2007 Martin Marietta produced 182 million tons of rock. That's the lowest level of production they've had since the year 2000. But they earned \$6.06 per share in 2007 versus \$2.39 in 2000. So even in a difficult environment, if the pricing power hypothesis holds and if these companies can raise prices on the order of six to seven percent per year over the course of a cycle, we'll do well.

**Question:**

Could you help me understand how the mandate of the Gates Foundation won't put pressure on Berkshire shares? I know the foundation is supposed to give the money away over ten years, and presumably they will sell Berkshire shares as they do that.

**Jon Brandt:**

Candidly, I haven't done a whole lot of research on the flow of shares out of the Gates Foundation into the market. They have been spaced out over a period of time and I believe they've already started selling some of it. This whole issue was pretty well thought through when Warren made the decision to contribute so many of his shares to the Foundation.

**Question:**

It's just something that seems at odds with supporting the shares. There might be some pressure if they have to sell on bad news or felt that it was their duty to sell to manage the position in the best interest of the charity.

**Jon Brandt:**

There are many companies whose founders have a lot of stock, and those shares get sold over time. My personal view is that shares find their value. If there's a single shareholder who's selling a lot of stock, it could create some temporary air pockets in the pricing

of the shares. But there's just so much money in the world looking to buy undervalued securities, I don't think that that particular pressure is going to cause a meaningful change in the quoted value of Berkshire Hathaway. If it did, the board could always institute a share repurchase plan. I put that very far down on my list of worries about Berkshire, personally.

**Question:**

This is perhaps an indirect way of asking about your investment time horizon. The first time I met Rick was some 30 years ago on an analyst trip to South Africa. Thirty years later, my question now is: with the much larger research group, are you looking at the frontier type of markets?

**Bob Goldfarb:**

How would you define the frontier?

**Question:**

Well, initially beyond the MSCI index. It would probably be markets that do have a stock exchange but somewhat limited volume.

**Bob Goldfarb:**

If the supply of stock is relatively limited, it's probably not going to be large enough to make it worth our while. We'd like to participate in that growth, but not necessarily from the domiciles of those frontiers. We're more likely to buy stock in companies that are selling into those markets but that are domiciled in countries that have much more developed securities markets.

**Greg Alexander:**

To answer your question more broadly, we're definitely thinking more internationally. I try to explain to my eldest child who's ten — I try to explain that in the olden days — more than ten years ago — if you wanted to order things, you had to take out this big book called the National Stock Summary — Bob, remember that?

**Bob Goldfarb:**

Yes, oh yes.

**Greg Alexander:**

It was this thick, and it had the address of every public company in the United States. So every one of us, in the top drawer of our desk, would have these cards that said, "Please

send your annual report,” and you could check that, “and your 10-K and your proxy statement.”

You would send it off and if a month later you hadn’t gotten it back, you would send off another card. Then if that didn’t work you would pick up the telephone and actually call them.

Now we can get the annual reports of a company in Europe or Asia or South America, or whatever — if it isn’t loaded in 30 seconds, we start getting irritated. So we’re definitely all thinking a lot more about that

**Question:**

Sequoia has sent some pretty hefty tax bills to its stockholders in the past couple of years. I wonder if you could comment on how the fund approaches tax management and what you see in the future in this aspect. You might also comment on the extent to which this was a factor in your decision to reopen the fund.

**Bob Goldfarb:**

One of many lessons that I learned from Bill Ruane was not to be too tax-oriented. That said, we would not have reopened the fund to taxable investors at this particular time if we thought it were highly probable that we would be realizing large taxable gains. But I certainly wouldn’t extend the time horizon on that beyond this year.

**Question:**

You mentioned that the Gates Foundation’s dispensing of stock was not on your list of Berkshire sensitivities. I wonder if another issue may be on your list. The four people who have now been named as potential successors to him as chief investment officers ... what kind of hard commitment do you think one or more of these four people may have made to the board?

**Jon Brandt:**

I don’t think I’m in a position to characterize that. I can tell you what I have heard — and first let me preface this by saying that Warren is 77, and I think there’s a good chance he’s going to live many more years. A lot of things could change between now and the time that a successor is needed.

I don’t know how many applicants he had but I wouldn’t be surprised if it numbered

well into the hundreds, if not more. From this pool, Warren identified four people he was comfortable with as being good analysts of businesses and people of integrity. He emphasized that he was looking for people who can foresee risks from events that perhaps have never happened before and who can think long into the future about preserving the retained earnings of Berkshire against unforeseen events.

He said that all four are happy where they are now; all four are independently wealthy; and all four would be willing to come to Berkshire tomorrow if something should happen to Warren that would necessitate that. I don’t think he would have extended an offer to people if he didn’t feel that they would make real commitments.

He’s said that when he buys businesses he looks for people who love the business and not the money. He wants people who are still going to come to work every day and try to do their best after he puts \$1 billion or \$2 billion in their bank account. I suspect that he did a similar kind of analysis with these four people, checking that there wasn’t going to be some other type of commitment that was going to steal their interest or distract them.

I think he’s a pretty good judge of character, and I’m sure he vetted all four of the people. But I can’t speak from my position here as to whether there is some kind of ironclad guarantee that these people won’t change their minds should something happen between now and the time Warren needs successors. I’m sure if something happened in their lives, where one or two of the four couldn’t continue to make that commitment that they would tell Warren about it.

**Question:**

This is a question about Whole Foods. Could you give us a summary of the issues and opportunities which they face?

**David Poppe:**

Sure. Whole Foods is interesting. They just had very poor earnings. The sales growth rate over the last ten years has been a shade under 20 percent. The earnings per share growth rate over the last ten years has been 11 percent, which is a reasonable growth rate. A lot of companies would be very happy to have it. But

it certainly wouldn't qualify as excellent or spectacular. And given the top line growth rate, it would qualify, I think, as disappointing.

Right now, I think Whole Foods' issues are mostly short term in nature. They made an acquisition of Wild Oats that's proven to be very expensive, both to buy and to integrate. They opened a store in London that in my personal opinion is not working out and it may not work out. It's also been very, very expensive.

At the same time, they ratcheted up their store growth rate from a pace of about 9-10 percent annual square footage growth per year to a pace of 15 or 16 percent annual square footage growth per year. That has created a lot of — I wouldn't say short term — but intermediate term costs. The management has been really clear for more than a year that earnings would be pressured in 2007 and 2008. So we knew that. We went in with our eyes open.

I don't think we or they thought earnings would be pressured to the extent that they are. But when I look forward, there are a lot of one-time costs related to integrating Wild Oats that do go away in the next couple of quarters, certainly by the beginning of fiscal 2009. The new stores — the first really large batch of new stores opened toward the end of 2007, and they hit the comparable store sales base beginning in the fourth quarter of 2008, first quarter of 2009. That should start helping results instead of hurting results, as these new stores start to generate positive comparable store sales and higher margins. There's a pretty plausible case to be made that the earnings in 2009 and 2010 could be up nicely.

I would also note that although the top line has consistently grown at a rapid rate, the earnings progress has been lumpy. There have been down years and then strongly up years following that. I think management realizes at this point that — I wouldn't say they've lost credibility — but they are frustrating their owners, and they are certainly frustrating the analysts who follow them on the sell side.

So all that is to say I don't think the issues facing Whole Foods are that the consumer doesn't like natural foods or doesn't like gourmet foods. The comparable store sales gains and the identical store sales increases have decelerated. But I think the consumer likes the

store. Traffic in the stores is still going up year by year. I think the store works.

I think there are a lot of costs that are associated with growth that have been higher than they expected — most particularly Wild Oats. And it's a little bit frustrating to see something that's got a 20 percent top line growth rate and an 11 percent bottom line earnings growth rate. That's not acceptable, and hopefully they see things the same way.

**Bob Goldfarb:**

I would add that John Mackey is clearly a visionary. We've invested with and looked at companies run by visionaries in the past — Peter Lewis of Progressive would be an example. It goes with the territory that the train sometimes goes off the tracks. But I think they will get the train back on the tracks.

**Question:**

I have a question about Walgreen. If you read the annual report three or four years ago, they said that with all the patents that were coming off over the next few years that generics would be a bigger part of the mix. They said that probably if sales go down a little bit, margins would be better. If you look at the last three or four quarters, it's not really the case. You see that same-store sales are perhaps four percent lower than they would have been if there had been fewer generics. But the EPS is not really growing as it used to. So my question is do you feel that the growth mode that they had five or ten years ago has been a little reduced in the last few years? If so, do you think they can expand it a little bit in the future?

**David Poppe:**

That's a good question. I am going to agree with you in a couple areas and disagree with you in a couple of areas. The earnings growth the last four quarters has not been great. But the earnings for really a long time prior to that including 2005 and 2006, when we had a heavy generics conversion cycle, were outstanding. The ten-year earnings growth rate for Walgreen, I think, is 16 percent, which again talking about Whole Foods at 11 percent — 16 percent is an excellent growth rate for earnings.

The earnings growth rate last year — which people look at almost as a debacle I think — was still 16 percent. The earnings

growth rate this year is going to be in the high single digits. I would say with Walgreen, it's fairly simple that you had a lot of branded drugs go generic for several years in a row culminating with Zocor, which is a statin that went to a generic in 2006. Since that cycled through, there haven't been any new significant generics for a few quarters now. The drugstore really makes a lot of money when a drug first goes to a generic because — to simplify it a little bit — they basically get paid a bonus if they can convert people very quickly from very expensive branded drugs to cheaper generic drugs. They get a very high reimbursement rate for a short period of time.

So right now there are no major new generics. And Zocor, which was a giant, is very hard to cycle against as you go through the second year with that. I think when you look forward — 2009, 2010, and 2011 — there are a lot of really powerful drugs that go generic and it culminates with the granddaddy of them all, which is going to be Lipitor. And Lipitor will be huge.

So I think the earnings growth rate should be better in the future than it is going to be in 2008. I think Walgreen — a 15-16 percent earnings compound — maybe it will be lower in the future. But it ought to be higher than the growth rate that they will show this year when there are no new powerful generics in that mix.

However, I would also say — you asked a question about the moat — I think the moat is a little bit less than it was before. Maybe not a lot less, but a little bit less. Their competitor, CVS, has made shrewd acquisitions and grown its market share. The PBM purchase that CVS made of Caremark — I think it's still a little bit unclear how that will all play out. But certainly, they are a formidable competitor.

I think Wal-Mart's decision to essentially give away drugs to generate traffic for the store — it hasn't really hurt Walgreen yet but it can't be good, long term — Wal-Mart's having hundreds of drugs that they sell for \$4 or three-month supplies for \$10. We are seeing the drugstore business consolidate down to where Walgreen has a 17 percent share and CVS has a 17 percent share and Wal-Mart and Rite Aid are probably around 10 each now. Four players are controlling more than half the market. Most of

the weak sisters are gone. So the people that you feasted on in the past, they are not there to give out more share. It's becoming a more competitive business, I think.

Walgreen has made some acquisitions to broaden the services that they can offer health care providers like offering specialty drugs and offering health care clinics in the store. These should work and should be successful, but they might initially pressure earnings a little bit as well.

Nevertheless, I actually don't think that Walgreen's earnings problems the last couple of quarters are strictly related to a loss of competitive strength. I really think if you did the math out on the generic conversions, that's a big part of it. The economy is a little bit slower, and they are a retailer. The front end comps — which is everything that's not a prescription — are still quite good. But they are down a point or two points from where they were before. Across the country, not just with Walgreen — prescription growth is a little bit lower this year than it has been.

For a long time, it's been three or four percent per year. If you look at the aging of the US population, it should be three or four percent growth per year going forward because 65-year-olds take more prescriptions than 55-year-olds do. But this year in particular, you've had — I think Zyrtec is the big one — but you've had some prescription drugs that have gone over the counter.

You've got a bad economy, higher copays. Some people are just filling fewer prescriptions. So I don't think the earnings issues this year are permanent. I would also say that in what may be a pretty poor year, they are still going to grow at a pretty decent rate.

**Question:**

Given Brown & Brown's business model and their primary market, they seem to be getting hurt by both the housing market and the regulatory environment. What do you think about their long term growth?

**Jon Brandt:**

That's a very good question. For those of you who haven't followed what's going on in Florida, after the two years when they had a series of hurricanes — 2004 and 2005 — insurance

rates went up a lot as private market carriers were licking their wounds over billions of dollars of losses. Rates went way up. I think they may have tripled on some types of properties. The governor of Florida and the legislature took steps to do what they felt was the right thing for the citizens of Florida, or at least what they perceived the citizens of Florida wanted, which was to lower insurance rates.

So they expanded a catastrophe fund that Florida had, and they also empowered something called Citizens, which was more of a primary insurance carrier, to underwrite personal and commercial insurance. Rates came down a lot and the commissions that Brown & Brown brokers earn for placing business are almost always calculated as a percentage of the premiums charged. So as rates have gone down on insurance, the commission rates have gone down. That's hurt Brown & Brown's business in the state of Florida. There's also been rate compression in the rest of the nation as we've gone into a soft market for insurance.

But the question is, over time will this situation in Florida continue? The state of Florida has basically assumed tremendous exposure. Should there be a serious hurricane season or even a normal hurricane season, the state could be on the hook for huge sums. They would then assess the taxpayers at some point. And at that point, it might not prove to be such a popular move. I know that right now the governor of Florida is very popular.

I don't think it was a smart move long term for the state to take on this kind of exposure by reducing prices below those provided by the private market. But I can't predict how long this state of affairs might last. Bob and I have talked about some other states with auto insurance entities to insure people who can't find a private market or just want the lower rate, and how long these pools have stayed in existence. Sometimes they stay around for a long time. What's happened in those states is that the rates have gone up and it's not been good necessarily because insurers have exited. New Jersey and Massachusetts are two examples of that. Now things have finally changed over the last few years in those two states.

It's hard to predict how long that government intervention is going to continue. However, we can say that the hardest comparisons to the periods when there was no government intervention have passed. Starting later this year, I think the comparisons will become easier. The homebuilding exposure — it's just like what Terence said — homebuilding goes in cycles. The level of new residential construction is lower now than it has been in many years, but I believe that over time we'll get back to more normalized levels. Brown & Brown does have some wholesale and retail business that is exposed to homebuilding. But over time that will come back to normalized, if not boom-time, levels.

It's harder to predict whether there will still be a Citizen's in ten years and how large and what the rules will be about how low they will be allowed to cut the rates. I believe Citizens was initially authorized as an insurance carrier of last resort but it has evolved into a carrier of first resort. Hopefully it will at least go back to being an underwriter of last resort.

**Question:**

I had a follow-up question on Whole Foods. You mentioned 11 percent earnings growth which I'm assuming is GAAP earnings, net income. My understanding is they have a lot of non-cash expenses, D&A, stock compensation, deferred rent, etc. So I think the cash earnings per share have grown faster than 11% or at least faster than the net income. I'm curious if you could comment on that specifically and then in general, do you look at cash earnings, owners' earnings or operating cash flow, etc. when you are valuing the companies?

**David Poppe:**

Of course we do. I would say depreciation in our view is a real expense because they are paying to build those stores. They are paying to maintain those stores. The cash earnings have grown at a faster rate, but it's still a disappointing rate given the rate of top line growth.

In buying Whole Foods, we thought about the amount of operating income it could be generating in 2010, 2015, not adding back depreciation because it's a real expense. They

are paying to build the stores; they are paying to maintain the stores. The stock option expense — again, that's a real expense. That money is being transferred from my pocket to those of the managers and employees.

But I think the core question that you're asking is how did we value Whole Foods or why did we buy Whole Foods at the price we did. It was really an expectation that, say, in 2015 it could be a substantially larger company than it is today. And to have one percent of your assets — it's not a five percent position — but to have one percent of your assets in a business that is managed by, as Bob said, a visionary, who is a little eccentric but who really has a concept that could be triple or quadruple the size it is today — those are not easy to find. I think it's worthwhile to have a piece of your portfolio in something that could grow very rapidly.

**Question:**

Do you think at 290 stores or whatever it is today after the Wild Oats acquisition, it could still double in size?

**David Poppe:**

I absolutely do. I haven't done a great scientific analysis of it. But I've either lived in or spent a lot of time in four different US cities. When I look around at those places, there are not nearly enough Whole Foods to meet the demand. Now that they've bought Wild Oats, it has changed a little bit.

But I was raised in Phoenix. There's a part of Phoenix near the Arizona Biltmore that's the wealthiest part of that city — there's not a Whole Foods in that area. There will be one, one day. There's not a Whole Foods in Scottsdale, Arizona, which is a very wealthy town. In Manhattan, there are four. Could there be ten? In my view, there could be. In my view, if they would build smaller ones, they could maybe squeeze in more than ten. That's a personal feeling. We haven't done a scientific demographic analysis of where the wealth is in this country and where the Whole Foods stores are. But doubling the store base feels very realistic.

**Question:**

I wonder whether you could comment on energy — both your outlook for the market

and the markets in general, and whether that is an area you would ever consider investing in.

**Girish Bhakoo:**

Yes, we look. There are people in that business whom we respect quite a bit. I wouldn't bet on \$120 oil forever, but \$50 or \$60 seems okay. If there are companies that can make money at that price, then I think we'd be open to the idea.

**David Poppe:**

I'd have to say, realistically, we spent some time a few years ago looking at some energy companies. I've been to Calgary to visit the tar sands' people — and this was some years ago — and we didn't make those investments because we weren't comfortable with the long term bet on oil at that time of \$35 a barrel. We came back — Greg was there, Girish was there, and I was there and Bob was there — and we said, "You know, \$35 a barrel oil, are we really prepared to ... because the oil sands projects don't really work if oil prices are below \$35 or even below \$40."

So I don't know if we made a wrong decision — we made a decision, and oil went the other way. So I would not have an expectation that we'd be making investments based on a belief that we could predict the future price of oil.

**Greg Alexander:**

In fact, I remember our last meeting with Canadian Natural Resources, which is pretty well along on a huge tar sands project. I know there are people here nodding who know more about this than I do. But I remember that the chairman, Al Markin, was worried about the debt load, and so I suggested to him that they could just sell more of the oil forward and hedge themselves. And like you're saying, it was around \$35.

Meanwhile, the oil sands projects have been vulnerable to every kind of cost escalation. Steel has gone up. Energy has gone up. Labor has gone up. Getting labor in Fort McMurray is very expensive. Yet after building this massively expensive \$10 billion operation their cash flow has been running so great as a result of high oil prices that CNQ is projected to be debt-free by the end of next year. So it's a good thing they didn't listen to me.

But in general, what we hear is that solar is coming along quickly and wind energy quicker than that. Then you have all this biomass stuff. Frankly, I think that if the US were just its own ... if it were a closed system, I'm sure oil would come down because eventually oil at these prices would generate enough conservation.

Actually, the record of the US — everyone says the US is a big energy hog, which is true — but in the last 35 years, the amount of GNP growth that the US has had has not been met by anything equivalent in terms of energy usage. I don't know what our energy usage is compared to 1973's, but the growth in it is nothing remotely as large as what the growth in GNP has been. So there has been fairly noticeable conservation over that span of time.

The alternative energy guys don't need \$120 oil. What they really need is to know that the price of oil won't go below a certain amount. In other words, if Boone Pickens is building \$2 billion worth of wind power or somebody is doing a bunch of solar reflectors out in the desert or what have you, they don't need oil to be \$120. What they want to know is that it is not going to go below whatever their hurdle is. If you own an oil well or natural gas while the price of oil goes from \$120 to \$60 back to the \$30 that it was a few years ago, you just make less money. But for a lot of alternative energy projects, the whole thing just becomes uneconomic if the price of oil goes too low.

I think that the government should put in a tax that kicked in below \$70, for example. If the price of oil went from \$120 to \$70, all of us would save money when we fill up our gas tank or turn on the heat in the winter. But if it went below \$70, the tax would kick in and that would protect the alternative energy people. I think that would really create a huge flowering of investment, because you would know that you were protected on the downside, which is what business people want.

The transportation fuel ... the thing with oil is that it's used internationally and it's not a US-only system. Most of the growth — which Girish was pointing out — is in the use of it for transportation fuels. So it's hard to — absent natural gas fueled vehicles or electric vehicles or whatever — you just specifically need oil.

So basically, to answer your question, I have no idea! But to us, it seems high, and we suspect that things will kick in over time. But do you have a different insight, Bob?

**Bob Goldfarb:**

No. I think that you are spot on.

**Greg Alexander:**

If there's anyone well connected to Congress, please pass this on.

**Question:**

Would you please comment on the prospects for Porsche now that it is combining with Volkswagen?

**Arman Kline:**

Porsche recently announced that it is going to go to 51% of VW, and they have not said they won't go higher. There's a lot of speculation about that. We still view these as two separate businesses. However, as we've commented before, we admire the Porsche management team, and there's no question that they are getting increasingly involved in VW.

More specifically, the new head of Audi global sales is the former head of Porsche American sales. So you're starting to see some cross pollination. VW's bottom line finally has been stronger in the last couple of years. But the top line has been pretty healthy as well. Greg knows a little bit more about VW than I do. But Porsche is going to benefit quite a bit from leveraging VW's resources in R&D as well as purchasing and, probably more importantly going forward, environmental technology.

As for the investment in VW itself, maybe Greg can comment on that.

**Greg Steinmetz:**

When Porsche bought VW, we were surprised to say the least. Here we had something that generates lots of money, one of the best brands in the world. Then they go out and buy a volume carmaker. We started thinking, "Oh my gosh, they just bought General Motors, they just bought Ford, a company that is so much bigger than them. This is going to be a disaster."

Well, the good news is they bought it at a very low price. They bought it right at the bottom and it subsequently went up a lot. As we got to know more about Volkswagen, we

discovered you can't really think about it as being exactly like Ford or General Motors because it doesn't have the pension issues, the legacy costs that those have.

It also has a pretty good brand in Europe. It has 30 percent of the market and Toyota hasn't really made inroads over there like they have here. That doesn't mean it's not going to happen. But Europeans like Volkswagen. It's a car that people admire and it sells at a little bit of a premium to some of the other volume car brands.

Also, most of the profits aren't coming from selling Golfs and Beetles — a big chunk of the profits comes from selling Audis. They made \$6 billion last year and almost half of that came from Audi. And Audi is kind of like BMW. We don't think about it as being BMW over here because Audi had a bad experience many years ago with an unintended acceleration problem. That tainted the image a little bit for a long time. But over in Europe, Audi sells just as many cars as BMW. That said, it's not Porsche.

If you look at the growth going forward for Porsche, there's still a lot there. They have a new car coming next year, the four-door Panamera sedan, that is going to give them a lot of growth. There will be more models after that. Another nice thing about it is Volkswagen and Audi are the biggest brands in China. They sold a million cars in China last year; so we get some exposure there

One thing we've learned about Dr. Weideking, who runs Porsche, is that he is all about making money. People say, "Well, he's an empire builder now." There's no evidence of that. If you looked at everything he's done since he's taken over that company, it's always been terrific for shareholders. It's also benefited him. But it's been good for shareholders. So if you look at the track record, it's possible for us to sleep at night with this investment in Volkswagen.

**David Poppe:**

I would just follow-up. In the end, Wiedeking bought an undervalued business which people didn't realize at the time. He secured factory capacity for Porsche. Porsche outsources a lot of its manufacturing; it's kind of an asset-light car manufacturer, but had a long-term problem of needing to secure

manufacturing capacity, and this deal secured that capacity and also secured cooperation on a lot of R&D projects particularly around electronics that would be really expensive for Porsche to do on its own as a small volume manufacturer, but which Audi and Volkswagen were going to have to do anyway.

Fundamentally, he bought an undervalued business. As Greg said, Volkswagen isn't the General Motors of Germany. Porsche began acquiring shares at less than a third of the current price. It's been an excellent use of capital.

**Arman Kline:**

If I could just add something to that, I was reading one of our old memos and I found an interesting number there, which is if Porsche earns what we think it is going to earn this year, and this is reported earnings so it includes the VW options gains that they have — over three years since we've owned the stock, we are going to earn net what we paid for the stock. And a good portion of that is from the VW investment gains; so it's clearly been a heck of an investment for them.

**Question:**

My question is about Fastenal. I heard recently that Fastenal has historically been a leading indicator of a recession, but that this environment is different for them since it was led by consumers in housing rather than by manufacturing activity. I'm wondering how you think Fastenal will make its way through the current environment.

**Chase Sheridan:**

I've been surprised by how well it's weathered the current environment because Fastenal does have some construction-related sales. It also has sales to original equipment manufacturers, which have not held up as well as the maintenance and repair operation business that is served by competitors such as Grainger. But when I think about Fastenal, it's a unique company. It has such a small share of its addressable market still to this day that I don't really worry too much about the cyclical ups and downs.

They are growing sales at a slightly slower rate than they used to but they have a new program called the Pathway to Profit,

which you may have heard about, which involves slowing their store growth. They used to increase their store base by about 14 percent a year. Now they are going to average about eight percent going forward. But they are not slowing the rate at which they invest in their salespeople. That's what really drives sales at Fastenal.

It's interesting — it's almost a misnomer, in a way, to call a branch a "store" when you're dealing with Fastenal. They had 2,160 sites as of the end of 2007. And I'll bet most of the people in this room have never seen one. They are off the beaten path. Fastenal may get 10 percent of its sales within the four walls of the store. What really drives the business are the salesmen getting out and knocking on doors.

So I think that once a company has saturated its market, the ups and downs of the economy become more important for the prospects of that company. But in Fastenal's case, even though it's a large company, it still has ten percent or less of the fastener market in the US and it sells a number of other items besides fasteners. Fasteners account for maybe 365,000 different SKUs out of something on the order of 860,000 SKUs that Fastenal now sells. But it is a cyclical business, don't get me wrong.

**Question:**

I was hoping you could tell us your feelings about Berkshire Hathaway's ability, given its size, to find acquisitions that will move the needle. Is it getting more difficult for them to do that, and how does that affect your long term view of the stock?

**Jon Brandt:**

I could give you a four-word answer and say, "Size is an anchor." But he has put \$35 billion to work in the past year. Warren will soon be visiting with the owners of private companies in Europe, looking to make deals where the founders of the companies don't have successors but want to make sure that the company they sell to treats their businesses as the precious masterpieces their founders made them into. So, that's one avenue that Berkshire is exploring, owners of private businesses in foreign countries. That also dovetails well with Warren's professed desire to develop more sources of non-dollar earnings. There are many

family-owned businesses in Europe of a size that makes sense for Berkshire.

And he's a very good deal-maker. The Marmon deal was reported in the press as a \$4.5 billion deal. But in fact, that was just for the 60 percent tranche that he agreed to buy in March of 2008. He actually agreed to buy all 100 percent of it over several years. If you do the math, presuming that it's all at the same price, it really is a \$7.5 billion deal. But there's an earn-out. If Marmon's earnings grow, the investment will presumably end up being \$8, \$9 or \$10 billion. There's also a billion dollars of debt. Warren also found the Mars/Wrigley deal to participate in. That involves \$2.1 billion of equity and \$4.4 billion of debt financing.

He has also put a lot of money in equities last year. I think it was something like \$19 billion on a gross basis. He sold some as well, so the net deployment into equity securities was a bit smaller than \$19 billion. But he put a lot of money into Johnson & Johnson, Kraft, and Burlington Northern.

My view is that these purchases show that he is prepared to accept lower returns on common stocks than he has in the past, and that if he can't find companies to buy in the private markets, he will buy portions of businesses in the equity markets.

He's also found ways to — and this actually doesn't require any deployment of cash — but what he's doing with derivatives is fascinating. Through the equity puts and the credit default swaps portfolio that he manages himself, he's already generated \$7.8 billion of cash.

There will likely be some losses on the credit default swaps, which are mostly on junk bond indexes. When he does things like this, he is basically acknowledging that he has to play in bigger pools of capital where he is not just insuring single issues of junk bonds or writing puts on single equities, but on indices of the S&P and several foreign indices. He's made his views clear about what the returns on stocks are likely to be over a longer period of time. He obviously feels that these equity puts are an attractive use of his balance sheet. But he didn't actually put any cash to work — he got almost \$8 billion of cash.

He can use that money however he likes. So the “problem,” as you might call it in quotes, is that he just keeps bringing in more cash; there’s more to deploy. He’s acknowledged he’s got size as an anchor, but he has a number of different roads he can take. That said, Berkshire is not going to compound at the 20 percent plus rate that it has over its history since he took over in 1965. But given what I think the market as a whole will deliver, Berkshire’s return will be very satisfactory and Berkshire Hathaway is an extraordinarily safe company.

**Question:**

Could you talk about the relative merits of MasterCard, especially since it’s run up and become quite a market darling relative to Visa, which just went public, as well as American Express, which is a big Berkshire holding.

**John Harris:**

Comparing MasterCard to Visa — they are both excellent businesses. I was reading in ... I suppose it’s a little indiscreet, but I was in the bathtub a couple weeks ago, and I had the newspaper out. I saw on the new Highs list, MasterCard hit 280, 290 or something like that. I looked over at the counter and my wife’s hairdryer was plugged in. I thought for a second about bringing it in the bathtub with me.

But MasterCard and Visa are great businesses. They are basically the same business. I can’t really think of many differences between the two except for the geographic allocation of their ... or the derivation, I guess I should say, of their profits.

For reasons that are not worth going into, the Visa that is owned by the public stockholders does not do business in Europe in any major way, whereas MasterCard has a very big business in Europe. On the other hand, Visa has a large business in debit payments in the US, which is a very rapidly growing market. And MasterCard has a much smaller business in debit in the US. They have a bigger debit business in Europe.

But all in all, it’s basically the same business. It requires no capital. It’s essentially a royalty on growth and global consumption and specifically global consumption on credit cards and debit cards, which across the country and

the world are taking share of the payments pie from cash and checks.

So you are tied with a lot of excellent tailwinds, and the business has extraordinarily good economic characteristics. They both face some legal risks that are significant, although those seem to have been put on the back burner, at least in the minds of most of the investors who own the stocks, judging by the prices that they get. But by and large, they are the same business.

Both are very different businesses than American Express because American Express is involved in a much larger ... a credit card transaction is sort of a complicated transaction, and American Express is involved in all aspects of it whereas the card associations as Visa and MasterCard are known, are only involved in a very small part of the transaction. But they happen to be involved in a very good part of the transaction. American Express is an excellent business, but it takes credit risk. They issue cards to people who make purchases and then owe American Express money. Some people don’t pay the money back. In times like these, that becomes a greater concern than it might be in a healthier economy. That’s not a risk that MasterCard and Visa face.

Another thing you can say about American Express — Bob said it to me best once — is they call it American Express for a reason. Even though it is a global brand, they have never really been successful in growing the share of their profits that come from outside the United States to any significant degree. They have sizeable businesses in a couple of foreign markets that tend to be closely aligned for one reason or another with the United States. But by and large, they have not found a way to grow in emerging areas like Asia and Latin America in the way that the card associations have. There are lots of reasons for that.

But they are all excellent businesses, all three of them. While they certainly have legal risks, the card associations, Visa and MasterCard, are better businesses than American Express is.

**Greg Alexander:**

I don’t know if Tom has anything to add on any of these credit card companies. Perhaps with or without a hair dryer anecdote?

**Tom Mialkos:**

The pricing power of the associations is going to be very important for the earnings of the two businesses, both Visa and MasterCard. Currently Visa and MasterCard keep about 10 percent out of the total interchange in the United States. Their yield is less than 20 basis points out of an interchange that's close to 200 basis points these days.

So if the yield that the associations currently get increases dramatically over the next five years, the earnings power of these businesses is going to be much greater than it is today. It's not only that these companies take share from cash and checks. They also might have significant pricing power.

What we have seen so far, and why they have been a surprise on the upside, is that they have been able to push through price increases very quickly. They have shown pricing power. This is a little bit of an unknown because the associations themselves are not sure how much they can raise prices. They are testing the waters because the service they are providing is somewhat of a social utility. It's a very important network; most of us use it every day. They have to be careful not to raise prices too much, too quickly. But as long as they raise prices by let's say two or three percent per year on their own fees, these price increases basically drop directly to their bottom line and you will see expanding margins. The margins will probably end up above 50 percent for both companies. On top of the volume growth, you're going to get the price increases. These factors will produce very fast EPS growth.

**Question:**

Berkshire has been such a wonderful holding for the fund and has added materially to its long term performance. Have you guys looked at other personal holding company type vehicles run by other talented managers, which may be smaller and able to compound at a high rate? Eddie Lampert comes to mind or Leucadia or some of the other people who are emulating the Berkshire model

**Jon Brandt:**

We've always admired Leucadia. Why is it that we've never pulled the trigger? I've looked at it a few times over the years. At no

point in time have there ever been any operating earnings to speak of.

They have done a tremendous job, despite that. But whenever you look at it on a static basis, there's just nothing you can hang your hat on and say, "This company has X-dollars per share of core earnings." You've always had to assume that the next deals are going to be great and that management will create value by buying things below their value and turning them around.

But it's been frustrating as an analyst who likes to see some kind of core cash flows and it has been a mistake, obviously, to have not bought it. But that's the prime reason why we've haven't. It's been a really good stock over the years. I think Greg knows the company better than I do.

**Greg Alexander:**

They are brilliant, yes. They actually did a very interesting transaction the other day where they bought some shares of Jefferies Group, the investment bank. You know how before the debit cards that John was referring to — remember how we used to go to the supermarket, you could write the check and then they would let you write the check for an extra \$20, and they would give that to you in cash?

I just noticed the other day that Leucadia invested \$400 million in Jefferies Group, but they actually paid them \$500 million worth of Leucadia stock, which Jefferies is allowed to sell. But Jefferies has to give \$100 million of cash back to Leucadia. They are very smart fellows, so I thought that was sort of interesting on both sides of the transaction.

**Jon Brandt:**

Have they ever paid a dollar of tax on anything?

**Greg Alexander:**

They are very smart people

**Bob Goldfarb:**

The question was also about Eddie Lampert. There are two ways we could invest and two reasons we won't. We could invest in his investment vehicle directly. But you're already paying us one percent, and I don't think you're paying us one percent to invest with somebody who is charging one and twenty. We

could invest in Sears, but we prefer owning Target, Wal-Mart and Lowe's, all of which compete with Sears.

**Question:**

Would you comment on Bed, Bath & Beyond? I noticed that a major competitor, Linens 'N Things, is going into bankruptcy. But the Bed, Bath & Beyond in our neighborhood has no customers in it.

**Trevor Magyar:**

There were two questions. The first relates to the Linens filing. And for those of you who haven't seen it, Linens filed for bankruptcy. According to the plans they laid out in that filing, they are going to be closing 100 to 120 stores. That can change and I don't think any of us here has any special insight into the bankruptcy process and how it's going to play out exactly.

What I will say is that I think it's positive for Bed, Bath. There's a high degree of overlap in terms of the markets that Bed, Bath operates in and the markets that Linens operates in. It's unclear what the transfer rate will be in terms of how much of that business comes to Bed, Bath stores. But again, we think it's likely to be a positive.

As for your second question, which was more of a comment regarding traffic in Bed, Bath, I would say that currently they've certainly been affected by the macro environment. Their comp in the last quarter was basically flat or just slightly negative. They have been impacted less than some of the other retailers out there but none of us think that Bed, Bath is immune to what's going on.

What I would say is that we are more confident than ever in Bed, Bath's competitive position. A lot of the work that we do goes on in our offices sitting behind desks and reading annual reports. But we do spend a fair bit of time in the stores. We continue to believe, having walked the aisles, that Bed, Bath's competitive position is as strong as ever.

It's a challenging space, the home goods space. Many have tried and failed. Bed, Bath has been an operator that has figured out a model that works. We think that's likely to stay the same over a cycle. So while we don't savor the current environment, and we think traffic is

likely to be impacted over the coming quarters or years, we feel good about the company's competitive position.

**Question:**

Can you tell us why you chose to invest in the aerospace defense arena with the Rolls-Royce group?

**Arman Kline:**

Obviously, the cycle has been very strong in the last few years. For those who don't know, Rolls-Royce is primarily in civil aerospace. They make jet engines for the large planes we fly every day. They also make engines for private jets. A fifth of their business is in defense aerospace and a fifth in engines for ships.

The timing was a little tricky because we knew the cycle was pretty strong. But what we started to see with Rolls-Royce was that a market that historically had three players, which were Pratt & Whitney, GE and Rolls-Royce, was slowly becoming a market that had two players. There have been three major new platforms recently, the 787 from Boeing and the A350 and the A380 both from Airbus. Pratt & Whitney is only on as a partner with GE on the A380. It is not on the other two. If you look at the pricing and the returns that manufacturers get when there are only two players on an air frame, they are clearly superior to what they get when there are three players. So that gives quite a bit of comfort going forward.

If you look at the backlogs of the 787 and the A350 specifically, they are the two most successful platforms ever launched by Boeing and Airbus. So there's a lot — many years .... Just to give you an idea, Rolls-Royce right now has a £50 billion backlog, so around \$100 billion of orders, and those have prepayments associated with them.

The final thing that I think attracted us to Rolls was the after-market. Fifty-five percent of their revenues is coming from parts & services now; 45 percent is from original equipment. They make much higher returns on parts & services. If you look at the percentage of the engines that they sell today, which are covered by long term contracts, it's nearly 100 percent. So you can see the tailwind. You should see a shift towards after-market revenues, which are more

profitable. Rolls has, I would argue, the strongest after-market network — stronger than GE's, stronger than Pratt's. So looking at all that, we became comfortable. That's not to say that it is going to be a great investment over a year. If flying hours drop, revenues and earnings from service may decline. But over time, it sure looked attractive, and I'm not sure whether the game of trying to time a stock perfectly is a good idea, if it looks attractive.

**David Poppe:**

There's a little bit of concern that we'll see order cancellations if the global economy gets weaker. But if you have an eight-year backlog and there are deposits, non-refundable deposits associated with all that, if you lose a third of the backlog, you still have a five-year-plus backlog of new engine deliveries. We took a fair amount of comfort from that.

**Question:**

I wanted to ask you where we are in the insurance pricing cycle, and how that impacts your investments with Progressive and Berkshire.

**John Harris:**

The personal auto insurance market is not in a great part of the cycle right now. Times were good in that business for longer ... they were better for longer than they've ever been, at least as far back as I've ever seen in history. The profit margin that companies like Progressive have earned over the past three or four years is I think basically unprecedented.

That has all come to an end. Unfortunately, it has been driven largely by Progressive's actions. That has been to our detriment as shareholders. But the cycle is not great, although I don't really know that we spend a whole lot of time thinking about the auto insurance cycle. The problems that Progressive has had over the last couple years don't really have much to do with the cycle.

I guess that's obvious by virtue of the fact that they've been driving the cycle. But Progressive's problems have more to do with an unfortunate ... in retrospect, a bad bet they made on reducing their prices. Combine that with some changes in the company's competitive position, which they acknowledge, and some external factors that I don't think they had

planned on, like the absence of any inflationary tailwind in that business, which it had enjoyed for a long time. All of those factors together have conspired to make life difficult for Progressive.

**Bob Goldfarb:**

Right now, we're closer to the bottom of the cycle in terms of pricing. We've seen some rate increases from Progressive and from some of its competitors. So I think that cycle is further along and closer to a turn than most other areas of insurance. Jon, do you want to talk about Berkshire's insurance businesses?

**Jon Brandt:**

Yes. Geico is one of the largest profit contributors to Berkshire and it is subject to the same cyclical forces that Progressive is. Supercatastrophe pricing has also come down a lot. The Berkshire 10Q says that supercat and individual risk premiums written in 2008 by National Indemnity were 50 percent less than in 2007 and 70 percent less than in 2006.

I think the key to being successful in reinsurance is being disciplined. It's not just that reinsurance rates go down when there's a softer cycle. The cycle is magnified for reinsurers because the primary rates are down at the same time your reinsurance rates are down so you've got to be super-careful. I think that's why you see Ajit Jain writing so much less business. When rates are coming down, you have to be more selective. You can't abolish the insurance cycle. The only way you can control it is by reducing your writings when prices go down and increasing them when prices go up. In their larger reinsurance divisions at Berkshire as well as in the primary divisions like National Indemnity, they've done just that over time.

In the annual report a few years ago, there was a chart about the premiums going up and down at National Indemnity. I'm talking about the primary division, which has been run wonderfully well by Don Wurster over the years. Their combined ratio tends to go up a little bit during the softer parts of the cycle. But they never lost a lot of money there. So the key is not where we are in the cycle but how the companies respond to it.

**Question:**

What is the fund's attitude to stocks that pay dividends such as the Canadian Oil Sands trusts?

**Bob Goldfarb:**

We look at stocks on a total return basis. So we're not averse to companies that pay dividends. But we do have a preference for companies that have the ability to reinvest their cash at high rates of return.

**Question:**

In the latest prospectus, you give the ten-year return on an after-tax basis, and we've all got to pay taxes. The difference between that and the S&P index is unremarkable. What parts of the portfolio at Sequoia should I have confidence in will change this trend over the next five to ten years?

**Bob Goldfarb:**

What do you mean by parts?

**Question:**

Market segments. Insurance, retail, Berkshire Hathaway.

**Bob Goldfarb:**

We really look at individual companies rather than groups. I think the present portfolio as a whole is positioned to deliver reasonable returns over the next ten years. But I wouldn't hazard a guess as to which segments will do best.

**David Poppe:**

We didn't do that well with oil. So I think we're going to skip trying to predict by sector.

**Question:**

Do you think that the growth prospects at O'Reilly are still attractive?

**Andrew Ewert:**

Yes, we do. O'Reilly, for those of you who don't know, is an auto parts retailer. Half of their business comes from serving the commercial segment. The other half is the do-it-yourself or the retail segment. They recently announced a merger with CSK. It's a turnaround, but it complements their geography quite well. CSK is primarily out in the western US, and O'Reilly is located more in the Midwest and Southeast.

They also have the opportunity to expand their existing store base organically. They currently don't have any presence in 11 states in the Northeast, and they have only a few stores in Florida. They are also just beginning to expand to the mid-Atlantic states. And they still have remaining distribution capacity in the upper Midwest as well as the Southeast.

Their closest commercial competitor, NAPA, has about 5,800 stores. Pro-forma for CSK, O'Reilly will have about 3,200 stores. Now, 6,000 stores in total is maybe a stretch because some markets are over-stored. But they do have a significant runway, I believe.

**Question:**

I have two questions. Both of them relate to the opening of the fund to new shareholders. The first question is what are the specific advantages to the current shareholder from your opening the fund to new shareholders?

The second question is prompted by two articles I've read indicating that Ruane, Cunniff could possibly sell the Sequoia Fund. Would you have any comments at all concerning that?

**Bob Goldfarb:**

With regard to your first question, earlier in the year we were running very close to fully invested. So that meant with the burn rate of cash redemptions and distributions, if we found a new stock to invest in or wanted to add to an existing position, we would have had to sell stock that we didn't want to sell. I believe that this would have been disadvantageous to the existing shareholders.

With regard to your second question, I did see that conjecture — that we opened the fund in order to grow our assets so we could sell the firm. And there's zero truth to it. It's not going to happen — ever.

**Question:**

I heard your answer concerning the current shareholders, but I'm not sure I understood it. Is the only advantage that you can make investments with new money coming in? Is that the biggest advantage?

**Bob Goldfarb:**

It depends again whether you are talking about a taxable investor or a non-taxable. Are you talking about a taxable investor?

**Question:**

Both.

**Bob Goldfarb:**

Both. Well, you have to differentiate because the advantages to the taxable investors are probably greater.

**Question:**

Then let's take taxable.

**Bob Goldfarb:**

We would be continuously selling shares over the next number of years. And you would be paying capital gains taxes on those sales that we didn't really want to make for fundamental reasons but had to make for reasons of cash flow.

**Question:**

I wonder if you could speak more about the alternative energies industry — your general opinion of that — and if you're considering anything in that direction.

**Greg Alexander:**

No, we've got nothing.

**Question:**

Can you tell us why? What's your opinion there?

**Greg Alexander:**

I'd have to think about that. But I guess it's too new. There have been times when we've looked at new industries. The firm used to own shares of Viacom when cable programming was new. We owned Lin Broadcasting when cell phones were just invented.

But many of the alternative energy companies are really akin to research and development. Just because someone comes up with what happens to be, for today, the best process for making the best solar arrays or the best biomass or whatever, doesn't mean it won't be obsolete tomorrow. It's more akin to a computer investment or something like that, which is not really our expertise.

**Jon Brandt:**

Greg, isn't the industry in Europe, where it's much bigger, heavily dependent on government subsidies, which are harder to predict as well?

**Greg Alexander:**

Yes, right.

**Greg Steinmetz:**

I can add — I have solar panels on my roof, and if US taxpayers weren't paying for more than half of that, I wouldn't have them on my roof.

**Greg Alexander:**

So it's not really subject to the kind of analysis that we do. We're looking for enduring franchises that we're relatively confident in.

**Bob Goldfarb:**

We do have a small investment via Berkshire in some wind farms. They are pretty big in it, but that's not the reason we own Berkshire.

**Question:**

Regarding the fund reopening two weeks ago, are you legally allowed to tell us today how business is?

**David Poppe:**

We've raised about \$75 million to date, and that's been offset some by normal redemptions, which was one of the reasons we opened the fund. So the net is less than \$75 million — something in the fifties, I think.

**Question:**

To me, that number seems lower than I would have expected. Did you have an expectation?

**Bob Goldfarb:**

We had none.

**David Poppe:**

The other thing I would say is most of the money has come in through retail investors. We have three so-called omnibus arrangements. Charles Schwab is one, where a person who has an account with Charles Schwab can buy Sequoia now. We've had meetings with some larger investment groups, and I don't know how those will turn out. But the people or institutions who might commit more money to

Sequoia have been meeting with us but have not necessarily come forward yet.

**Bob Goldfarb:**

I would also say we're not looking to raise a lot of money at the present time.

**David Poppe:**

You could tell from the slick and sophisticated marketing campaign that we have not maximized the potential of Sequoia.

**Question:**

This is more of a comment than a question. For the past few years, the meeting has been just questions and answers. I very much miss the opening statement that used to be made. It took 20 minutes to a half an hour. I know it was made by Bill Ruane, and of course he's not here anymore.

But I think the meeting has lost the charm or — I don't know what the word is — but it has lost a lot of the positive aspects that existed before. I'd like to know if you would consider going back to having that kind of structure. Because to be quite honest, sitting here, it's almost like we're pulling teeth to get answers. The structure of this particular meeting has been completely different than any of the other ones I've been to. And to go back even further, I desperately miss the opening comments when you imparted your intelligence to us.

**Bob Goldfarb:**

I used to give talks, and some were more successful than others. They may have taken 20 minutes to deliver but they took 20 days to prepare.

**Question:**

That's not an answer.

**Bob Goldfarb:**

I think I have better uses for my time.

**David Poppe:**

Honestly, Bob says 20 days — Bob spent an enormous amount of time on these speeches. It's a better deal for you guys if Bob is spending time reading annual reports and talking to our analysts than if he is writing a speech about China's position in the world.

**Greg Alexander:**

Personally I liked Bob's "baking bread" speech a couple years ago. If there was, Bob, a year when you really had a point of view about stock option expensing, for example, or about something else you wanted to communicate, would you think about it?

**Bob Goldfarb:**

I might consider it.

**Jon Brandt:**

We'll take your suggestions under advisement — how's that?

**Question:**

I'd like to ask a question about Berkshire Hathaway. It's about a response you made and so did Warren Buffett and Charlie Munger at their meeting. We're told that the future won't be like the past. Berkshire is going to have to change when they leave. In actual performance for the past 12 years, Berkshire's stock price has increased 51 percent. For the past decade, it's been equal to the S&P, no better. Do you ever worry that there's a ceiling to Berkshire Hathaway?

**Jon Brandt:**

When Warren and Charlie talk about returns being lower in the future, I think they are talking about the rate of compounding in intrinsic value. I don't think they are predicting that the stock price will go up less than 51% in the next ten years. Remember that in the spring and summer of 1998, Berkshire hit an all-time high up to that date both in price and also probably in terms of premium to intrinsic value.

So as I talked about last year at the meeting — sure, maybe in retrospect not to have sold some of our shares at \$84,000 in June of 1998 was a mistake. But there were a lot of things that happened in '99, 2000, and 2001 that perhaps couldn't have been reliably forecasted in 1998. There was a blow-up of the underwriting culture at Gen-Re, which cost billions of dollars. Warren himself was surprised at what happened there. That's been fixed. Several of the common stocks in the portfolio including Disney, Coke and Gillette also saw large declines. We knew that these stocks were richly valued but perhaps underestimated the real business problems that

these companies were having at the time. No one foresaw 9/11 and the huge losses that tragedy would cause for reinsurers.

So my sense — what you had between 1993 and 1998 in terms of stock price appreciation represented unsustainable growth above that achieved by the growth of the intrinsic business value. And then, over the last ten years you've had intrinsic value growth that has been more rapid than stock price growth. But the intrinsic value growth has been steadier over the 15-year period than the stock price activity would suggest.

So, if you take the last ten years, it looks like Berkshire's only gone up, whether it's the 4.5 percent a year that you are implying or some other figure is not so important. What's more important is that I think the intrinsic value has grown at something close to 10 percent over the last ten years. And maybe it's been 12 percent over the last 15 years.

So I think what you're asking is do we think that Berkshire is going to grow less than that going forward, and if so why do we still own it. Am I misinterpreting your question?

**Question:**

Yes. I want to know why the stock price remains low. What will happen to the stock without him?

**Jon Brandt:**

I don't know what will happen to the stock without him. It depends on how well the company is managed. Over the long term the stock price will follow the growth in intrinsic value. Over the short term it is very hazardous to predict stock price movements. I just don't pay too much attention to short term reactions of the stock market.

**Greg Alexander:**

We have a lot of confidence in Warren. He is a very young 77. I think the result of your calculation reflects that you started it during a year when the stock was probably higher in relation to its underlying value than it had long previously been. If you come back in two years and quote us the ten-year record, I think you will find some very satisfactory numbers.

**Question:**

You're taking off the 15 percent cap on foreign investments. Is there a new explicit or implicit limit for foreign investments? And how have you changed your staffing in research to accommodate this new direction?

**Bob Goldfarb:**

There's no limit. You make a very valid point that investing in foreign companies with the same degree of research intensity that we do on companies in the United States requires a lot more man hours. So I would expect that if we add a lot more foreign holdings, we will have more staff than if we maintain the same amount of foreign holdings.

**Question:**

My question is if you could speak a little bit about the business points of exchanges, and why they would not pass the test for an enduring competitive advantage?

**Bob Goldfarb:**

I'd say they do. We missed them.

**Question:**

Once your analysts target a particular security, does Sequoia use a committee process to judge the merits of the securities? Suppose you have a variety of similarly attractive investments — how does Sequoia's investment process relate to Ruane, Cunniff's managed accounts in terms of investment advice and portfolio overlap?

**Bob Goldfarb:**

If we find a new holding, we buy the same percentage in the individual portfolios as we do in Sequoia. We're not a big believer in committees and meetings. That's been our history for 38 years. David and I, as I said earlier, are co-managers. So the ultimate decision is in our hands. But it's certainly made consulting the analysts who have done the work on the project, as well as others. Everybody expresses their opinion, and we listen.

**Question:**

Can you tell us about any sectors you do not like at the moment? Second, how much do you look at the macro economic environment?

**Bob Goldfarb:**

Does anyone have any sectors that he is shorting or thinks should be shorted?

**Jon Brandt:**

Mainland China, although that's already gone down a bit.

**David Poppe:**

We're really a one-balance-sheet-at-a-time, one-company-at-a-time kind of investors. We don't spend a lot of time on macro. I think you see — and Bob talked about this last year — you see something like a concentration in retail or in companies that have a little too much exposure to homebuilding. Sometimes that can bite you. If you own Mohawk, do you need to own a number of other companies that are also exposed to the home sector?

It's not necessarily the best way to construct a portfolio scientifically. But we have had some success and we're comfortable going at it one company at a time, one balance sheet at a time. We don't spend a lot of time on macro issues.

There are whole sectors that we don't really follow because we don't feel we have expertise. The one that has come up in the past that everybody knows about is technology. We just are not comfortable with our expertise in that area.

**Bob Goldfarb:**

If we thought we could predict the macro environment for the next five years, we'd pay a lot of attention to it. But we know that we can't.

**Question:**

I'm wondering going forward with regard to new investors coming into the fund, given the capital gains situation that Sequoia still has, will you be expecting more tax-free entities to enter the fund? Is there a way that you could monitor that?

The other thing is do you think you will get more institutions coming into the fund? And then when finally the economy bottoms or at least we all think it has, you may see a flood of money, given your retail expertise and exposure. I'm wondering if you're thinking about possible constraints that a fund might initiate to protect longer term shareholders.

**Bob Goldfarb:**

I would hope we wouldn't attract individuals who are looking at Sequoia because of sectors we're investing in. A year later, they might find that they are in very different sectors than the ones they thought they were buying into.

As far as the tax-free and taxable investors are concerned, the investors choose to invest with us. We don't choose our investors. So it's their selection that's going to determine the mix of tax-free and taxable.

**Question:**

The firm's Progressive holdings have declined significantly over the last several quarters. Could you enlighten me a little bit about that decision?

**Bob Goldfarb:**

That decision was a reaction to the lack of success that they've had with a number of their growth initiatives. Historically, they've wanted to compete around 96. Their goal has been to write at 96 or better. When they were writing below 90, they would close the umbrella.

This time, initially they didn't close the umbrella when they were writing in the mid-eighties because when they tested elasticity of demand, it just wasn't there. Taking rate down didn't attract enough new policyholders. The economic trade-off was awful.

I think subsequently they decided, "We want to go to 96, and try to grow. And at 96, we think we have an edge and we can put pressure on our competitors." So they are getting close to 96. We'll see if they can grow with the combined ratio at that level.

With that, I want to thank all of you for attending, and we look forward to seeing you next year.



